Corporate Legal Framework

DCOM404

CORPORATE LEGAL FRAMEWORK

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SYLLABUS

Corporate Legal Framework

Objectives: This course is aimed at teaching the laws within which any business in India is supposed to operate and which defines the nature and enforceability of business transactions.

Sr. No.	Topics
1.	**Laws of Contract:** meaning, nature of Contract, elements of valid contract, proposal, consideration, Laws of contract: Agreement declared as void, performance of contract, Discharge of contract, remedies for Breach of Contract.
2.	Consumer protection Act, 1986, FEMA Act, 1999,
3.	Information technology Act, 2000, The competition Act 2002
4.	**Negotiable Instrument Act, 1881:** meaning, types of negotiable instruments, rules and regulations associated with the Act.
5.	**Indian Companies Act, 1956:** Meaning, kinds of Companies.
6	**Formation of Company:** Documents related with incorporation: Memorandum of Association, Articles of Association, and Prospectus.
7	**Share Capital:** Company Management and Administration, types of Meetings, Liquidation of Company.
8	**Industrial Law:** Factories Act, 1948, Workmen's compensation Act, 1923.
9	Employee provident fund Act, 1952, payment of gratuity Act 1972, minimum wages Act, 1948, trade unions Act, 1926.
10	**The Securities and exchange board of India:** Establishment of SEBI, Powers and Functions of SEBI.

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Unit 1: Laws of Contract

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Objectives

After studying this unit, you will be able to:

- Discuss the meaning of contract and essential of valid contract
- Explain the consent and mistake of law
- Describe consideration and rules regarding consideration
- Discuss the breach of contract

Introduction

As you all know that we enter into contracts every day. Some of these are made consciously, for example, purchase or sale of a share of a company or a plot of land. Sometimes we do not even realise that we are making a contract, e.g., hiring a taxi, buying a book, etc. In any case, a contract, howsoever made, confers legal rights on one party and subjects the other party to some legal obligation. In the case of people engaged in business, they carry on business by entering into contracts. Thus, the business executives, corporate counsels, entrepreneurs, and professionals in different fields deal frequently with contracts. At times, they have to draft one such contract or scrutinize it or provide inputs to its making or even interpret it. Therefore, it is necessary for them to know what constitutes a contract. The law relating to contracts is contained in the Indian Contract Act, 1872. For business executives, contract law is tremendously significant because it underlies or is related to all major areas of law affecting business.

1.1 Contracts

A contract is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another. If the party, which had agreed to do something, fails to do that, then the other party has a remedy.

Example: D Airlines sells a ticket on 1 January to *X* for the journey from Mumbai to Bangalore on 10 January. The Airlines is under an obligation to take *X* from Mumbai to 10 January. In case the Airlines fail to fulfil its promise, *X* has a remedy against it. Thus, *X* has a right against the Airlines to be taken from Mumbai to Bangalore on 10 January.

A corresponding duty is imposed on the Airlines. As there is a breach of promise by the promisor (the Airlines), the other party to the contract (i.e., *X*) has a legal remedy.

1.1.1 Offer and Acceptance

Offer is not only one of the essential elements of a contract but it is the basic building block also. An offer is synonymous with proposal. The offeror or proposer expresses his willingness "to do" or "not to do" (i.e., abstain from doing) something with a view to obtain acceptance of the other party to such act or abstinence [s.2(a)]. Thus, there may be 'positive' or 'negative' acts which the offeror is willing to do.

The essential of a valid an offer is:

1. An offer must give rise to legal consequences. In *Balfour v/s Balfour,* (1919) 2 KB 571, the husband promised to pay £30 to his wife every month. On his failure to pay, the wife sued it was held that it did not create legal relationship and hence she could not recover it.
2. The term of offer must be definite or capable of being made definite.
3. An offer must be distinguished from an invitation to offer.

Harvey v/s facey (1893) AC 553 X telegraphed to A" will you sell bumper hall pen? Telegraph lowest cash price answer paid

A replied by telegram" lowest price bumper hall pen $ 900" X telegraphed "we agree to buy $900 added by you"

It was held that it was a mere statements of the lowest price at which the vendor would sell it contained no implied offer to sell. Hence no concluded contract between parties

Every offer must be communicated to the offeree

Example: Anna offer to sell her book to Begum. Anna is making an offer to do something, i.e., to sell her a book. It is a positive act on the part of the offeror.

Specific and General Offers

An offer can be made either to (i) A definite person or a group of persons, or to (ii) the public at large. An offer made either to a definite person or a group of persons is a specific offer. The specific offer can be accepted by that person to whom it has been made. Thus, if a real estate company offers to sell a flat to Amar at a certain price, then it is only Amar who can accept it. The offer made to the public at large is a general offer. A general offer may be accepted by any one by complying with the terms of the offer. The celebrated case of *Carlill v Carbolic Smoke Ball Co* (1813) 1 Q.B.256 is an excellent example of a general offer.

Example: A Patent Medicine company advertised that it would give a reward of £100 to anyone who contacted influenza after using smoke balls of the company for a certain period according to the printed directions. Mrs Carlill purchased the advertised smoke ball and contacted influenza inspite of using the same according to the printed directions. She claimed the reward of £100. The company resisted the claim on the ground that advertisement was only an invitation to offer. They argued further that no offer was made to her, and that in any case she had not communicated her acceptance assuming the advertisement was an offer. She filed a suit for the recovery of the reward. Held that the advertisement in such type of cases amounted to general offers. She could recover the reward as she had accepted the offer by complying with the terms of the offer.

Implied Offer

An offer, implied from the conduct of the parties or from the circumstances of the case, is known as implied offer. If the company proposes, over telephone, to sell the flat to Rajiv at a certain price then this is an offer by an act (by oral words). This is an express offer.

Acceptance of an Offer

When the person to whom the offer is made signifies his assent thereto, the offer is said to be accepted [s.2(b)]. Thus, acceptance is the act of giving consent to the proposal. The offeree is deemed to have given his acceptance when he gives his assent to the proposal. The acceptance of an offer may be express or implied. It is express when the acceptance has been signified either in writing or by words of mouth or by performance of some required act of the offeree. The acceptance by performing the required act may be exemplified with reference to *Carlill v. Carbolic Smoke Ball Co.* case (supra).

Rules regarding acceptance

1. An offer can be accepted only by the person to whom it is made
2. Acceptance should be unconditional and absolute

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3. Acceptance should be communicated
4. Acceptance should be according to the prescribed form
5. Acceptance must be given before the offer lapses or is revoked
6. Provisional acceptance is no acceptance

Under Indian law communication of acceptance is complete as against the proposer when it is put in a course of transmission to him so as to be out of the acceptor; as against the acceptor when it comes to the knowledge of proposer

Thus according to Sir William Anson "an acceptance is to offer what a lighted match is to a train of gun powder". It produces something which cannot be recalled or undone. But there is a choice to the man who had the train to remove it before the match is applied.

Example: A shopkeeper received an order from a customer – a household lady. He executed the order by sending the goods. The customer's order for goods constitutes the offer which was accepted by the shopkeeper by sending the goods. It is a case of acceptance by conduct. Here, the shopkeeper is accepting the offer by the performance of the act (i.e., sending the goods).

Difference between Offer and Invitation to Offer

An offer is to be distinguished from an invitation to offer. A prospective shareholder by filling up a share application form, usually attached to the prospectus, is making the offer. An auctioneer at the time of auction inviting offers from the bidders is not making an offer. The price lists, catalogues and inviting tenders, restaurants menu cards, ATM, railways time table and quotations are mere invitations to offer. Likewise a display of goods with a price tag on them in a shop window is construed an invitation to offer and not an offer to sell.

Task M agreed on Monday to sell his property to N by a written agreement which stated that 'this offer to be left over until Saturday 10 AM'. In the meantime, on Wednesday M enters into a contract to sell the property to O.N. who was sitting in the next room, hears about the deal between M and O. On Friday, N accepts the offer and delivers to M, the letter of acceptance. Is N's acceptance valid? Give reasons.

[***Hint:*** N's acceptance is valid; the acceptance being made before revocation of the offer by M].

1.1.2 Privity of Contract

As a contract is entered into by two or more persons thereby creating rights and obligations for them, it is a party to the contract only who can enforce his rights as against the other party (i.e., the promisor). The basic principle underlying law of contracts is that a stranger to a contract cannot maintain a suit for a remedy. The law entitles only those who are parties to the contract to file suits for exercising their rights. This is known as 'privity of contract'. This rule can be traced to the fact that the law of contracts creates *jus in personam* as distinguished from *jus in rem*. Therefore, a stranger to a contract cannot maintain a suit.

Example: *A* is indebted to *B*. *A* sells certain goods to *C*.*C* gives a promise to *A* to pay off *A*'s debt to *B*. In case *C* fails to pay, *B* has no right to sue *C*, being a stranger to the contract between *C* and *A*. In other words *C* is not in privity with *B*. However, *C* is in privity with *A*.

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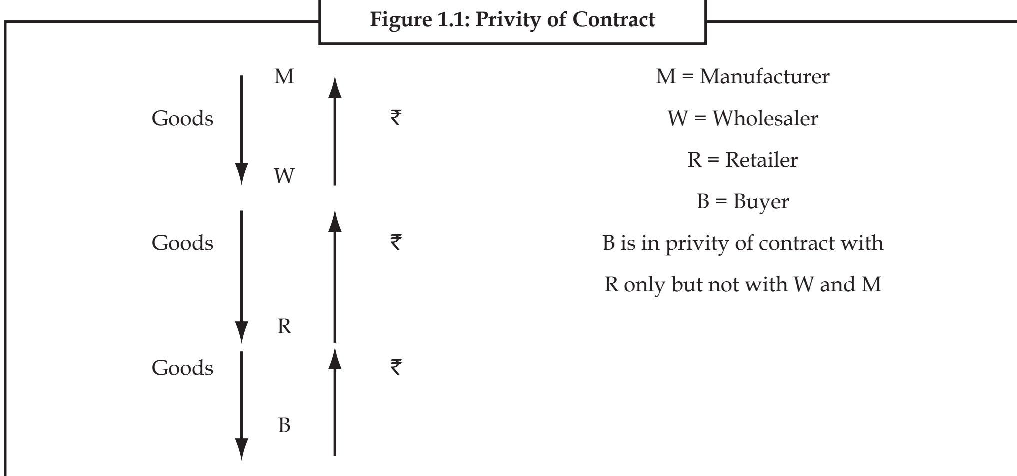
Figure 1.1: Privity of Contract



1.1.3 Formation of a Contract

There are different modes of formation of a contract. It may be made in writing or by word of mouth, or be inferred from the conduct of the parties or the circumstances of the case.

Note You should be concerned about contract law because it determines how parties to the contract will need to keep the promises they make. Although very few contracts ever end up in court, if the parties to a contract disagree on something and are unable to resolve the disagreement, they may have to resort to the judicial process.

Task S, a singer, contracts with M, the manager of a theatre, to sing at the latter's theatre for two evening in every week during the next two months. M engages to pay her ₹ 300 for each evening's performance. On the seventh evening, S willfully absents herself from the theatre. M, in consequence, wants to rescind the contract and claim compensation for the loss suffered by him through the non-fulfilment of the contract by S. Advise. [***Hint:*** M is entitled to rescind contract and claim compensation. s.75]

1.2 Classification of Contracts

Contracts may be of different types based on (i) Validity or enforceability, (ii) Mode of formation and (iii) Performance.

1.2.1 Classification of Contracts According to Formation

A contract may be (a) Made in writing (b) By words spoken and (c) Inferred from the conduct of the parties or the circumstances of the case. Accordingly, contracts may be classified according to the mode of formation as express contracts and implied contracts. If the terms of a contract are expressly agreed upon (whether by words spoken or written) at the time of the formation of the contract, the contract is said to be an express contract. An implied contract is one which is inferred from the acts or conduct of the parties or the course of dealing between them.

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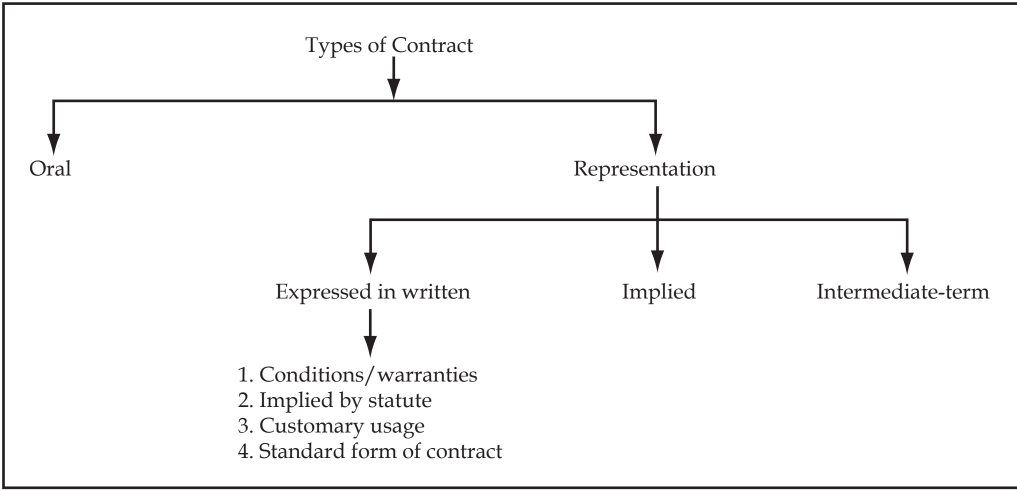

Contracts need not be in Writing

The terms of a contract may be stated in words (written or spoken). This is an express contract. Thus, there may be a verbal or oral contract. Also the terms of a contract may be inferred from the conduct of the parties or from the circumstances of the case. This is an implied contract.

Example: A enters into a public transport, for going to his destination. The law will imply a contract from the very nature of the circumstances, and he will be obliged to pay for the journey.

Contracts and Documents to be in Writing

There are certain contracts and documents which are required to be in writing and are to be signed by the parties thereto. Some of these are:

(i) A bill of exchange, cheque, promissory note, etc., under the Negotiable Instruments Act, 1881.

(ii) A memorandum of association of a company registered under the Companies Act, 1956.

(iii) An articles of association of a company registered under the Companies Act, 1956.

(iv) An application for shares in a company.

(v) An application for transfer of shares in a company.

Contracts and Documents which are required to be registered

There are some contracts and documents which are required to be not only in writing but, in addition, are required to be registered with some competent authority or the other. Some of these are:

(i) Transfer of immovable property, i.e., lease, sale, mortgage or gift thereof.

(ii) A memorandum of association of a company.

(iii) An articles of association of a company.

(iv) Mortgage and charges of properties by a company.

(v) Documents coming within the purview of the Registration Act, 1908.

Notes

An implied contract may be implied in fact or implied in law. Contracts implied in fact and contracts implied in law are not really contracts at all.

Formal and Informal Contracts

A formal contract is one to which the law gives special effect because of the formalities or the special language used in creating it. The best example of formal contracts is negotiable instruments, such as cheques. Informal contracts are those for which the law does not require a particular set of formalities or special language. Sometimes informal contracts are called 'simple' contracts.

1.2.2 Classification According to Validity

Contracts may be classified according to their validity as (i) Valid, (ii) Voidable, (iii) Void, (iv) Unenforceable (v) illegal.

A contract to constitute a valid contract must have all the essential elements discussed earlier. A voidable contract is one which may be repudiated (i.e., avoided) at the will of one or more of the parties, but not by others. Until it is so repudiated it remains valid and binding. It is affected by a flaw (e.g., misrepresentation, fraud, coercion, undue influence), and the presence of any of these defects enables the party aggrieved to take steps to repudiate the contract. It shows that the consent of the party, who has the discretion to repudiate, was not free.

Example: A, a man enfeebled by disease or age, is induced by B's influence over him, as his medical attendant to agree to pay B an unreasonable sum for his professional services. A can avoid the contract. A's consent is not free; it is affected by undue influence employed by B. A can take steps to set the contract aside.

If the party entitled to avoid the contract fails to do so within a reasonable time, he will be estopped from avoiding it if the other party has altered his position to his prejudice or a third party has acquired some rights in a *bona fide* manner.

Example: A purchased certain goods from B by making a misrepresentation of some facts. Later B comes to know about the representation made by A. However, B does not, within a reasonable time, repudiate the contract. A sells those goods to C, a *bona fide* purchase for value. C's title shall be a good title.

An agreement which is not enforceable by either of the parties to it is void *ab initio* such an agreement is without any legal effect. Under s.11, an agreement with a minor is void. Sometimes, a contract is valid at the time of formation, but may become void afterwards.

Example: A contracts to take indigo for B to a foreign port. A's government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

An illegal agreement is one that the courts will not enforce because the purpose is to achieve an illegal end. Illegal contract are those contract that are forbidden by law. All illegal contracts are void. Because of the illegality of their nature they cannot be enforced by any court of law. Infact even associated contracts cannot be enforced. Contracts which are opposed to public policy or immoral are illegal. Similarly contracts to commit crime like supari contracts arte illegal contracts.

Notes

1.3 Essential of a Valid Contract

It is important to have valid offer. Following are the essentials of a valid offer:

1. The terms of the offer must be definite, unambiguous and certain or capable of being made certain. If the terms of the offer are loose, vague, ambiguous or uncertain, it is not a valid offer.
2. An offeree must have knowledge of the offer before he can accept it. The offer must be communicated to the other party. The communication of offer is complete only when it comes to the knowledge of the offeree. If the offer is lost on the way in transit it is no offer. This is true of specific as well as general offers.
3. An offer cannot contain a term the non-compliance of which may be assumed to amount to acceptance. An offeror cannot say that if the offeree does not accept the offer within two days the offer would be deemed to have been accepted. Such a burden cannot be imposed on the offeree. It is for the offeree to accept the offer or not; and therefore, he may communicate his acceptance accordingly.
4. If a person makes a statement without any intention of creating a binding obligation this does not amount to an offer. It is only a mere declaration of intention to offer.

   Example: An auctioneer, *L*, advertised that a sale of office furniture would take place at a particular place on a stated day. *H* traveled down about 100 km. to attend the sale but found the furniture was withdrawn from the sale. He claimed compensation from the auctioneer. *Held*, that auctioneer was not liable.
5. Where two parties make identical offers to each other in ignorance of each other's offer this does not result in a contract. Such offers are known as cross offers and neither of the two can be called an acceptance of the other.
6. The offer must be made with a view to obtain acceptance thereto.
7. The offer must be made with the intention of creating legal relationship. An offer of a purely social or domestic nature is not a valid offer.
8. The offer must be communicated to the offeree before it can be accepted. This is true of both specific and general offers.
9. An offer must be distinguished from a mere invitation to offer.

What is a Standard Form Contract?

A standard form contract is a document which is generally printed, containing terms and conditions, with certain blanks to be filled in. It is prepared by the business people. The customer has only to sign it. Therefore, from his standpoint, the freedom to contract is restricted. Many of the contracts now being entered into by consumers are not the result of individual negotiations; rather they are one-sided contracts. The consumer has to accept them or leave them. Rather than permit the form to be varied, the firm or industry imposing it simply refuses to deal with anyone who will not accept its terms. A contract thus is imposed by a party having a strong bargaining power on a party having a weak bargaining power. Hence, such a contract is known as a contract of adhesion. Most contracts for photocopier machines, insurance, automobiles, telephone, water and power connection and a host of other goods and services are contracts of adhesion. In fact, the process of dilution of the freedom of the parties to contract has started in a big way and a time might come when it shall only be a myth.

Notes

1.4 Consent

We have seen earlier that an offer by one party is accepted by the other party. The consent of the offeree to the offer by the offeror is necessary. It is essential to the creation of a contract that both parties agree to the same thing in the same sense. When two or more persons agree upon the same thing in the same sense they are said to consent.

Example: A agrees to sell his Maruti car Delux model for ₹ 1.20 lakhs. *B* agrees to buy the same. There is a valid contract since *A* and *B* has consented to contract on the same subject matter. Free consent is one of the essentials of a valid contract. Consent is said to be free when it is not caused by:

1. Coercion,
2. Undue influence,
3. Fraud,
4. Misrepresentation or
5. Mistake.

1.4.1 Meaning of Coercion

Coercion is (i) the committing or threatening to commit any act forbidden by the Indian Penal Code or (ii) the unlawful detaining or threatening to detain any property to the prejudice of any person whatever with the intention of causing any person to enter into an agreement.

Example: A threatens to kill *B* if he doesn't transfer his house in *A*'s favour for a very low price. The agreement is voidable for being the result of coercion. However, it is not necessary that coercion must have been exercised against the promisor only, it may be directed at any person. *(Chikkan Amiraju v/s Alwar Setti)*

Effect of Coercion on the Validity of Contract

When consent to an agreement is caused by coercion the agreement is voidable at the option of the party whose consent was so obtained. Thus, the aggrieved party can have the contract set aside if he so desires otherwise the contract is a valid one. However, a person, to whom money has been paid or anything delivered under coercion, must repay or return it to the other party.

Example: A railway company refused to deliver certain goods to the consignee except upon the payment of an illegal charge for carriage, and he paid the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

1.4.2 Meaning of Undue Influence (S. 16)

Undue influence consists in the improper exercise of power over the mind of one of the contracting parties by the other. A contract is said to be induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

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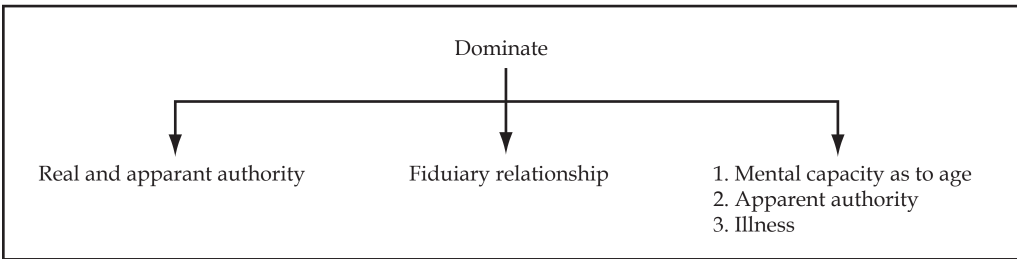

The party in the dominating position uses that portion to obtain unfair advantages.

Example: *A*, a man enfeebled by disease or age, is induced by *B*'s influence over him as his medical attendant to agree to pay *B* an unreasonable sum for his professional services, *B* employs undue influence.

Some of the relationships which raise a presumption of undue influence are:

1. Parent and child;
2. Guardian and ward;
3. Doctor and patient;
4. Spiritual guru and disciple;
5. Lawyer and client;
6. Trustee and beneficiary.

However, the presumption of undue influence can be rebutted by showing that the party said to have been influenced had independent legal advice of one who had full knowledge of the relevant facts. There is no presumption of undue influence in the relationships between

1. Husband and wife;
2. Master and servant;
3. Creditor and debtor;
4. Landlord and tenant.

The burden of proving that the contract is not induced by undue influence lies on the party who is in a position to dominate the will of the other. On the other hand, in relationships where undue influence is not presumed the party alleging undue influence must prove that it existed.

Consequences of Undue Influence

An agreement caused by undue influence is voidable at the option of the party whose consent was obtained by undue influence. However, any such contract may be set aside either absolutely or if the party who was entitled to avoid it has received any benefit there under then upon such terms and condition as the court deems fit.

Example: *A*, a money lender, advanced ₹ 1,000 to *B*, a household lady, and by undue influence induced *B* to execute a bond with interest at 8 per cent per month. The court may set the bond aside ordering *B* to repay ₹ 1,000 with such interest as the court may deem just.

Notes

Extra Precautions to be taken while entering into Contract with a Pardanashin Woman

A pardanashin woman is one, who according to the custom of her community, observes complete seclusion. The courts in India regard such women as being especially open to undue influence.

Money Lending Transactions

In money lending transactions the rate of interest being high, or that the borrower is in urgent need of money is not an evidence of undue influence.

Example: A, being in debt to *B*, the money lender, contracts for a fresh loan at compound interest of 25 per cent the transaction may be held to be unconscionable and a reduced rate of simple interest may be awarded.

1.4.3 Meaning of Fraud

Fraud means and includes any of the following acts committed by a party to a contract with intent to deceive the other party thereto or to induce him to enter into a contract:

(i) The suggestion as a fact of that which is not true by one who does not believe it to be true;

(ii) Active concealment of a fact by one having knowledge or belief of the fact;

(iii) Promise made without any intention of performing it;

(iv) Any other act fitted to deceive;

(v) Any such act or omission as the law specifically declares to be fraudulent.

Essential Elements or Conditions for an Fraud to Exist

For a fraud to exist the following are the essential elements:

1. There must be a representation or assertion and it must be false. To constitute fraud there must be an assertion of something false within the knowledge of the party asserting it.
2. The representation or assertion alleged to be false must be of a fact. A mere expression of opinion, puffery or flourishing description does not constitute fraud.
3. The representation or statement must have been made (a) knowingly or (b) without belief in its truth or (c) recklessly, carelessly whether it be true or false. In (a) and (b) there seems to be no difficulty since fraud is proved when it is shown that a false representation has been made knowingly or without belief in its truth.
4. The representation, statement, or assertion must have been made with the intention of inducing the other party to act upon it.
5. The representation must in fact deceive. It has been said that a deceit which does not deceive is not a fraud.
6. The party subjected to fraud must have suffered some loss. It is a common rule of law that there is no fraud without damages.

Example: A informs *B* fraudulently that *A*'s estate is free from encumbrance. *B* therefore buys the estate. The estate in fact is subject to a mortgage. *B* may either avoid the contract or may insist on its being carried out and the mortgage deed redeemed.

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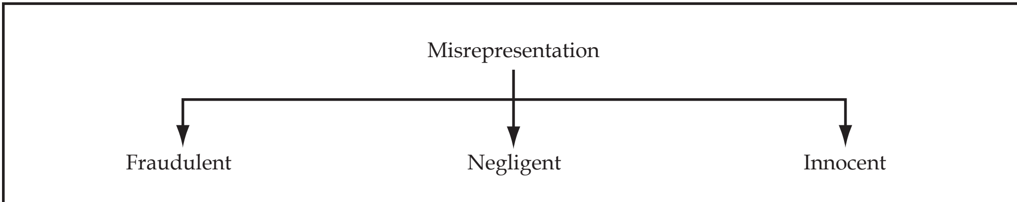
1.4.4 Meaning of Misrepresentation

Misrepresentation is also known as simple misrepresentation whereas fraud is known as fraudulent misrepresentation. Like fraud, misrepresentation is an incorrect or false statement but the falsity or inaccuracy is not due to any desire to deceive or defraud the other party. Such a statement is made innocently. The party making it believes it to be true. In this way, fraud is different from misrepresentation.



The case of misrepresentation may be classified into the following three groups:

1. The positive assertion in a manner not warranted by the information of the person making it, of that which is not true though he believes it to be true.
2. Any breach of duty which without an intent to deceive gives an advantage to the person committing it (or anyone claiming under him) by misleading another to his prejudice or to the prejudice of anyone claiming under him.
3. Causing however innocently a party to an agreement to make a mistake as to the substance of a thing which is the subject of the agreement.

Example: *A* chartered a ship to *B* which was described in the 'Charter Party' and was represented to him as being not more than 2,800 tonnages registered. It turned out that the registered tonnage was 3,045 tons. *A* refused to accept the ship in fulfillment of the charter party. He would be entitled to avoid the charter party by reason of the erroneous statement as to tonnage.

Consequences of Fraud and Misrepresentation

The party aggrieved or wronged has two remedies viz, (i) he can avoid the performance of the contract (ii) he can insist that the contract shall be performed and that he shall be put in the position in which he would have been if the representation made had been true. In case of fraud he has an additional remedy, i.e., he can sue for damages.

Exceptions to the Principle that the Party Aggrieved or Wronged by Misrepresentation cannot Claim Damages

The directors of a company are liable in damages under s.62 of the Companies Act, 1956, even for misstatements, i.e., misrepresentation in the prospectus issued by the company inviting public for subscription. Also where there exists a confidential relationship between the parties (such as solicitor and client), and negligent representation is made by one to the other then the aggrieved party may claim damages.

Differences between the Fraud and Misrepresentation

The following are the points of difference between the two:

1. In case of fraud, the party making false or untrue representation makes it with the intention to induce the other party to enter into a contract. Misrepresentation, on the other hand, is innocent i.e., without any intention to deceive or to gain an advantage.

Notes

2. Both fraud and misrepresentation make a contract voidable at the option of the party wronged. But in case of fraud, the party defrauded gets the additional remedy of suing for damages caused by such fraud. In case of misrepresentation generally the only remedies are rescission and restitution.
3. In case of fraud, the defendant cannot take the plea that the plaintiff had the means of discovering the truth or could have done so with ordinary diligence. In case of misrepresentation it could be a good defense.

Cases of Fraud or Misrepresentation in which the Contract is not Voidable

There are two exceptions to the principle that the party aggrieved or wronged can avoid the contract. Firstly, where the party whose consent was caused by fraud or misrepresentation had the means of discovering the truth with ordinary diligence. Secondly, where the party after becoming aware of the fraud or misrepresentation takes a benefit under the contract or in some way affirms it.

1.4.5 Meaning of 'Mistake'

Mistake may be defined as an erroneous belief on the part of the parties to the contract concerning something pertaining to the contract. For example, *A* agrees to buy from *B* a certain house. It turns out that the house had been destroyed by fire before the time of the bargain though neither party was aware of the fact. The agreement is void. *A* cannot insist for possession of the house. The agreement is void as there is a mistake on the part of both the parties about the existence of the subject matter.

Different Kinds of Mistake

Broadly there are two kinds of mistake:

1. Mistake of fact
2. Mistake of law.

Mistake of Fact

Further mistake of fact may be either: (a) Bilateral or (b) Unilateral. The mistake of law may be (a) mistake of law of the land and (b) mistake of foreign law.

When both the parties to the agreement are under a mistake of fact essential to the agreement, the mistake is called a bilateral mistake and the agreement is void.

For example, *A* agrees to sell to *B* a specific cargo of goods supposed to be on its way from London to Mumbai. It turns out that before the day of the bargain the ship conveying the cargo had been cast away and the goods lost. Neither party was aware of the facts. The agreement is void. An erroneous opinion, however, as to the value of thing which forms the subject matter of the agreement is not to be deemed a mistake as to a matter of fact.

There is a unilateral mistake where only one party to a contract is under a mistake as to a matter of fact. Generally speaking, such a contract is not invalid. Thus, where a person due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must bear the consequences.

Example: A sold rice to *B* by sample, and *B* thinking that they were old rice, purchased them. In fact, the rice were new. *B* cannot avoid the contract.

Notes

Mistake of Law

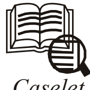
It may be (i) mistake of law of the land, or (ii) mistake of foreign law. In the first case the rule is "Ignorantia juris non-excusat".

Meaning of "ignorantia juris non excusat": It means ignorance of law is no excuse. A contract is not voidable because it was caused by a mistake as to any law in force in India. Thus, where *A* and *B* make a contract grounded on the erroneous belief, that a particular debt is barred by the Limitation Act; the contract is not voidable. (s.21) Further, "a mistake as to a law not in India has the same effect as a mistake of fact".

Mistake of Foreign Law: The above maxim – "ignorance of law is no excuse" is inapplicable to foreign law. The mistake of foreign law is to be treated as a mistake of fact.

Consequences of Mistake on Contracts: Mistake renders the contract void and as such in case of a contract which is yet to be performed the party complaining the mistake may repudiate it, i.e., need not perform it. If the contract is executed the party who received any advantage must return it or make compensation for it as soon as the contract is discovered to be void.

Task Peter, by way of misrepresentation, leads Deepak erroneously to believe that 100 quintals of indigo are made annually at Peter's factory, Deepak examines the accounts of the factory and finds that only 50 quintals of indigo have been made. Afterwards, Deepak buys the factory. Deepak now wants to avoid the contract on the ground of misrepresentation. Advise him giving reasons.



Caselet

Expedience, Misrepresentation, or Falsification?

Dr. Leyos is a senior scientist in an internationally respected cancer research institute. His research group has recently been studying the regulation of a novel gene that may be a primary factor in allowing tumors to metastasize. Three pilot (preliminary) experiments have shown positive results consistent with the hypothesized role, but none of these studies is publishable. In the first case, investigators were not blinded to the origins of the samples for data collection and analyses. In a second case, adequate controls were not included and in the third case, the freezer thawed resulting in some sample degradation. However, despite these limitations, all three pilot experiments were consistent with a clear confirmation of the hypothesis. Based on these results, a definitive experiment was designed and carried out. Because of the long incubation periods and assay times, the experiment required six months to complete. Because demonstration of the effect required pooling of 20 mice for each data point, the experiment was extremely costly both in lives of animals and dollars spent. On completion of the final assays, Dr. Leyos learned that labels fell off of two samples, one for a control group and the other for an experimental group. If the two samples are omitted from the analysis, the results just miss reaching the accepted level of statistical significance ($P<0.05$). If the samples are assigned to control and experimental groups one way, the final analysis is also not statistically significant and is not consistent with the previous three experiments. However, if the unlabeled samples are applied in the opposite way, the final analysis is statistically significant and consistent with the pilot studies. Dr. Leyos is trying to decide among the following courses of action.

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Notes

Repeat the experiment (at a cost of approximately 6 months, 300 animals, and $40,000).

Repeating the experiment is an ethically permitted and ethically encouraged approach. One of the role related responsibilities of scientists is to achieve accurate reproducible results. Whatever the reasons, unless the experiment is repeated, Dr. Leyos cannot attest that the results are accurate or reproducible.

However, the grant that funded this project did not budget for repeat of the experiment. So while Dr. Leyos wants to repeat the experiment, he must now decide among a number of courses of action.

1. Take $40,000 already approved by the funding agency to support a post-doctoral student and use that money to cover the additional experiment.
2. Apply for other funding to repeat the experiment. In the proposal, Dr. Leyos explains that the results are currently just shy of statistical significance, but does not give details about the earlier problems.
3. Explain the problems that have occurred to the funders and request additional funds to support the testing required for statistical significance.

Take $40,000 already approved by the funding agency to support a post-doctoral student and use that money to cover the additional experiment

Altering the use of research funds without permission of the funder is usually illegal. Funders sometimes specify that small amounts of money (in the neighborhood of $500) can be redistributed between approved categories. Reapportioning a great deal of money, such as $40,000 in this case, is legally and ethically prohibited. It is not an example of fabrication, falsification or plagiarism, however it does seriously deviate from conventional practice and is likely to violate contractual terms between the funder and the institution. Although not technically classified as research misconduct, it is usually directly disallowed in the agreement between the grantor and the grantee institution. It is within the funder's prerogative to have the opportunity to agree or disagree with proposed major changes in the budget or work plan.

Apply for other funding to repeat the experiment. In the proposal, Dr. Leyos explains that the results are currently just shy of statistical significance, but does not give details about the earlier problems.

This choice is ethically permitted. Additional funds should be requested with explicit description of how those funds would be used. Withholding information about the laboratory's woes does not necessarily count as deception. Deceiving potential funders is ethically prohibited. However, it is a matter of convention as to how explicit Dr. Leyos would need to be about his previous problems. Choosing not to tell a potential funder about the freezer failure or the missing labels counts as deception *only* if Dr. Leyos has a duty to offer such information. Although Dr. Leyos would be ethically and legally required to report disconfirming data, these results he currently has are ambiguous, not disconfirming.

Explain the problems that have occurred to the funders and request additional funds to support the testing required for statistical significance.

This choice is ethically permitted. Additional funds may be requested from the funder with explicit description of how those funds would be used and why additional funds are needed. Dr. Leyos does not necessarily have a duty to detail the catastrophes that have caused the results to be shy of statistical significance and, thus, resulted in the new request, but it is ethically permitted, perhaps even ethically encouraged, to offer the full explanation.

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Notes

Attempt to publish the findings omitting the questionable samples.

This choice is ethically permitted. While not ideal, Dr. Leyos is meeting role-related-responsibilities by presenting the results of the experiment in an accurate, reproducible way, even if the results were less than one would have hoped. Although Dr. Leyos would be ethically and legally required to report disconfirming data, these results are ambiguous, not disconfirming.

Assign the two samples to their likely groups and publish the statistically significant and convincing results.

This choice is research misconduct, specifically, fabrication. Assigning the samples as one hopes they belong is equivalent to making up data or results. This choice is legally and ethically prohibited. This choice could also be seen as falsification. Falsification includes changing or omitting data or results such that the research is not accurately reported.

Suppose you are the investigator in the lab next door and hear about Dr. Leyos' choice from your graduate assistant, who was told by Dr. Leyos' graduate student.

Don't pursue it. You have enough to do without getting caught up in a controversy like this.

This is ethically prohibited as it is a violation of the researcher's role as an institutional agent. PHS policy counsels that all employees or individuals associated with the institution should report observed, suspected, or apparent misconduct, although that expectation is ethical rather than legal. Any person in a supervisory or administrative role is ethically required (and in most institutions, legally required) to report suspected misconduct.

Have a discussion with Dr. Leyos in which you attempt to argue for another alternative.

This choice is ethically ideal. While it is important to talk with Dr. Leyos in a way that doesn't implicate the graduate students, this choice gives Dr. Leyos an opportunity to think through the proposed action with a colleague. Perhaps Dr. Leyos is so sure of the results that self-deception has set in. Perhaps Dr. Leyos is not aware of the seriousness of the consequences of his intended action. A conversation provides the opportunity for Dr. Leyos to change course without allegations of misconduct. However, it is also ethically and legally required for supervisors to protect the complainants (in this case, students engaged in informal communication) from retaliation.

Discuss the situation with your graduate students and other colleagues, explaining the problems with Dr. Leyos' approach.

This choice is ethically prohibited. Cases of suspected misconduct should be pursued in conversation with Dr. Leyos or with the Research Integrity Officer. PHS procedures for responding to allegations of scientific misconduct counsel, "Institutional employees who make, receive, or learn of an allegation of scientific misconduct will protect, to the maximum extent possible, the confidentiality of information regarding the whistle blower, the respondent, and other affected individuals." Discussing Dr. Leyos' choice with others violates his confidentiality.

Report the situation to your department chair, dean, or other institutional officer.

This choice is ethically permitted and may become ethically and legally required. While it is ethically ideal to talk with Dr. Leyos first and help the scientist understand the seriousness of the consequences of his intended action, it is ethically permissible to approach officers within the institution who have the responsibility of conducting pre-inquiry review. If a conversation with Dr. Leyos doesn't change the intended action, it is ethically required to bring the allegation to an institutional officer.

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Notes

According to PHS policy, if an individual is unsure if an incident falls within the definition of scientific misconduct, he or she may call the Research Integrity Officer to discuss the situation informally.

Source: ultrasonics.bioen.illinois.edu/admin/upload/Case%20study_SZ.doc

1.5 Consideration

One of the essential elements of a valid contract is that it must be supported by consideration. In simple terms consideration is what a promisor demands as the price for his promise. The term consideration is used in the sense of *quid pro quo*, i.e., "something in return". This something or consideration need not be in terms of money. This "something" may even be some benefit, right, interest or profit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other party. Also a promise by one party may be consideration for the promise of other party. Thus, a person who makes a promise to do something usually does so as a return of equivalent of some loss, damage or inconvenience that may have been occasioned to the other party in respect of the promise. The benefit so received, or the loss, damage or inconvenience so caused is regarded, in law, as the consideration for the promise.

Section 2 (d) defines consideration as: "When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise".

The object of the consideration should not be

1. Forbidden by law
2. Defeat the provision of law
3. Injurious to person or property
4. Agreement injurious to public policy
5. Agreement opposed to public policy (section 23)

Example: A agrees to sell his motorcycle to B for ₹ 20,000. Here B's promise to pay the sum of ₹ 20,000 is the consideration for A's promise to deliver the motorcycle, and A's promise to deliver the motorcycle is the consideration for B's promise to pay ₹ 20,000.

An agreement without consideration is void (nudum pactum) s.25. However, the following agreement without consideration is valid agreement.

1. Natural love and affection
2. Compensation for past voluntary services
3. Promise to pay a time based debt
4. Creation of agency does not require consideration

Rules regarding Consideration

The following rules as regards consideration emerge from the definition given in s.2 (d):

1. Consideration must move at the desire of the promisor and therefore an act done by the promise at the desire of a third party is not a consideration. *(Durga Prasad v/s Baldeo)* A building at a market place at the order of the collector was to be made for which the defendant, a tenant made promise to pay, later refused was held not liable as consideration is from third party.

Notes

2. ***Consideration may move either from the promisee or any other person.*** It is not necessary that the consideration must move from the promisee. It may move from any other person. In such a situation, the promisee can maintain a suit even if he is a stranger to the consideration. But he must not be a stranger to the contract.

   Capacity of a stranger to consideration to file a suit: We have seen earlier that a stranger to a contract cannot maintain a suit. However, a stranger to consideration can maintain a suit. Consideration may be supplied either by promisee or any other person.

Example: A, a lady, by a deed of gift, transferred certain property to her daughter with a direction that the daughter should pay an annuity to A's brother as had been done by A. On the same day, the daughter executed a writing in favour of A's brother agreeing to pay the annuity of ₹ 653. Afterwards, she declined to fulfill her promise saying that no consideration had moved from A's brother to her. A's brother was held entitled to recover the money (*Chinnayya v. Ramayya*, 4 Mad 137).

3. ***Consideration need not be adequate.*** How much consideration or payment must there be for a contract to be valid, is always the lookout of the promisor. Courts do not see whether a person making the promise has recovered full return for the promise. Thus, if A promises to sell his pen worth ₹ 80 for ₹ 20 only the inadequacy of the price in itself shall not render the contract void. But where A pleads coercion, undue influence or fraud, then the inadequacy of consideration will also be a piece of evidence to be looked into.

4. ***Consideration must be real and competent.*** A consideration for a contract must be real and not illusory. Also, the consideration must be competent, i.e., it must be something to which law attaches some value.

Example: (i) A promises to discover treasure by magic. The agreement is void, being illusory. (ii) A received summons to appear as a witness at a trial. B, a party to the suit, promises to pay An ₹ 1000 in addition to A's expenses. The promise of B is not enforceable as A was under a legal duty to appear and give evidence. The agreement is void as it is without competent consideration. (iii) A promises to pay an existing debt punctually if B, the creditor, gives him discount. B agrees to give discount. The promise to give discount is without consideration and cannot be enforced.

5. ***Consideration must be legal.*** Illegal consideration renders a contract void.

6. ***A consideration may be present, past or future.*** A consideration which moves simultaneously with the promise is called present (or executed) consideration. 'Cash Sales' provides an excellent example of the present consideration. Where the consideration is to move at a future date it is called future or executory consideration. It takes the form of a promise to be performed in the future.

Example: A, a shopkeeper, promises B, a household lady, to deliver certain items of grocery after three days. B promises to pay for it on delivery.

A past consideration is something wholly done, forborne or suffered before the making of the contract.

Example: A saves B's life. B promises to pay A ₹ 10,000 out of gratitude. The consideration for B's promise is a past consideration, something done before making of the promise.

Task X, an old lady, by a deed of gift, made over certain property to her daughter D, with the specific directions that she should pay P, who is the sister of the old lady, a sum of ₹ 100 per month. The same day D entered into an agreement with P to pay her the agreed amount. D now refuses to pay her aunt P, the above amount on the plea that no consideration had moved from P to D.P, therefore, sues D. Is the suit maintainable and can D be held liable to pay the amount? [***Hint.*** D can be held liable to pay the amount to P. Consideration may move even from a stranger-s.2 (d)]

1.6 Quasi-contracts

We have seen above that one of the essentials of a valid contract is that it is based on an agreement between the parties. Sometimes, however, obligations are imposed on a party by law (regardless of any agreement), and an action is allowed to be brought by another party. Such obligations are known as quasi-contracts, but the Act (Ss. 68-72) describes them as "certain relations resembling those created by contract".

1. Claim for necessaries supplied to a person incompetent to contract.
2. Reimbursement of money paid which was due by another
3. Obligation of person enjoying benefit of non gratuitous act (s 70)
4. Finder of lost goods (s 71)

Example: A, a tradesman, leaves goods at B's warehouse by mistake. B treats the goods as his own. B is bound to pay A for them.

They are remedies devised by the courts. Courts apply them when the legal requirements of Indian Contract Act, 1872 for contract formation do not exist, but it would be grossly unjust to permit one party to benefit – without paying – from what he received from the other.

A contract implied in fact is not expressly stated. Rather, a court, examining the facts and circumstances, implies the existence of the contract from the acts or conduct of the parties. If a tourist asks a garage owner to repair his car, a court will infer that the tourist agreed to pay a reasonable amount, although neither party says anything about it. The parties may not have thought consciously that they were forming a contractual relationship. Still, it is only common sense that the tourist and the garage owner agreed to an exchange of services for money. And, that is why the courts devised contracts implied in fact.

A contract implied at law, also called a quasi-contract, is an obligation imposed by a court to do justice between the parties even though they never exchanged, or intended to exchange, promises. In this instance, a court implies a contract to prevent one party's unjust enrichment at the other's expense.

1.7 Agreements Declared Void (Secs.26-30)

The Act declares certain agreements to be void. Some of them (such as the following) have already been explained:

(i) agreements entered into through a mutual mistake of fact between the parties (Sec.20);

(ii) agreements, the object or consideration of which is unlawful (Sec.23);

(iii) agreements, part of consideration of which is unlawful (Sec.24);

(iv) agreements made without consideration (Sec.25).

Notes

Some other agreements which are declared to be void are explained below:

Agreements against Public Policy (Secs.26-28)

An agreement which conflicts with morals of the time and contravenes any established interest of society is void as being against public policy. Some of the agreements which are against public policy and have been declared to be void by law. These are as follows:

(i) Trading with enemy,

(ii) Agreements for stifling prosecution,

(iii) Contracts in the nature of champerty and maintenance,

(iv) Agreement for the sale of public offices and titles are void,

(v) Agreements in restraint of parental rights are void,

(vi) Agreements in restraint of marriage of any person other than a minor is void.

Agreement in Restraint of Trade

Sec.27 provides that "every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind is, to that extent, void". All agreements in restraint of trade, whether general or partial, qualified or unqualified, are void. It is, therefore, not open to the courts to enter into any question of reasonableness or otherwise of the restraint [*Khemchand v. Dayaldas*, (1942) Sind, 114].

1.8 Performance of Contract

A contract creates obligations. 'Performance' of contract means the carrying out of obligations under it. The parties to contract must either perform or offer to perform their respective promises unless such performance is dispensed with or excused under the provisions of the Indian Contract Act, or some law. It may happen that the promisor offers performance of his obligation under the contract at the proper time and place but the promisee refuses to accept the performance. This is called as 'Tender' or 'Attempted Performance'. The promise may be performed by promisor himself or his agent or by his legal representative.

1.8.1 Joint Performance of Promises

There are many types of joint performance of promises such as devolution of joint liabilities, liabilities of joint promisors, right of contribution amongst joint promisors, release of joint promisor and devolution of joint rights.

1. ***Devolution of joint liabilities:*** When two or more persons have made a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfill the promise. In the event of death of any of them, his representative jointly with the survivor or survivors and in case of the death of all promisors, the representatives of all of them jointly must fulfill the promise.

2. ***Liabilities of joint promisors:*** When two or more persons make a joint promise, the promisee may, in the absence of an express agreement to the contrary, compel anyone or more of such joint promisors to perform whole of the promise. Thus, the liability of joint promisors is joint as well as several.

Example: A, *B* and *C* jointly promise to pay *D* ₹ 3,000. *D* may compel either *A*, or *B* or *C* or any two of them to pay him ₹ 3,000.

Notes

3. ***Right of contribution amongst joint promisors:*** Where, a joint promisor has been compelled to perform the whole promise, he may compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

Example: A, *B* and *C* are under a joint promise to pay *D* ₹ 3,000. *C* is unable to pay anything and *A* is compelled to pay the whole amount of ₹ 3,000. *A* is entitled to receive ₹ 1,500 from *B*.

4. ***Release of joint promisor:*** Where two or more persons have made a joint promise, a release of one of such joint promisor by the promisee does not discharge the other joint promisor or promisor; neither does it free him from the responsibility to the other joint promisor or promisor.

5. ***Devolution of joint rights:*** When a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract, the right to claim performance rests with all the joint promisees and after the death of any of them.

Example: A, in consideration of ₹ 5,000 lent to him by *B* and *C*, promises *B* and *C* jointly to repay them that sum with interest on a day specified. *B* dies. The right to claim performance rests with *B*'s representative jointly with *C* during *C*'s life, and after *C*'s death with the representatives of *B* and *C* jointly.

1.8.2 Rules regarding the Time, Place and Manner of Performance of Contracts

There are several rules regarding the time, place and manner of performance of contract. These are as follow:

1. Where the time for performance has been specified and the promisor has undertaken to perform it without application by the promisee, the promisor must perform on the day fixed during the usual business hours and at the place at which the promise ought to be performed. *Promises* to deliver goods to *B* at his warehouse on 15th July. *A* offers the goods at *B*'s warehouse but after the usual hours for closing it. The performance of *A* is not valid

2. Where the time of performance is not specified and the promisor agrees to perform without a demand from the promisee, the performance must be made within a reasonable time. What is a reasonable time is, in each particular case, a question of fact.

3. Where a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, the promisee must apply for performance at a proper place and within the usual business hours. What is a proper time and place is, in each particular case, a question of fact.

4. When a promise is to be performed without application by the promisee and no place is fixed for its performance, the promisor must apply to the promisee to appoint a reasonable place for the performance of the promise, and perform it at such place. *A* undertakes to deliver 1,000 kilos of Jute to *B* on a fixed day. *A* must apply to appoint a reasonable place for the purpose of receiving it and must deliver it to him at such place.

5. The performance of any promise may be made in any manner or at any time which the promisee prescribes or sanctions.

Notes

1.8.3 Appropriation of Payments

Appropriation of payments means application of payments. When a debtor owes several debts in respect of which the payment must be made (to the same creditor), the question may arise as to which of the debts, payment is to be appropriated.

In India, the rules regarding appropriation of payments are contained in Ss. 59 to 61 which, in fact, have adopted with certain modifications the rules laid down in Clayton's case.

The provisions of these sections are summarized hereunder:

1. ***Appropriation by debtor:*** Where a debtor, owing several distinct debts to one person, makes a payment to him with express intimation that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied to that debt.

Example: *A* owes *B* among other debts, the sum of ₹ 974. *B* writes to *A* and demand payment of his sum. *A* sends to *B* ₹ 974. This payment is to be applied to the discharge of the debt of which *B* had demanded payment.

2. ***Appropriation by creditor:*** Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him by the debtor.

Example: *A* obtains two loans of ₹ 20,000 and ₹ 10,000, respectively. Loan of ₹ 20,000 is guaranteed by *B*. *A* sends the bank ₹ 5,000 but does not intimate as to how it is to be appropriated towards the loans. The bank appropriates the whole of ₹ 5,000 to the loan of ₹ 10,000 (the loan not guaranteed). The appropriation is valid and cannot be questioned either by *A* or *B*.

3. ***Where neither party appropriates:*** Where neither party makes any appropriation, the payment is to be applied in discharge of the debts in order of time, including time-barred debts. If the debts are of equal standing the payment is to be applied proportionately.

   Rule in Hallett's Estate Case. The rule in Hallett's Estate Case is an exception to the above Rule 3. The rule applies where a trustee had mixed up trust funds with his own funds. In such a case, if the trustee misappropriates any money belonging to the trust, the first amount so withdrawn by him would be first debited to his own money and then to the trust funds. Similarly, any deposits made by him would first be credited to trust fund and then to his own fund, whatever be the order of withdrawal and deposit.

Example: *A* trustee deposits ₹ 10,000 being trust money with a bank and subsequently deposits ₹ 50,000 of his own in the same account. Thereafter, he withdraws ₹ 10,000 from the bank and misappropriates it. The said withdrawal will not be appropriated against the trust amount of ₹ 10,000 but only against his own deposit though this was made later than the first deposit thus leaving the trust fund intact.

1.8.4 Different Modes of Discharge of Contracts

A contract may be discharged by:

(i) Performance,

(ii) Tender;

(iii) Mutual consent;

(iv) Subsequent impossibility;

(v) Operation of law;

(vi) Breach; and

(vii) Novation and Assignment of Contracts.

Discharge of Contracts by Performance or Tender

The obvious mode of discharge of a contract is by performances that is where the parties have done whatever was contemplated under the contract; the contract comes to an end. Thus, where *A* contracts to sell his car to *B* for ₹ 1,85,000, as soon as the car is delivered to *B* and *B* pays the agreed price for it, the contract comes to an end by performance. The tender or offer of performance has the same effect as performance.

Meaning of Mutual Consent

If the parties to a contract agree to substitute a new contract for it, or to rescind it or alter it, the original contract is discharged. A contract may terminate by mutual consent in any of the six ways viz. Novation, rescission, alteration and remission, waiver and merger. Novation means substitution of a new contract for the original one.

Accord and Satisfaction

These two terms are used in English law. In England, remission must be supported by a fresh consideration. The 'accord' is the agreement to accept less than what is due under the contract. The 'satisfaction' is the consideration which makes the agreement operative. In other words, 'satisfaction' means the payment or fulfilment of the lesser obligation. An 'accord' is unenforceable, but an 'accord' accompanied by 'satisfaction' is valid and thereby discharges the obligation under the old contract.

Discharge of Contracts by Impossibility of Performance

A contract may be discharged because of impossibility of performance. There are two types of impossibility: (i) Impossibility may be inherent in the transaction (i.e., the contract), (ii) Impossibility may emerge later by the change of certain circumstances material to the contract. In a limited number of circumstances, "frustrating" events may be regarded by the courts as affecting the contract in such a fundamental manner as to render further performance of the contract " impossible".

Examples of Inherent Impossibility: (i) A promises to pay B ₹ 50,000 if B rides on a horse to the moon. The contract is void *ab initio*. (ii) A agrees with *B* to discover treasure by magic. The agreement is void *ab initio*, as there is impossibility inherent therein.

Discharge of a Contract by Operation of Law

Discharge by operation of law may take place in four ways first by death. Death of the promisor results in termination of the contract in cases involving personal skill or ability. By insolvency, the insolvency law provides for discharge of contracts under certain circumstances so where an order of discharge is passed by an insolvency court the insolvent stands discharged of all debts incurred previous to his adjudication, third b*y merger.* When between the same parties, a new contract is entered into, and a security of a higher degree or a higher kind is taken, the previous contract merges in the higher security. Thus a right of action on an ordinary debt would be merged in the right of suing on a mortgage for the same debt and by the unauthorized alteration of terms of a written document. Where any of the parties alters any of the terms of the contract without seeking the consent of the other party to it, the contract terminates.

Notes

Discharge of Contracts by Breach

A breach of contract is one party's failure, without a legal excuse, to live up to any of its promises under a contract.

Novation and Assignment of Contracts

Assignment means transfer. When a party to a contract transfers his right, title and interest in the contract to another person or persons, he is said to assign the contract. Assignment of a contract can take place by (i) operation of law or (ii) an act of parties.

The rules regarding assignment of contracts are: Firstly, the obligations or liabilities under a contract cannot be assigned except by Novation. Thus, if *A* owes *B* ₹ 10,000, he cannot transfer his obligation to pay to *C* and compel *B* to collect money from *C*. However, if the promisee agrees to such an assignment he will be bound by it. In such a case a new contract is substituted for the old one. This is called 'novation'. Secondly, rights and benefits under a contract may be assigned. Thirdly, the rights of a party under a contract may amount to actionable claims which can be assigned by a written document. Notice of the assignment is to be given to the debtor to make it valid.

Case Study

Carbolic Smoke Ball Company

The Carbolic Smoke Ball Company made a product called the "smoke ball". It claimed to be a cure for influenza and a number of other diseases. The smoke ball was a rubber ball with a tube attached. It was filled with carbolic acid (phenol). The tube was then inserted into the user's nose. It was squeezed at the bottom to release the vapours into the nose of the user. This would cause the nose to run, and hopefully flush out the cold. In fact the inflammation caused by the device would have probably increased susceptibility to catching influenza.

The Company published advertisements in the Pall Mall Gazette and other newspapers on November 13, 1891, claiming that it would pay £100 to anyone who got sick with influenza after using its product according to the instructions set out in the advertisement. £100 reward will be paid by the Carbolic Smoke Ball Company to any person who contracts the increasing epidemic influenza colds, or any disease caused by taking cold, after having used the ball three times daily for two weeks, according to the printed directions supplied with each ball.

£1000 is deposited with the Alliance Bank, Regent Street, shewing our sincerity in the matter.

During the last epidemic of influenza many thousand carbolic smoke balls were sold as preventives against this disease, and in no ascertained case was the disease contracted by those using the carbolic smoke ball.

One carbolic smoke ball will last a family several months, making it the cheapest remedy in the world at the price, 10s. post free. The ball can be refilled at a cost of 5s. Address: "Carbolic Smoke Ball Company, "27, Princes Street, Hanover Square, London."

Mrs. Louisa Elizabeth Carlill saw the advertisement, bought one of the balls and used three times daily for nearly two months until she contracted the flu on January 17, 1892. She

Contd...

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claimed £100 from the Carbolic Smoke Ball Company. They ignored two letters from her husband, who had trained as a solicitor. On a third request for her reward, they replied with an anonymous letter that if it is used properly the company had complete confidence in the smoke ball's efficacy, but "to protect themselves against all fraudulent claims" they would need her to come to their office to use the ball each day and checked by the secretary.

Mrs. Carlill brought a claim to court. The barristers representing her argued that the advertisement and her reliance on it was a contract between her and the company, and so they ought to pay. The company argued it was not a serious contract.

Question

Do you agree to what the company says? Justify.

(***Hint:*** summarize this case in your word.)

1.9 Breach of Contract

A contract terminates by breach of contract. If the promisor has not performed his promise in accordance with the terms of the contract or where the performance is not excused by tender, mutual consent or impossibility or operation of law, then this amounts to a breach of contract on the part of the promisor. The consequence of this is that the promisee becomes entitled to certain remedies. The breach of contract may arise in two ways: (i) anticipatory and (ii) actual.

1.9.1 Anticipatory Breach of Contracts

The anticipatory breach of contract occurs when a party repudiates it before the time fixed for performance has arrived or when a party by his own act disables himself from performing the contract.

Example: A contracts to supply B with certain articles on 1st August. On 20th July, he informs B that he will not be able to supply the goods. B is entitled to sue A for breach of promise.

The anticipatory breach is also known as 'breach by repudiation'. Repudiation is a clear statement by one party before performance is due that it cannot or will not perform a material part of the contract obligation. Suppose that the day before your friend was to pick up the fiat that you are promised to sell him, you sent your friend a message that you decided to sell the car to someone else. That would be repudiation or anticipatory breach. It also would be repudiation if your friend heard from another reliable source that you sold the car to someone else (There would be no reason to believe that you would get it back to sell the car to your friend tomorrow). However, it is not repudiation if one party will not perform because of an honest disagreement over the contract's terms.

Consequence of Anticipatory Breach

Where a party to a contract refuses to perform his part of the contract before the actual time arrives, the promisee may either (i) rescind the contract and treat the contract as at an end, and at once sue for damages, or (ii) he may elect not to rescind but to treat the contract operative and wait for the time of performance and then hold the other party liable for the consequences of non-performance. In the latter case, the party who has repudiated may still perform if he can.

The anticipatory breach of contract does not by itself discharges the contract. The contract is discharged only when the aggrieved party accepts the repudiation of the contract, i.e., elects to rescind the contract. Thus, if the repudiation is not accepted and subsequently an event happens

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discharging the contract legally, the aggrieved party shall lose his right to sue for damages. A agreed to load a cargo of wheat on B's ship by a particular date but when the ship arrived, a refused to load the cargo. B did not accept the refusal and continued to demand the cargo. Before the last date of loading had expired war broke out rendering the performance of the contract illegal. Held, the contract was discharged and B could not sue for damages [*Avery v. Bowen* (1856) 6 E & B 965].

1.9.2 Actual Breach of Contracts

The actual breach can occur by (i) failure to perform as promised, (ii) making it impossible for the other party to perform. The failure to perform means that one party must not have performed a material part of the contract by a stated deadline. The actual breach by failure to perform may take place (a) at the time when performance is due, or (b) during the performance of the contract. Thus, if a person does not perform his part of the contract at the stipulated time, he will be liable for its breach.

Example: A, the seller, offers to execute a deed of sale only on payment by the buyer of a sum higher than is payable under the contract for sale, he shall be liable for the breach. But, if the promisor offers to perform his promise subsequently, the question arises whether it should be accepted, or whether the promisee can refuse such acceptance and hold the promisor liable for the breach. The answer depends upon whether time was considered by the parties to be of the essence of the contract. Section 55 provides the meaning of 'time to be the essence of a contract' and is discussed.

Breach during the performance of the contract. The actual breach of contract also occurs when during the performance of the contract, one party fails or refuses to perform his obligation under the contract.

Example: A contracted with a Railway Company to supply it certain quantity of railway chairs at a certain price. The delivery was to be made in instilments. After a few instilments had been made, the Railway Company asked A to deliver no more. Held, A could sue for breach of contract.

How is a contract breached by making performance impossible? Suppose you hire an agency to clean carpets in your home on Saturday for ₹ 500. You go out for the day neglecting to make arrangements to let the agency people into your home to clean the carpets. You have breached the contract by making performance impossible. You would owe the money since the cleaning agency could not clean and because the agency probably turned down requests to clean for other clients.

Partial Breach of a Contract

That happens when a non-material (unimportant) part of the contract gets breached. It may happen if the contract has several divisible parts each of which you may treat as a separate contract. Then you could sue for damages even though the breach is not complete. An example of this would be agreeing to perform a duty once every three months for one year and then not performing for the final three months.

1.9.3 Remedies for Breach of Contracts

When someone breaches a contract, the other party is no longer obligated to keep its end of the bargain. From there, that party may proceed in several ways: (i) the other party may urge the breaching party to reconsider the breach; (ii) if it is a contract with a merchant, the other party

may get help from consumers' associations; (iii) the other party may bring the breaching party to an agency for alternative dispute resolution; (iv) the other party may sue for damages; or (v) the other party may sue for other remedies.

What is the Point of Getting the Breaching Party to Reconside?

One advantage is that it is cheap. Often the only cost is the price of a phone call and a little pride. The breaching party may have breached the contract because of a misunderstood communication with the other party. Perhaps the breaching party just needs a little more time. Or may be both parties could negotiate. That could still leave both of them better off than if they went to court. If the aggrieved party hires a lawyer, the first thing that lawyer is likely to do is to convince the breaching party to perform. For this purpose, it is advisable that all records of communication with the breaching party are kept. Once the aggrieved party sees itself in for a struggle, it must make a file. Keep copies of any letters that the aggrieved party sends. You should move all receipts, warranty cards, and the like to this file. In case the breaching party does not budge, what else the aggrieved party can do. If the dispute is with a merchant, the aggrieved party might want to contact the manufacturers of the product. If it involves a large chain of stores such as Bata, contact the management of the chain. This goes for services, too. If it does not help, the aggrieved party should contact a consumer association, either in its city or state. It may approach the District Consumer Forum in the district or the MRTP Commission at New Delhi. Sometimes trade associations such as Chambers of Commerce may be able to help. Some business groups have consumer grievance cells. One might try print media "action lines".

Remedies for Breach of Contracts

As soon as either party commits a breach of the contract, the other party becomes entitled to certain reliefs. These remedies are available under the Indian Contract Act, 1872, as also under the Specific Relief Act, 1963. There are three remedies under the Specific Relief Act, 1963: (i) a decree for specific performance (s.10); (ii) an injunction (s.38-41); (iii) a suit on quantum meruit (s.30), Remedies under the Indian Contract Act, 1872 are: (i) rescission of the contract (s.39) and, (ii) damages for the loss sustained or suffered.

Rescission of the Contract

When a breach of contract is committed by one party, the other party may treat the contract as rescinded. In such a case the aggrieved party is freed from all his obligations under the contract. Thus, where A promises B to supply one bag of rice on a certain date and B promises to pay the price on receipt of the bag. A does not deliver the bag of rice on the appointed day, B need not pay the price. A person who rightfully rescinds the contract is entitled to compensation for any damage which he has sustained through the non-fulfillment of the contract.

1.9.4 Payment of Damages (S.75)

Another relief or remedy available to the promisee in the event of a breach of promise by the promisor is to claim damages or loss arising to him there from. Damages under s.75 are awarded according to certain rules as laid down in Ss.73-74. Section 73 contains three important rules: (i) Compensation as general damages will be awarded only for those losses that directly and naturally result from the breach of the contract. (ii) Compensation for losses indirectly caused by breach may be paid as special damages if the party in breach had knowledge that such losses would also follow from such act of breach. (iii) The aggrieved party is required to take reasonable steps to keep his losses to the minimum. It is the duty of the injured party to minimize loss. He cannot claim to be compensated by the party in default for loss which is really not due to the breach but due to his own neglect to minimize loss after the breach.

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Thus, the loss or damages caused to the aggrieved party must be such that either (i) it arose naturally or (ii) the parties knew, when they made the contract, was likely to arise. In other words, such compensation cannot be claimed for any remote or indirect loss or damage sustained by reason of the breach of the contract.

Section 74 provides that if the parties agree in their contract that whoever commits a breach shall pay an agreed amount as compensation, the court has the power to award a reasonable amount only, subject to such agreed amount.

Different Types of Damages

There are four types of damages:

Ordinary

These damages are those which naturally arise in the usual course of things from such breach. The measure of ordinary damages is the difference between the contract price and the market price at the date of the breach. If the seller retains the goods after the breach, he cannot recover from the buyer any further loss if the market falls, nor is he liable to have the damages reduced if the market rises.

Examples: (i) A contracts to deliver 10 bags of rice at ₹ 500 a bag on a future date. On the due date he refuses to deliver. The price on that day is ₹ 520 per bag. The measure of damages is the difference between the market price on the date of the breach and the contract price, i.e., ₹ 200. (ii) A contracts to buy B's ship for ₹ 2, 00,000 but breaks his promise. A must pay to B by way of compensation the excess, if any, of the contract price over the price which B can obtain for the ship at the time of the breach of promise.

The ordinary damages cannot be claimed for any remote or indirect loss or damages by reason of the breach. The ordinary damages shall be available for any loss which arises naturally in the usual course of things. A railway passenger's wife caught cold and fell ill due to her being asked to get down at a place other than the railway station. In a suit by the plaintiff against the railway company, held that damages for the personal inconvenience of the plaintiff alone could be granted, but not for the sickness of the plaintiff's wife, because it was a very remote consequence.

What is the most common remedy for breach of contracts?

The usual remedy for breach of contracts is suit for damages. The main kinds of damages awarded in a contract suit are ordinary damages. This is the amount of money it would take to put the aggrieved party in as good a position as if there had not been a breach of contract. The idea is to compensate the aggrieved party for the loss he has suffered as a result of the breach of the contract.

Special Damages

These damages are claimed in case of loss of profit, etc. When there are certain special or extraordinary circumstances present and their existence is communicated to the promisor, the non-performance of the promise entitles the promisor to not only the ordinary damages but also damages that may result there from. The communication of the special circumstances is a prerequisite to the claim for special damages.

Examples:

1. A, a builder, contracts to erect and finish a house by the first of January, in order that B may give possession of it at that time to C, to whom B has contracted to let it. A is informed of the contract between B and C. A builds the house so badly that before the 1st of January it falls down and had to be rebuilt by B, who in consequence loses the rent which he was to have received from C, and is obliged to make compensation to C for the breach of his contract. A must make compensation to B for the cost of rebuilding the house, for the rent lost and for the compensation made to C.

2. A delivers to B, a common carrier, a machine to be conveyed without delay to A's mill, informing B that his mill is stopped for want of the machine. B unreasonably delays the delivery of the machine and A, in consequence, loses a profitable contract with the government. A is entitled to receive from B, by way of compensation, the average amount of profit which would have been made by the working of the mill during the time that delivery of it was delayed. But, however, the loss sustained through the loss of the government contract cannot be claimed.

3. X's mill was stopped due to the breakdown of a shaft. He delivered the shaft to Y, a common carrier, to be taken to a manufacturer to copy it and make a new one. X did not make known to Y that delay would result in a loss of profits. By some neglect on the part of Y the delivery of the shaft was delayed in transit beyond a reasonable time. As a result, the mill remained idle for a longer time than otherwise would have been, had the shaft been delivered in time? Held, Y was not liable for loss of profits during the period of delay as the circumstances communicated to Y did not show that a delay in the delivery of the shaft would entail loss of profits to the mill.

4. Where *A* contracts to sell and deliver to *B* on the 1st of January certain cloth which *B* intends to manufacture into caps of a particular kind for which there is no demand except in that season. The cloth is not delivered till after the appointed time and too late to be used that year in making caps. *B* is entitled to receive from *A* only ordinary damages, i.e., the difference between the contract price of the cloth and its market price at the time of delivery but not the profits which he expected to obtain by making caps, nor the expenses which he has incurred in making preparation for the manufacture of caps.

Whether Payment of Interest at a Higher Rate Amounts to Penalty?

Whether an agreement to pay interest at a higher rate in the case of breach of a contract amounts to penalty shall depend upon the circumstances of each case However, following rules may be helpful in understanding the legal position in this regard.

(i) A stipulation for increased interest from the date of default shall be a stipulation by way of penalty if the rate of interest is abnormally high. A gives B a bond for the repayment of ₹ 1,000 with interest at 12% p.a. at the end of six months with a stipulation that in case of default interest shall be payable at the rate of 75 per cent from the date of default. This is a stipulation by way of penalty and B is only entitled to recover from A such compensation as the court considers reasonable.

(ii) Where there is a stipulation to pay increased interest from the date of the bond and not merely from the date of default; it is always to be considered as penalty.

(iii) As regards compound interest, it is not itself a penalty. But it is allowed only in cases where the parties expressly agree to it. However a stipulation to pay compound interest at a higher rate on default is considered as a penalty.

(iv) An agreement to pay a particular rate of interest with stipulation that a reduced rate will be acceptable if paid punctually is not a stipulation by way of penalty. Thus, where a bond

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provided for payment of interest at 12% p.a. with a provision that if the debtor pays interest punctually at the end of every year the creditor would accept interest at the rate of 9% p.a. Such a clause is not in the nature of penalty and hence interest @ 12% shall be payable.

Vindictive or Punitive Damage

These damages are awarded with a view to punish the defendant and not solely with the idea of awarding compensation to the plaintiff. These have been awarded (a) for breach of a promise to marry; (b) for wrongful dishonour of a cheque by a banker possessing adequate funds of the customer. The measure of damages in case (a) is dependent upon the severity of the shock to the sentiments of the promisee. In case (b), the rule is smaller the amount of the cheque dishonored larger will be the amount of damages awarded.

Nominal Damages

These are awarded in cases of breach of contract where there is only technical violation of the legal right but no substantial loss is caused thereby. The damages granted in such cases are called nominal because they are very small, for example, a rupee. This small amount is awarded as a matter of course.

Case Study

Robinson

Robinson, a college football player, signed a contract on December 2 with the Detroit Lions, a pro football club. The contract was a standard form that contained a clause stating, "This agreement shall become valid and binding upon each party only when and if it shall be approved by the League Commissioner." In late December, Robinson informed the Detroit Lions that he would not be playing for them because he had signed on with the Dallas Cowboys. On January 12 the Commisioner approved the contract. Detroit then sued Robinson for breach of contract.

Question

Was there ever a contract between Robinson and the Detroit Lions? Why or why not?

Ans: When Robinson signed the contract it was subject to the approval of the Comissioner. This was an express condition precedent and by Robinson signing, he has an implied good faith effort to allow the Commisioner the opportunity to accept. Robinson's power of revocation was temporarily suspended while he was waiting to be approved by the Comissioner. His later revocation is considered a antipatory repudiation. Subsequently, when the Commisioner approved the contract, it was binding and Robinson's repudiation can be considered a material breach by the Detroit Lions.

Source: http://www.askmehelpdesk.com/corporate-law/case-study-breach-contract-11531.html

1.10 Summary

- In this unit, you studied about contracts. The law relating to contracts is contained in the Indian Contract Act, 1872. For business executives, contract law is tremendously significant because it underlies or is related to all major areas of law affecting business.
- A contract is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another.

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- If the party, which had agreed to do something, fails to do that, then the other party has a remedy.
- Offer is not only one of the essential elements of a contract but it is the basic building block also. Misrepresentation is also known as simple misrepresentation whereas fraud is known as fraudulent misrepresentation.
- Mistake may be defined as an erroneous belief on the part of the parties to the contract concerning something pertaining to the contract. The term consideration is used in the sense of quid pro que, i.e., "something in return".
- A lunatic is a person who is mentally deranged due to some mental strain or other personal experience.
- An alien is a person who is a citizen of a foreign country. A contract creates obligations. 'Performance' of contract means the carrying out of obligations under it. Appropriation of payments means application of payments.
- A breach of contract is one party's failure, without a legal excuse, to live up to any of its promises under a contract.
- A contract terminates by breach of contract.
- If the promisor has not performed his promise in accordance with the terms of the contract or where the performance is not excused by tender, mutual consent or impossibility or operation of law, then this amounts to a breach of contract on the part of the promisor.

1.11 Keywords

Acceptance: The act of giving consent to the proposal.

Coercion: The committing or threatening to commit any act forbidden by the Indian Penal Code.

Contract: A contract is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another.

Express Acceptance: When the acceptance has been signified either in writing or by words of mouth or by performance of some required act of the offeree.

Formal Contract: The law gives special effect because of the formalities or the special language used in creating it.

Money Lending Transactions: The rate of interest being high, or that the borrower is in urgent need of money is not an evidence of undue influence.

Offer: An offer is synonymous with proposal.

Undue Influence: It consists in the improper exercise of power over the mind of one of the contracting parties by the other.

1.12 Self Assessment

State whether the following statements are true or false:

1. An agreement, the meaning of which is not certain or capable of being made certain, is valid.
2. An attempt to deceive which does not deceive is not fraud.
3. Communication of offer is complete when the letter of offer is posted.

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4. A valid contract results from identical cross offers.
5. Performance of the contract may be made only by the parties to the contract.

Fill in the blanks:

6. A .... is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another.
7. An offer, implied from the conduct of the parties or from the circumstances of the case, is known as ....
8. A prospective shareholder by filling up a share application form, usually attached to the prospectus, is making the offer. An .... at the time of auction inviting offers from the bidders is not making an offer.
9. .... are those for which the law does not require a particular set of formalities or special language.
10. .... consists in the improper exercise of power over the mind of one of the contracting parties by the other.

1.13 Review Questions

1. Define contract. Why must you, as a manager, know as to what constitutes a contract?
2. Define offer. Distinguish between offer and invitation to offer.
3. When does mental incompetence prohibit a valid contract? Is minor competent to contract?
4. "A minor's estate is liable for necessaries of life supplied". Comment.
5. What is meant by 'unilateral mistake'?
6. The term consideration is used in the sense of '*quid pro quo*' or 'something in return'. Does this 'something' to be necessarily in terms of money? Illustrate your answer.
7. "Insufficiency of consideration is immaterial but an agreement without consideration is void". Comment.
8. Discuss the reasons due to which the offer lapses or is revoked. If no time is fixed by the offeror within which the offer is to be accepted does the offer remain open for an indefinite period of time?
9. Explain the meaning of undue influence. When is it presumed as regards persons in particular relationships?
10. What are the main types of remedies for breach of a contract?

Answers: Self Assessment

1. False
2. True
3. False
4. False
5. False
6. contract
7. implied offer
8. auctioneer
9. Informal contracts
10. Undue influence

1.14 Further Readings

Notes

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, 2007.

S.S Gulshan, *Business Law*, Third Edition, Excel Books, New Delhi, 2006.

S.S Gulshan, *Mercantile Law*, Third Edition, Excel Books, New Delhi, 2006.

Online links

http://lawcommissionofindia.nic.in/1-50/Report13.pdf

http://business.gov.in/manage_business/contract_law.php

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Unit 2: The Consumer Protection Act

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Objectives

After studying this unit, you will be able to:

- Explain important terms related to consumer
- Discuss rights of consumers
- Describe remedies available for consumer

Introduction

In the earlier unit, you came to know about the law of contacts. In this unit, you will study about the Consumer Protection Act.

The Consumer Protection Act, 1986 was born. It is described as a unique legislation of its kind ever enacted in India to offer protection to the consumers. The Act is claimed to have been designed after an in-depth study of consumer protection laws and arrangements in UK, the USA, Australia and New Zealand. The main objective of this Act is to provide better protection to the consumers. Unlike other laws, which are punitive or preventive in nature the provisions of this Act are compensatory in nature. The Act intends to provide simple, speedy and inexpensive redressal to the consumers' grievances.

2.1 Important Terms

The Preamble to the Act spells out its objects in the following words: "An Act to provide for better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and other authorities for the settlement of consumers' disputes and for matters connected therewith."

Thus, the objects of the Consumer Protection Act are:

1. To provide for better protection of interests of consumers.
2. In order to meet the aforesaid objective, to provide for the establishment of consumer councils and other authorities

3. To empower the Consumer Councils and other authorities to settle consumers' disputes and matters connected therewith.

Other salient features of the Act are:

1. It applies to all goods and services unless specifically exempted by the Central Government.
2. It covers all sectors whether private, public or co-operative.
3. It confers certain rights on consumers.
4. It envisages establishment of consumer protection councils at the Central and State levels whose main object shall be to promote and protect the rights of the consumers.
5. The provisions of this Act are in addition to and not in derogation of the provisions of any other Act.

Notes The Act in terms of geographical application extends to the whole of India except the State of Jammu and Kashmir [S.1(2)]. Further, it applies to all goods and services, unless otherwise expressly notified by the Central Government.

The Consumer Protection Act, 1986 was substantially amended in 1991, 1993 and 2002.

Complainant: A complainant means any of the following and having made a complaint:

(i) a consumer; or

(ii) any voluntary consumer association registered under the Companies Act, 1956 or under any other law for the time being in force; or

(iii) the Central Government or any State Government; or

(iv) one or more consumers, where there are numerous consumers having the same interest; or

(v) in case of death of consumer, his legal heir or representative.

Complaint: 'Complaint' means any allegation in writing made by a complainant with a view to obtaining any relief under the Act, that:

(i) any unfair trade practice or restrictive trade practice has been adopted by any trader or service provider; and the complainant has suffered loss or damage;

(ii) the goods bought by him or agreed to be bought by him suffer from defect(s) in any respect;

(iii) the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;

(iv) a trader or the service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price (a) fixed by or under any law for the time being in force; (b) displayed on the goods or any package containing such goods; (c) displayed on the price list exhibited by him by or under any law for the time being in force; (d) agreed between the parties;

(v) goods which will be hazardous to life and safety when used are being offered for sale to the public (a) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force; (b) if the trader could have known with due diligence that the goods so offered are unsafe to the public.

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Consumer: 'Consumer' means any of the following persons:

1. A person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised or under any system of deferred payment i.e., in respect of hire-purchase transactions. The term includes any other user of such goods when such use is made with the approval of the buyer.
2. A person who hires or avails of any services for consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment. The term includes any other beneficiary of such services with the approval of the first mentioned person.

Example: Byford Motors inserted an advertisement in newspapers stating that a person booking a Premier Padmini car could enter into a contest in a lottery conducted by them. Under it, a person who was successful in the draw could be entitled to two free tickets from New Delhi to New York and back. Shri S.S. Srivastava was one of the persons who was successful in the draw. He asked the dealers to give him the value of two tickets which was refused and he was asked to produce two passports to enable them to book the tickets. Mr. Srivastava, however, produced one passport immediately but the second after the end of the financial year. The dealer refused to give the tickets on the ground that the accounts of the financial year had been closed and they could not carry forward the liability of that year to the next financial year under the provisions of the Income-tax Act and Rules.

The contention of the dealer is correct. Mr. Srivastava is not a consumer. He has received the car for which he has paid and there is no complaint as to any defect therein. The announcement of free air tickets to New York was an additional attraction attached to the sale which depended upon a lottery draw. It is not an intrinsic part of the car sale deal for which he made the payment. Thus, as far as the lottery was concerned, it could not be said that Mr. Srivastva was a consumer.

Consumer dispute [Sec.2(1)(c)]: It means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

Task S admitted his only infant son in a private nursing home. As a result of strong dose of medicine administered by the nursing attendant, the child became mentally retarded. S wants to make a complaint to the district forum seeking relief by way of compensation on the ground that there was deficiency in service by the nursing home. Does his complaint give rise to a consumer dispute? Who is the consumer in the instant case? [***Hint:*** Yes, this complaint gives rise to a consumer dispute. S is a consumer who hires the services of the nursing home. Also the infant is a beneficiary and therefore he is also a consumer.]

Defect [Sec.2(1)(f)]: A 'defect' is defined to mean any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the trader in any manner whatsoever in relation to any goods.

Deficiency: Parallel to 'defect' in case of goods, deficiency is relevant in case of services. Accordingly, it is defined to mean any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

Notes

Example: The management of Excel Public School owned a swimming pool and offered swimming facilities to the public on payment of certain fee. The management had engaged an experienced coach for coaching people how to swim. One day, a boy of 14 years got drowned and died while learning swimming. The father of the deceased boy claimed for relief. The school management denied responsibility by stating that it had requisitioned services of a qualified and experienced coach. The coach also denied responsibility claiming that he had taken all possible precautions, taken the boy out of water and removed water from his stomach.

The father of the deceased boy succeeded in his claim for relief. The school and the coach were deficient in rendering service to the deceased. The admission to the swimming pool was on payment of certain fees, therefore the complainant had hired the services of the school for consideration. The father of the deceased is a consumer and the negligence of the coach amounts to deficiency in service.

District Forum: 'District Forum' means a consumer Dispute Redressal Forum established under clause (a) of Sec.9. This section provides that for the purposes of the Act a Consumer Disputes Redressal Forum to be known as the 'District Forum' established by the State Government in each district of the State by notification. The State Government may, if it deems fit, establish more than one District Forum in a district.

Goods: 'Goods' under this Act shall have the same meaning as assigned to them under the Sale of Goods Act, 1930. Accordingly, 'Goods' means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale [Sec.2(7) of the Sale of Goods Act, 1930].

Manufacturer: The expression 'Manufacturer' for the purpose of this Act, means any of the following persons:

(i) A person who makes or manufactures any goods or part thereof.

(ii) A person who does not make or manufacture any goods but assembles parts thereof made or manufactured by others. But, where a manufacturer dispatches any goods or parts thereof to any branch office maintained by him, such branch office shall not be deemed to be manufacturer even though the parts so dispatched to it are assembled at such branch office and are sold or distributed from such branch office.

(iii) A person who puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer.

National Commission: 'National Commission' means the National Consumer Disputes Redressal Commission established under clause (c) of Sec.9. This section provides that there shall be established for the purposes of this Act a National Consumer Disputes Redressal Commission established by the Central Government by notification. The Government vide powers conferred upon it under the said clause established a National Commission in 1987.

Example: A dealer in precious stones and gems had sent four parcels of gems by registered post duly insured to a consignee in U.S.A., but the parcels did not reach the destination. The investigation revealed that the parcels were either lost in transit or were stolen. The postal authorities admitted their liability and made payment of postal charges in respect of each parcel. The insured agreed to settle the claim. However, he insisted that the payment of the insured amount should be made in U.S. dollars. The insurer denied their liability to pay in dollars to the dealer. The dealer made a complaint to the National Commission.

Notes

The dealer would not succeed as he continues to be the owner of the goods and the title in the goods has not passed to the consignee. It is the dealer who has the insurable interest in the goods.

Service

'Service' means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but *does not include* the rendering of any service free of charge or under a contract of personal service.

Example: Maina Devi's husband took a life insurance policy for ₹ 50,000. Before the second premium fell due, he died due to sudden illness. The claim made by her was not entertained for as long as 14 years. It was only when she got her miseries published in newspapers and certain MPs took up the matter in Parliament that she was sent a cheque for ₹ 50,39.

She made a complaint to the National Commission for deficiency of service by Life Insurance Corporation of India. The National Commission held that the Corporation had been highly negligent in the performance of its services. Maina Devi, the complainant, had suffered hardship and loss on account of deficiency in service. She was held entitled to interest @12% p.a. from the date of expiry of 3 months from the date of death of the assured till the amount was paid to her. The Commission also awarded her compensation of ₹ 15,000 for mental torture and harassment.

Restrictive Trade Practice

This definition was introduced in the Act vide Amendment Act, 1993. It has now been amended by the Amendment Act, 2002. It provides that a "restrictive trade practice" means a trade practice which tends to bring about manipulation of price or its conditions of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include:

(a) delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price.

(b) any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent to buying, hiring or availing of other goods or services;

Task *S* booked a motor vehicle through one of the dealers. He was informed subsequently that the procedure for purchasing the motor vehicle had changed and was called upon to make further payment to continue the booking before delivery. On being aggrieved, *S* filed a complaint with the State Commission. Would he succeed? [***Hint:*** S would not succeed, as he is not a consumer. The sale transaction has not taken place so far. Therefore there is no question of any defect in the goods. In case it is alleged that the dealer is indulging in any unfair trade practice and that S has suffered some loss or damage as a result thereof, then S has to prove all these before his petition can be entertained.]

Notes

Notes **Model Form of a Complaint**

Before the Hon'ble District Consumer Disputes Redressal Forum at ....

....

or

Before the Hon'ble State Consumer Disputes Redressal Commission at ....

....

1. Particulars of Complaint:
   - (a) Full name ....
   - (b) Complete address ....
   - (c) Village, Tehsil, City and State ....
2. Particulars of the Opposite Party:

   Opposite Party No. 1
   - (a) Full Name of dealer/shop/firm/manufacturer ....
   - (b) Complete Address ....
   - (c) Village, Tehsil, City and State ....

   Opposite Party No. 2
   - (a) Full name of dealer/shop/firm/manufacturer ....
   - (b) Complete Address ....
3. Particulars relating to goods/services complained of:
   - (a) Details of goods/services:
     - (i) Item of goods with quantum/nature of service ....
     - (ii) Date when goods purchased/service obtained ....
     - (iii) Amount paid as consideration ....

   (Attach photocopies of bill/voucher/receipt etc.)
   - (b) Whether the complaint relates to:
     - (i) Loss or damage as a result of restrictive trade practice or unfair trade practice adopted by the trader;
     - (ii) One or more defects in the goods;
     - (iii) Deficiency in service;
     - (iv) Excess price charged by trader (above the price fixed by or under any law for the time being in force or displayed on goods or package containing such goods).
   - (c) If the complaint relates to b (i) above, please indicate the nature of unfair trade practice adopted by the trader, such as:
     - (i) statement as to the quality etc., of goods sold/service made;
     - (ii) sponsorship of goods/dealer;

Contd...

Notes

(iii) warranty/guarantee with period promised;

(attach photocopy of warranty/guarantee card, if any)

(iv) Disparaging of goods of other traders.

(d) If the complaint relates to b (ii), nature and extent of defects in goods.

(e) If the complaint relates to b (iii), nature and extent of deficiencies in service.

(f) If the complaint relates to b (iv), details of price fixed and price charged.

(g) Any other details connected with the complaint (such as, when defect in goods or deficiency in service was first noticed).

4. Details of attempts made to get the matter complained of settled and result thereof:

(i) Personal negotiations.

(ii) Written communication with trader/opposite party.

(Attach copies of correspondence).

(iii) Application made to other authorities, such as MRTP Commission.

5. Whether any other law/rules/regulations/procedure applicable.

6. Details of documents/witnesses relied upon to substantiate the complaint.

(i) Vouchers/bills etc., including those mentioned in 3 (a) (iii) above;

(ii) Individual witnesses, if any.

7. Reliefs claimed:

(i) To get defects in the goods removed and/or

(ii) To replace the goods with new goods and/or

(iii) To return the price/charges paid

(iv) Compensation claimed for financial loss/injury/interest suffered due to the negligence of the opposite party/parties

(Justify with reasons the extent of compensation claimed for the loss or injury).

8. The Forum/State Commission has Jurisdiction to entertain the complaint in view of:

(a) s.11 (i)/s.17 of the Act,

(b) The extent of amount involved being ₹ ....

(c) The cause of action having accrued at ....

Prayer

It is, therefore, most respectfully prayed that (here give details of prayer)

....

....

Through .... Authorised Representative/Advocate/Voluntary Consumer Association (give here names and addresses).

Place .... Complainant

Date ....

Verification

Contd...

Notes

I, ... S/o .... resident of .... do solemnly declare and state that the particulars stated above are true to the best of my knowledge and belief and no part thereof is false and nothing material has been concealed therefrom. The annexures are exact copies (translations of their originals). I undertake to pay any sum required for the conducting of test in the laboratory as per the provisions of s.13 (1) (d) of the Consumer Protection Act, 1986.

Verified at .... this .... day of .... two thousand

Deponent

Enclosures (Mark enclosures as Annexures I, II, III, etc.)

1. ....
2. ....
3. ....

2.2 Rights of Consumers

For the first time in the history of consumer legislation in India, the Consumer Protection Act, 1986 extended a statutory recognition to the rights of consumers. Sec.6 of the Act recognizes the following six rights of consumers:

1. ***Right to safety,*** i.e., the right to be protected against the marketing of goods and services which are hazardous to life and property.
2. ***Right to be informed,*** i.e., the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be, so as to protect the consumer against unfair trade practices.
3. ***Right to choose:*** It means right to be assured, wherever possible, access to a variety of goods and services at competitive prices. In case of monopolies, say, railways, telephones, etc., it means right to be assured of satisfactory quality and service at a fair price.
4. ***Right to be heard,*** i.e., the consumers' interests will receive due consideration at appropriate forums. It also includes right to be represented in various forums formed to consider the consumers' welfare.
5. ***Right to seek redressal:*** It means the right to seek redressal against unfair practices or restrictive trade practices or unscrupulous exploitation of consumers. It also includes right to fair settlement of the genuine grievances of the consumers.
6. ***Right to consumer education:*** It means the right to acquire the knowledge and skill to be an informed consumer.

Task Ram booked a car through one of the dealers. He was informed subsequently that the procedure for purchasing the car had changed and was called upon to make further payment to continue the booking before delivery. On being aggrieved, Ram filled a complaint with the sate commission. Would he succeed?

Notes

Note Mohan submitted certain documents before the Sub-Registrar for registration claiming these as will. These documents were found to be a deed of conveyance and also improperly stamped. The Sub-Registrar impounded the documents and forwarded these to the Collector of Stamps. The Collector of Stamps asked Mohan to appear before him. He neither appeared before the Collector of Stamps nor submitted any other documents. Mohan instead filed a complaint before the Consumer Forum that he has been harassed for 3 years and that there has been deficiency in service on the part of the Sub-Registrar and the Collector of Stamps.

Mohan is not a consumer. The Sub-Registrar and Collector of Stamps only perform their statutory duties to raise and collect the state revenue, which is a part of the sovereign function of the State. The Registration Act and the Stamp Act are meant primarily to augment the state revenue. A person who presents documents for registration and pays the stamp duty on it or the registration fee does not become a consumer. Also the officers under these two Acts are not rendering any service to Mohan. Therefore, Mohan is not a consumer and has no remedy under the Consumer Protection Act.

2.3 Nature and Scope of Remedies available to Consumers

To provide simple, speedy and inexpensive redressal of consumer grievances, the Act envisages three-tier quasi-judicial machinery at the District, State and National levels. At the District level there are to be District Fora as the redressal fora. The State Government may, if it deems fit, establish more than one District Forum in a District. At the State level, there are to be similar redressal commissions to be known as State Commissions and at the National level, there is a National Consumer Disputes Redressal Commission to be known as National Commission.

Who can file a Complaint? (Sec.12)

Any of the following persons may file a complaint under the Act:

1. The consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.

   In case of death of a consumer, his legal heir or representative can file a complaint.

2. Any recognised consumers association namely, any voluntary consumer association registered under the Companies Act, 1956 or any other law for the time being in force. It is not necessary that the consumer is a member of such an association.

3. One or more consumers, where there are numerous consumers having the same interest, with the permission of the District Forum, on behalf of, or for the benefit of, all consumers so interested.

4. The Central or the State Government.

The Amendment Act, 2002 has amended Sec.12. It provides as follows:

1. Every complaint shall be accompanied with such amount of fee as prescribed.

2. On receipt of a complaint, the District Forum may, by order, allow the complaint to be proceeded with or rejected.

   However, a complaint shall not be rejected unless an opportunity of being heard has been given to the complainant.

3. Where a complaint is allowed to be proceeded with, the District Forum may proceed with the complaint in the manner as provided under the Act.

Where to file a Complaint?

1. If the value of the goods or services and the compensation, if any, claimed does not exceed rupees twenty lakhs, then the complaint can be filed in the District Forum within the local limits of whose jurisdiction the opposite party actually resides or carries on business or has a branch office or personally works for gain or where the cause of action, wholly or in part, arises (Sec.11).
2. If the value of the goods or services and compensation, if any, claimed exceeds rupees twenty lakhs but does not exceed rupees one crore, the complaint can be filed before the State Commission [Sec.17].

   Where a joint petition is filed on behalf of a large number of victims, it is the total amount of compensation claimed in the petition (and not the individual claims) that will determine the question of jurisdiction. In case the total compensation claimed exceeds, presently, ₹ 20 lakhs but does not exceed ₹ one crore, the matter can be heard by the State Commission *[Public Health Engineering Department v Uphokta Sanrakshan Samiti* (1992)].

   The State Commission shall also have the jurisdiction to entertain appeals against the orders of any District Forum within the State. [Sec.17].
3. If the value of goods or services and the compensation, if any, claimed exceeds ₹ one crore, complaint can be filed before the National Commission [Sec.21]. The National Commission shall also have the jurisdiction to entertain appeals against the orders of any State Commission [Sec.21].

How to file a Complaint?

There is no fee for filing a complaint before any of the aforesaid bodies. The complainant or his authorised agent can present the complaint in person. The complaint can also be sent by post to the appropriate Forum/Commission. The complaint should be addressed to the President of the Forum/Commission. A complaint should contain the following information:

(a) the name, description and address of the complainant;

(b) the name, description and address of the opposite party or parties, as the case may be, as far as they can be ascertained;

(c) the facts relating to complaint and when and where it arose;

(d) documents, if any, in support of the allegations contained in the complaint;

(e) the relief which the complaint is seeking.

Procedure on Admission of Complaint (Sec.13)

1. ***Procedure in respect of goods where the defect alleged requires no testing or analysis:***

   (i) Refer a copy of the admitted complaint within 21 days from the date of its admission to the opposite party mentioned in the complaint directing him to give his version of the case within a period of 30 days or such extended period not exceeding 15 days, as may be granted by the District Forum.

   (ii) Where the opposite party, on admission of a complaint referred to him under (a) above, denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Forum,

Notes

the District Forum shall proceed to settle the consumer disputes in the manner specified in clauses (c) to (g) hereunder.

2. ***Procedure in respect of goods where the defect alleged requires analysis or testing:***

   (i) Where a complainant alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, the District Forum shall obtain a sample of the goods from the complainant, seal it and authenticate it in the manner prescribed. It shall then refer the sample so sealed to the appropriate laboratory along with a direction that such laboratory make an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect alleged in the complaint or from any other defect and to report its findings thereof to the District Forum within a period of 45 days of the receipt of the reference or within such extended period as may be granted by the District Forum [Clause (c)].

   (ii) Before any sample of the goods is referred to any appropriate laboratory under clause (c), the District Forum may require the complainant to deposit to the credit of the Forum such fees as may be specified, for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question [Clause (d)].

   (iii) The District Forum shall remit the amount deposited to its credit under clause (d) to the appropriate laboratory to enable it to carry out the analysis or test as aforesaid. On receipt of the report from the appropriate laboratory, the District Forum shall forward a copy of the report along with such remarks as the District Forum may feel appropriate to the opposite party [Clause (e)].

   (iv) If any of the parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the method of analysis or test adopted by the appropriate laboratory, the District Forum shall require the opposite party or the complainant to submit in writing his objections in regard to the report made by the appropriate laboratory [Clause (f)].

   (v) The District Forum shall thereafter give a reasonable opportunity to the complainant as well as the opposite party of being heard as to the correctness or otherwise of the report made by the appropriate laboratory and also as to the objection made in relation thereto under clause (f) and issue an appropriate order under Sec.14 [Clause (g)].

Power of the District Forum [Sec.13(4)]

District Forum shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:

(i) the summoning and enforcing the attendance of any defendant or witness and examining the witness on oath;

(ii) the discovery and production of any document or other material object producible as evidence;

(iii) the reception of evidence on affidavits;

(iv) the requisitioning of the concerned analysis or test from the appropriate laboratory or from any other relevant source;

(v) issuing of any commission (i.e., warrant conferring authority) for the examination of any witness; and

(vi) any other matter which may be prescribed.

Notes

Reliefs available to Consumers (Sec.14)

If, after the proceeding conducted under Sec.13, the District Forum is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services are proved, it shall issue an order to the opposite party directing him to do one or more of the following things, namely:

(a) to remove the defect pointed out by the appropriate laboratory from the goods in question;

(b) to replace the goods with new goods of similar description which shall be free from defects;

(c) to return to the complainant the price, or as the case may be, the charges paid by the complainant;

(d) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party;

(e) to remove the defects in goods or deficiencies in the services in question;

(f) to discontinue the unfair trade practice or the restricted trade practice or not to repeat them;

(g) not to offer the hazardous goods for sale;

(h) to withdraw the hazardous goods from being offered for sale;

(ha) to cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature;

(hb) to pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently.

(hc) to issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement.

(i) to provide for adequate costs to parties.

In (a) above, the District Forum shall have the power to grant punitive damages, as it deems fit.

Time-frame for Decisions of Consumer Courts

The complaint should be decided by the Redressal Forum, as far as possible, within a period of 3 months from the date of the notice received by the opposite party where complaint does not require analysis or testing of the commodities and within 5 months if it requires analysis or testing of commodities.

Appeal to State Commission

Any person aggrieved by an order made by the District Forum may prefer and appeal against such order to the State Commission within a period of 30 days from the date of the order. However, the State Commission may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period.

Appeal to National Commission

Any person aggrieved by an order made by the State Commission may prefer an appeal against such order to the National Commission within a period of 30 days from the date of the order [Sec.19].

Notes

No appeal by a person, who is required to pay any amount in terms of an order of the State Commission, shall be entertained by the National Commission, unless the appellant has deposited 50 per cent of the amount or ₹ 55000 whichever is less.

Sec.19A provides that an appeal filed before the state commission or the National Commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of 90 days from the date of its admission.

Appeal to the Supreme Court against the Orders of National Commission

Any person, aggrieved by an order made by the National Commission, may prefer an appeal against such order to the Supreme Court, within a period of 30 days from the date of the order. However, Supreme Court may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period [Sec.23].

Limitation Period (Sec.24A)

The District Forum, the State Commission or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.

Vacancies or Defects in Appointment not to Invalidate Order (Sec.29A)

No Act or proceeding of the District Forum, the State Commission or the National Commission shall be invalid by reason only of the existence of any vacancy amongst its members or any defect in the constitution thereof.

Enforcement of orders of the District Forum, the State Commission or the National Commission. The Amendment Act, 2002 has substituted Sec.25 by a new section. It provides as follows:

1. Where an interim order made under this Act is not complied with, the District Forum or the State Commission or the National Commission, as the case may be, may order the property of the person, not complying with such order, to be attached.
2. No attachment made under Sub-sec.(1) shall remain in force for more than three months at the end of which, if the non-compliance continues, the property attached may be sold and out of the proceeds thereof, the District Forum or the State Commission or the National Commission may award such damages as it thinks fit to the complainant and shall pay the balance, if any, to the party entitled thereto.
3. Where any amount is due from any person under an order made by a District Forum, State Commission or the National Commission, as the case may be, the person entitled to the amount may make an application to the District Forum, the State Commission or the National Commission, as the case may be, and such District Forum or the State Commission or the National Commission may issue a certificate for the said amount to the Collector of the district (by whatever name called) and the Collector shall proceed to recover the amount in the same manner as arrears of land revenue.

Task Suggest the time frame for decisions of consumer court?

2.4 Appeal

Notes

Appeal to State Commission

Any person aggrieved by an order made by the District Forum may prefer and appeal against such order to the State Commission within a period of 30 days from the date of the order. However, the State Commission may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period.

A proviso to s.15 provides that no appeal by a person, who is required to pay any amount in terms of an order of the District Forum, shall be entertained by the State Commission unless the appellant has deposited 50 per cent of that amount or ₹ 25000, whichever is less.

Section 17B provides that the State Commission shall ordinarily function in the State Capital but may perform its functions at such other place as the State Government may notify from time to time. This is known as constitution of Circuit Benches.

Procedure Applicable to State Commissions

The provisions of Ss.12, 13 and 14 (Discussed under procedure applicable to District Forums) and the rules made there under for the disposal of complaints by the District Forum shall, with such modifications as may be necessary, be applicable to the disposal of disputes by the State Commission [s.18].

Appeal to National Commission

Any person aggrieved by an order made by the State Commission may prefer an appeal against such order to the National Commission within a period of 30 days from the date of the order [s.19].

No appeal by a person who is required to pay any amount in terms of an order of the State Commission, shall be entertained by the National Commission, unless the appellant has deposited 50 per cent of the amount or ₹ 55000 whichever is less.

Section 19A provides that an appeal filed before the state commission or the National Commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of 90 days from the date of its admission.

Power and Procedure Applicable to the National Commission [S.22]

Section 22 has been substituted by a new section by the Amendment Act, 2002. It provides as follows:

1. The provisions of sections 12, 13 and 14 and the rules made there under for the disposal of complaints by the District Forum shall be applicable to the disposal of disputes by the National Commission.

2. The National Commission shall have the power to review any order made by it, when there is an error apparent on the face of the record.

   Power to set aside ex parte orders: Section 22 A provides that where an order is passed by the National Commission ex parte against the opposite party or a complainant, as the ase may be, the aggrieved party may apply to the Commission to set aside the said order in the interest of justice.

Notes

Transfer of cases: Section 22 B provides that on the application of the complainant or of its own motion, the National Commission may, at any stage of the proceeding, in the interest of justice, transfer any complaint pending before the District Forum of one state to a District Forum of another state or before one State Commission to another State Commission.

Circuit Benches: Section 22 C provides that the National Commission shall ordinarily function at New Delhi and perform its functions at such other place as the Central Government may notify from time to time.

Vacancy in the office of the President: Section 22 D provides that when the office of the President of a District Forum, State Commission, or of the National Commission, as the case may be, is vacant or a person occupying such office is, by reason of absence or otherwise, unable to perform the duties of his office, these shall be performed by the senior-most member of the District Forum, the State Commission, or of the National Commission, as the case may be.

Do Consumer Forums have the Right to Grant Interim Stay (Temporary Injunction)

The Supreme Court in *Morgan Stanley Mutual Fund v Karick Das and Dr Arvind Gupta v SEBI and Others* (II 1994 CPJ 7) held that consumer forums do not have any power to pass any interim order. It ruled that under s.14 relief by way of ad-interim stay was not at all contemplated. Therefore, the forums granting any stay by way of interim order would be acting beyond their jurisdiction under the Act. The Amendment Act, 2002 however, has provided for issue of interim orders by redressal agencies.

Appeal to the Supreme Court against the Orders of National Commission

Any person, aggrieved by an order made by the National Commission, may prefer an appeal against such order to the Supreme Court, within a period of 30 days from the date of the order. However, Supreme Court may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period [s.23].

No appeal by a person who is required to pay any amount in terms of an order of the National Commission shall be entertained by the Supreme Court unless that person has deposited 50 per cent of that amount or ₹ 55000 whichever is less.

Finality of Orders (S.24)

Every order of a District Forum, the State Commission or the National Commission shall, if no appeal has been preferred against such order under provisions of the Act, be final.

Limitation Period (S.24A)

The District Forum, the State Commission or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.

However, a complaint may be entertained after the specified period of two years if the complainant satisfies the District Forum, the State Commission or the National Commission, as the case may be, that he had sufficient cause for not filing the complaint within such period. But, no such complaint shall be entertained unless the District Forum, the State Commission or the National Commission, as the case may be, records its reasons for condoning such delay.

Notes

Note

Model Form of Appeal

Before the Hon'ble Consumer Disputes Redressal Commission (State Commission) at ....
....

Memorandum of Appeal No .... of ....

In the matter of

Name ....

Full Address ....

Village/Tehsil/District .... Appellant(s)

Versus

Name ....

Address ....

Village/Tehsil/District .... Respondent(s)

The humble appeal of the Appellant (s) above named most respectfully showeth:

1. This appeal is directed under s.15 of the Consumer Protection Act, 1986 against the order of the District Forum .... in application No .... of .... passed on ...., received by the appellant on ....
2. This appeal is filed within the time limit provided under s.15 of the Consumer Protection Act, 1986. This appeal, being barred by limitation, is accompanied by an application for condonation of delay for consideration by the Commission, as per rule .... of the Consumer Protection Rules of .... State (delete whichever is not applicable),
3. Brief facts of the case are stated hereunder (please furnish herein the details of the case and the decision of the District Forum) ....
....
4. The grounds on which appeal is preferred are stated hereunder (the grounds should be numbered consecutively without any arguments or narrative) ....
....
5. The appellant has not preferred any other appeal against the order impugned herein.
6. Prayer: It is, therefore, respectfully prayed that your lordship may be graciously pleased to allow the appeal and set aside/modify the order of the District Forum appealed against.
7. List of enclosures
   (i) Certified copy of the order of the District Forum appealed against
   (ii) Affidavit
   (iii) ....
   (iv) ....

Signature

Place .... (To be signed by the Appellant and

Date .... Authorised Representative/advocate)

Notes

Case Study

Service Delivery Agencies

Governmental responsibility for food in Canada is divided among the federal, 10 provincial, three territorial, and thousands of municipal governments. Some 77 pieces of legislation govern food inspection among three levels of government. Federal responsibility centres on export and inter-provincial trade: protecting and expanding export markets for Canadian food products, and facilitating interprovincial trade. In addition, the federal government sets food safety, quality and grading standards for products sold interprovincially and internationally and administers regulations aimed at preventing the production or sale in Canada of dangerous, adulterated or misbranded products.

Provinces and municipalities are responsible for:

The intraprovincial aspects of the food industry, including local food processing, the food service industry, and the food retail industry.

They decide whether and how to inspect local operations, including restaurants and grocery stores, as well as dairies and meat plants whose products are sold within the province. (Moore and Skogstad, p. 130) The federal government of Canada faced a number of food security problems in the early 1990s, which facilitated adoption of innovative reform measures:

1. Canada's reputation for high quality food had been damaged by the "tainted tuna" scandal.
2. Resources for additional inspection of fish products were not available; resources were not only scarce but shrinking.
3. The Government wanted to reform its public service along the lines achieved in the United Kingdom and New Zealand, where separate agencies were spun off from government.
4. Developments in international trade and potential developments in interprovincial trade:
   (a) Industry and governments favoured harmonized standards and streamlined inspection to ensure the competitiveness of the Canadian food industry domestically & internationally.
   (b) Canadian producers/processors were vulnerable to trade challenges in a fragmented system.
   (c) Gaps resulting from non-inspection or non-rigorous inspection were perceived by processors as a weak link, despite the small percentage of overall production represented and assurances outlined in the Auditor General of Canada's 1994 Report.
   (d) Closer integration of the US and Canadian markets under free trade agreements made the industry anxious to reduce the costs and inefficiencies resulting from differing provincial standards e.g. fluid milk.
5. The "national treatment" principle in the North American Free Trade Agreement could be interpreted to mean that imports must meet the provincial standard of the province they enter rather than the standard required for inter-provincial or international trade. This could drag down Canadian food standards to the lowest common denominator.

Contd...

(a) Canadian exporters were concerned about being denied access to external markets on the grounds that Canadian food safety standards and inspection systems were not equivalent to those of the markets into which they were shipping.

(b) The 1994 SPS Agreement required that countries use their food safety and animal, plant and health regulations only to the extent necessary to protect human, animal life or health, not for trade protection purposes.

6. Emergence of alternatives to high-cost prescriptive regulation: New scientific and technological tools furnished the Government with opportunities to shift additional costs and a significant degree of responsibility for food safety to the food industry itself. Risk assessment methods allowed the allocation of food inspection resources on a risk basis. One such risk-based tool, the Hazard Analysis Critical Control Point (HACCP) system, developed for the US space program, was deemed more effective than existing systems in ensuring food safety. Canada was the first government to adopt this system, for its fish inspection program. It was so well accepted internationally that Canadian meat packing plants were subsequently required to conform to US regulations requiring large American meat packing plants to implement a HACCP plan by January 1998.

7. National unity was threatened, and solutions suggested in the winning Liberal platforms in the 1993 and 1997 elections were renewal of the federation, including better coordination of services and reduction in overlap and duplication among governments.

The Government of Canada consolidated all of its food inspection and quarantine services from Health Canada, Fisheries and Oceans, and Agriculture and Agri-Food Canada into one self-standing Agency effective April 1, 1997. The Agency reports not to a deputy minister but directly to the Minister of Agriculture and Agri-Food. The Agency has separate employer status, and so can hire and fire its own employees, rather than working through the Public Service Commission. It also has a number of financial flexibilities not available to government departments, most notably the capacity to retain revenues.

Protecting the public interest is a major concern in creating alternate Service Delivery Agencies (ASDs) in Canada. Employing the Auditor General of Canada's definition of the public interest when assessing ASDs, the CFIA addressed whether there was an appropriate focus on public objectives, maintenance of public service values and adequate control over public funds and assets. On all counts the CFIA's self-assessment concluded it was serving the public interest.

The Auditor General of Canada was appointed as an external auditor under the CFIA Act, with duties to audit the CFIA's financial statements and assess the fairness and reliability of the performance information provided in the Agency's Annual Report to Parliament. The Auditor General also has authority to conduct periodic value-for-money audits of the Agency.

Clarification of food-related roles and responsibilities of federal government departments has led to:

(a) A more integrated and comprehensive approach (gate-to-plate) to trichinosis in swine, tuberculosis in cattle and zoonotic diseases such as salmonella enteritidis in poultry.

(b) Improved capacity to respond to outbreaks of food-borne illness and threats to the food system presented by medicated feeds and antibiotic residues.

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Notes

(c) Separation of health and safety standard setting from inspection, permitting new flexibilities for inspection.

(d) Separation of health risk analysis from risk management, thereby fulfilling a World Health Organization principle.

(e) Reduced criticism of conflict of interest because the same department was responsible for promoting and regulating an industry (fisheries).

8. A more integrated and comprehensive approach (gate-to-plate) to trichinosis in swine, tuberculosis in cattle and zoonotic diseases such as salmonella enteritidis in poultry.

9. Improved capacity to respond to outbreaks of food-borne illness and threats to the food system presented by medicated feeds and antibiotic residues.

10. Separation of health and safety standard setting from inspection, permitting new flexibilities for inspection.

11. Separation of health risk analysis from risk management, thereby fulfilling a World Health Organization principle.

12. Reduced criticism of conflict of interest because the same department was responsible for promoting and regulating an industry (fisheries).

Question

Analyse the kind of agency it is. (***Hint:*** It is a self-standing agency with a separate employer status and more financial flexibilities.)

2.5 Summary

- The earlier principle of "Caveat Emptor" or "let the buyer beware" which was prevalent has given way to the principle of "Consumer is King".
- The origins of this principle lie in the fact that in today's mass production economy where there is little contact between the producer and consumer, often sellers make exaggerated claims and advertisements, which they do not intend to fulfill.
- This leaves the consumer in a difficult position with very few avenues for redressal.
- The onset on intense competition also made producers aware of the benefits of customer satisfaction and hence by and large, the principle of "consumer is king" is now accepted.
- The need to recognize and enforce the rights of consumers is being understood and several laws have been made for this purpose. In India, we have the Indian Contract Act, the Sale of Goods Act, the Dangerous Drugs Act, the Agricultural Produce (Grading and Marketing) Act, the Indian Standards Institution (Certification Marks) Act, the Prevention of Food Adulteration Act, the Standards of Weights and Measures Act, the Trade and Merchandise Marks Act, etc which to some extent protect consumer interests.
- However, these laws required the consumer to initiate action by way of a civil suit, which involved lengthy legal process proving, to be too expensive and time consuming for lay consumers.
- Therefore, the need for a simpler and quicker access to redressal to consumer grievances was felt and accordingly, it lead to the legislation of the Consumer Protection Act, 1986.
- 'Service' means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing.

- 'Goods' means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land.

2.6 Keywords

Complaint: Complaint many allegation in writing by a complainant with a view to obtaining any relief under the Act.

Consumer: Any person who buys any goods for consideration which has been paid or promised or partly paid and partly promised.

Consumer Dispute: Dispute where the person against whom a complaint has been made, denies or disputes the allegation contained in the complaint.

Defect: It is defined to mean any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained.

Service: Service means service of any description which is available to potential users and includes, but not limited.

2.7 Self Assessment

Choose the appropriate answers:

1. Consumer Protection Act, applies to
   (a) All products and services (b) Only physical products
   (c) Only services (d) Only certain products and service
2. Any of the following made a complaint EXCEPT
   (a) A consumer
   (b) The Central Government
   (c) In case of death of consumer, his legal heir or representative
   (d) None
3. Consumer Protection Act, 1986 was amended in
   (a) 1991, 1993 and 2001 (b) 1991, 1993 and 2002
   (c) 1992, 1993 and 2002 (d) 1992, 1993 and 2001
4. Right to acquire the knowledge and skill to be an informed consumer is a:
   (a) Right to be heard (b) Right to be informed
   (c) Right to consumer education (d) Right to safety
5. The expression 'Manufacturer' for the purpose of this Act, means any of the following, EXCEPT.
   (a) A Hindu Undivided Family
   (b) A person who makes are manufactures any goods
   (c) A person who does not make or manufacture any good but assembles part thereof made
   (d) All of the above

Notes

6. The complaint can be filled in the 'District Forum' if
   (a) The value of goods or services and compensation, if any, claimed exceeds rupees twenty lakhs.
   (b) The value of goods or services and compensation, if any, claimed exceeds rupees twenty lakhs but not exceed rupees 1 crores.
   (c) Both (a) and (b)
   (d) Only (a)
7. Which amendment of Consumer Protection Act, permitted representative complaints.
   (a) Consumer Protection Act, 1991 (b) Consumer Protection Act, 1992
   (c) Consumer Protection Act, 1993 (d) Consumer Protection Act, 2002
8. Transfer of cases comes under which section.
   (a) Sec.22 B (b) Sec.22 C
   (c) Sec.22 D (d) Sec.22 A
9. Sec.28 A inserted in which amendment of Consumer Protection Act,
   (a) Amendment Act, 1991 (b) Amendment Act, 1992
   (c) Amendment Act, 1993 (d) Amendment Act, 2002
10. AGMARK stands for:
    (a) Agricultural Process and Grading and Marketing Act,
    (b) Agricultural Products and Grading and Marketing Act,
    (c) Agricultural Products and Graduate and Marketing Act,
    (d) None

2.8 Review Questions

1. Describe the main features of the Consumer Protection Act, 1986.
2. What are the objects which the Consumer Protection Act, 1986 seeks to achieve?
3. Can the following be regarded as consumers?
   (a) A patient of a government hospital.
   (b) A person who registers himself for a telephone connection.
   (c) A person sending a telegram.
4. Examine the rights of a consumer enshrined under the Consumer Protection Act, 1986.
5. Explain the procedure District Forum follows on receipt of a complaint from a consumer.
6. What sort of complaint may be lodged under the Act?
7. Where and how can a complaint be made? State the jurisdiction of the various redressal agencies in this regard.
8. Discuss the Appeal to State Commission.
9. In which way the Consumer Protection Act can help the consumers in the redressal of their grievances.

Answer: Self Assessment

Notes

1.	(a)	2.	(d)
3.	(b)	4.	(c)
5.	(a)	6.	(a)
7.	(c)	8.	(a)
9.	(d)	10.	(b)

2.9 Further Readings

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, 2007.

S.S Gulshan, *Business Law,* Third Edition, Excel Books, New Delhi, 2006.

S.S Gulshan, *Mercantile Law,* Third Edition, Excel Books, New Delhi, 2006.

Online links

http://consumerredressal.com/default.aspx

http://delhistatecommission.nic.in/

http://www.ncdrc.nic.in/

http://www.apcentralpower.com/consumer_griv_red/consumerforum1.htm

Notes

Unit 3: FEMA Act, 1999

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Objectives

After studying this unit, you will be able to:

- Describe the provisions relating to an authorized person
- Discuss miscellaneous provisions
- Explain the directorate of enforcement
- Discuss the regulation and management of foreign exchange

Introduction

In the earlier unit, you came to know about the Consumer Protection Act. In this unit, you will study about the Foreign Exchange Management Act.

The Foreign Exchange Management Act (FEMA), 1999 (FEMA) replaces the Foreign Exchange Regulation Act (FERA) 1973. FERA was introduced in 1974 to consolidate and amend the then existing law relating to foreign exchange. FERA aimed at having stringent controls to conserve India's foreign exchange. FERA was amended in 1993 to bring about certain changes, as a result of introduction of economic reforms and liberalisation of the Indian economy.

3.1 Definition under the Act

Notes

Authorised Person. It means an authorised dealer, money changer, offshore banking unit or any other person for the time being authorised under the Act to deal in foreign exchange or foreign securities.

Capital account transaction. It means a transaction which alters the assets or liabilities, including contingent liabilities, outside India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in Sec.6(3).

Currency. This expression includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers' cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instrument as may be notified by the Reserve Bank. Vide Notification No. FEMA 15/2000/RB dated May 3, 2000, RBI has notified 'debit cards', 'ATM' cards or any other instrument by whatever name called that can be used to create a financial liability, as 'currency'.

Currency notes. It means and includes cash in the form of coins and bank notes.

Currency account transaction. It means a transaction, other than a capital account transaction and without prejudice to the generality of the foregoing, such transaction includes—(i) payments due in connection with foreign trade, other current business, services and short term banking and credit facilities in the ordinary course of business; (ii) payments due as interest on loans and as net income from investments; (iii) remittances for living expenses of parents, spouse and children residing abroad; and (iv) Expenses in connection with foreign travel, education and medical care of parents, spouse and children.

Export. 'Export' with its grammatical variations and cognate expressions, means. (i) the taking out of India to a place outside India any goods, (ii) provision of services from India to any persons outside India.

Foreign currency. It means any currency other than Indian currency.

Foreign security. The expression means any security, in the form of shares, stocks, bonds, debentures, or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividend is payable in Indian currency.

Indian currency. It means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under Sec.28A of the Reserve Bank of India Act, 1934.

Person resident outside India. It means a person who is not resident in India.

Transfer. The expression 'transfer' includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer or right, title, possession or lien.

Definitions of certain other terms used under FEMA Regulations are:

Non-resident Indian (NRI). It means a person resident outside India who is a citizen of India or is a person of Indian origin.

Overseas Corporate Body (OCB). The expression means a company, partnership firm, society and other corporate body owned directly or indirectly to the extent of at least 60 per cent by non-resident Indians. Further, the expression includes overseas trusts in which not less than 60 per cent beneficial interest is held by non-resident Indians directly or indirectly but irrevocably.

Person of Indian Origin (PIO). It means a citizen of any country other then Bangladesh or Pakistan, if

(a) he at any time held Indian passport; or

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(b) he or either of his parents or any of his grandparents was a citizen of India by virtue of the Constitution of India or the Citizenship Act of 1955; or

(c) the person is a spouse of an Indian citizen or a person referred to in (a) and (b).

Convertible currency/Hard currency. Certain currencies are freely convertible i.e. one can exchange these currencies with any other currency without any restriction. Major among these are: Dollars (USA), Pound Sterling (UK), Euro (European Common Currency), Deutsche Mark—DM (Germany), Yen (Japan), Franc (France), Lira (Italy) etc. This is often called 'hard currency'.

3.2 Provisions relating to an Authorised Person

Authorised Person

Sec.10 provides that the Reserve Bank may, on an application made to it in this behalf, authorise any person to be known as authorised person to deal in foreign exchange or in foreign securities, as an authorised dealer, money changer or offshore banking unit or in any other manner as it deems fit. The authorization shall be in writing and shall be subject to the conditions laid down therein. An authorization so granted may be revoked by the Reserve Bank at any time if it is satisfied that (a) it is in public interest to do so; or (b) the authorised person has failed to comply with the condition subject to which the authorization was granted or has contravened any of the provisions of the Act or any rule, regulation, notification, direction or order made thereunder.

Duties of an Authorised Person

The duties of an authorised person as provided in the Act are summarised hereunder:

1. ***To comply with RBI directions [Sec.10(4)].*** An authorised person shall, in all his dealings in foreign exchange or foreign security, comply with such general or special direction or order as the Reserve Bank may, from time to time, think fit to give.
2. ***Not to engage in unauthorized transactions [Sec.10(4)].*** Except with the previous permission of the Reserve Bank, an authorised person shall not engage in any transaction involving any foreign exchange or foreign security which is not in conformity with the terms of authorization under this section.
3. ***To ensure compliance of FEMA provisions [Sec.10(5)].*** An authorised person shall, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and to give such information, as will reasonably satisfy him that the transaction will not involve and is not designed for the purpose of any contravention or evasion of the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder. Where the said person refuses to comply with any such requirement or makes only unsatisfactory compliance therewith, the authorised person shall refuse in writing to undertake the transactions and shall, if he has reason to believe that any such contravention or evasion as aforesaid is contemplated by the person, report the matter to the Reserve Bank.

Powers of the Authorised Person

1. To deal in or transfer any foreign exchange or foreign security to any person [Sec.3(a)]
2. Receive any payment by order or on behalf of any person resident outside India in any name. [Sec.3(c)]

   However, an authorised person is not allowed to credit the account of any person without any corresponding remittance from any place outside India.

3. To open NRO, NRE, NRNR, NRSR and FCNR accounts.
4. To sell or purchase foreign exchange for current account transactions. [Sec.5]
5. To sell or purchase foreign exchange for permissible capital account transactions. [Sec.6].

Bank's Powers to issue Directions to Authorised Persons (Sec.11)

The Reserve Bank may, for the purpose of securing compliance with the provisions of this Act and of any rules, regulations, notifications or directions made thereunder, give to the authorised persons any direction in regard to making of payment or the doing or desist from doing any act relating to foreign exchange or foreign security.

Task Who is the authorized person according to comply with RBI directions?

3.3 Regulation and Management of Foreign Exchange

Secs.3-9 deal with regulation and management of foreign exchange.

Dealings in Foreign Exchange etc. (Sec.3)

It prohibits any person other than an authorised person from (a) dealing in or transferring any foreign exchange or foreign security to any person or (b) making any payment to or for the credit of any person resident outside India in any manner; or (c) receive otherwise than through an authorised person any payment by order or on behalf of any person resident outside India in any manner. (d) entering into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Holding of Foreign Exchange etc.

Sec.4 provides that except as otherwise provided in the Act; no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

Note **Portfolio Investment Scheme for NRI**

A non-resident Indian (NRI) may purchase/ sell shares and/or convertible debentures of an Indian company, through a registered broker on a recognised stock exchange, subject to the following conditions:

(i) The NRI designates a branch of an authorised dealer for routing his/her transactions relating to purchase and sale of shares/convertible debentures under this Scheme, and routes all such transactions only through the branch so designated.

(ii) The paid up value of shares of an Indian company, purchased by each NRI both on repatriation and on non-repatriation basis, does not exceed 5 per cent of the paid up value of shares issued by the company concerned.

(iii) The paid up value of each series of convertible debentures purchased by each NRI both on repatriation and on non-repatriation basis, does not exceed 5 per cent of

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the paid up value of each series of convertible debentures issued by the company concerned.

(iv) The aggregate paid up value of shares of any company purchased by all NRIs does not exceed 10 per cent of the paid up capital of the company and in the case of purchase of convertible debentures, the aggregate paid up value of each series of debentures purchased by all NRIs does not exceed 10 per cent of the paid up value of each series of convertible debentures. The aggregate ceiling of 10 per cent referred to in this clause may be raised to 24 per cent if a special resolution to that effect is passed by the General Body of the Indian company concerned.

(v) The NRI investor takes delivery of the shares purchased and gives delivery of shares sold (i,e., speculative purchases are not permitted).

(vi) Payment for purchase of shares and/or debentures is made by inward remittance in foreign exchange through normal banking channels or out of funds held in NRE/FCNR account maintained in India if the shares are purchased on repatriation basis and by inward remittance or out of funds held in NRE/FCNR/NRO account of the NRI concerned maintained in India where the shares/debentures are purchased on non-repatriation basis.

(vii) The link office of the designated branch of the authorised dealer shall furnish to the Chief General Manager, Reserve Bank of India (ECD), Central Office, Mumbai a report on daily basis.

(viii) The net sale/maturity proceeds (after payment of taxes) of shares and/or debentures of an Indian company purchased by NRI under this Scheme, can be credited only in designated branch of an authorised dealer:

(a) In NRO account, where the shares and/or debentures were purchased on non-repatriation basis, or

(b) It can be remitted abroad or credited to his/its NRE/FCNR/NRO account, where purchased on repatriation basis.

Current Account Transactions

Sec.5 explains dealings in current account transactions. This section provides that any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction. Also it empowers the central government to impose reasonable restrictions for current account transaction in the public interest in consultation with the Reserve Bank of India by making appropriate rules.

Regulation of Capital Account Transactions

Sec.6 provides that any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

Export of Goods and Services

Sec.7 deals with export of goods and services. Every exporter is required to furnish to Reserve Bank or any other authority as prescribed, a declaration containing true and correct particulars regarding the amount representing the full export value or if the full export value of the goods is not ascertainable at the time of export, the value which the exporter having regard to prevailing market conditions expects to receive on sale of the goods in a market outside India. Every exporter is also required to furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realisation of the export proceeds.

Notes

Note

Regulations made by the Reserve Bank of India

By virtue of s. 6(3) and s. 47, the Reserve Bank of India has made some regulations. The more important ones are given below.

1. ***Foreign Exchange Management (Investment in Firm or Proprietary concern in India) Regulations, 2000.*** The objective of this Regulation is to regulate investment by a person resident outside India in a partnership firm or proprietory concern in India.

2. ***Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000.*** Under these Regulations, the Reserve Bank regulates investment in foreign securities either by direct investment or otherwise. Thus there are certain restrictions on a person resident in India to issue or purchase or transfer or acquire a foreign security.

3. ***Foreign Exchange Management (Deposit) Regulations 2000.*** The Regulations are meant to regulate matters relating to deposits between a person resident in India and a person resident outside Indian. Under these regulations an authorised dealer in India may accept deposit under the following schemes:

   (i) Non-resident (External) Account Scheme

   (ii) Foreign Currency (Non-Resident) Account Banks Scheme

   (iii) Non-resident (Ordinary) Account Scheme

   (iv) Non-resident (Non-Repatriable) Rupee Account Scheme

   (v) Non-resident (Special) Rupee Account Scheme.

4. ***Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations 2000.*** These Regulations prescribe rules for opening, holding, maintaining of Foreign Currency Accounts and the limits upto which amounts can be held in such accounts by a person resident in India.

5. ***Foreign Exchange Management Regulations 2000*** provide for (i) Manner of receipt of foreign exchange (ii) Receipt of payment for export in certain cases (iii) Manner of payment in foreign exchange.

6. ***Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2000.*** These Regulations govern as regards a person resident outside India : (i) issue of or recording of a transfer of security; (ii) acquisition of rights shares (iii) issue of shares under Employees' Stock Options Scheme (iv) remittance of sale proceeds of an Indian security held by him (v) purchase by him of any equity/preference/convertible preference shares and convertible debentures issued by an Indian company.

7. ***Foreign Exchange Management (Acquisition and Transfer of Immovable Property outside India) Regulations 2000.*** These Regulations govern the acquisition or transfer of any immovable property situated outside India by a person resident in India.

8. ***Foreign Exchange Management (Acquisition and Transfer of Immovable Property) Regulations 2000.*** These regulations govern the acquisition and transfer of property in India by (i) an Indian citizen resident outside India, (ii) a person of Indian origin.

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9. ***Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations 2000.*** These Regulations govern the establishment by a resident outside India of branch or office or other place of business in India.

10. ***Foreign Exchange Management (Export of Goods and Services) Regulations 2000.*** These Regulations provide for (i) declaration as regards export of goods and services, (ii) indication of importer-exporter code number as allotted by the Director General of Foreign Trade under s. 7 of the Foreign Trade (Development and Regulation) Act, 1992, (iii) submission of evidence in support of the above mentioned declaration, (iv) manner of payment of export value of goods, (v) period within which export value of goods, software to be realised, (vi) export on elongated credit term, (vii) submission of export documents with the authorised dealer, (viii) delay in receipt of payment, (ix) advance payment against exports.

3.4 Contravention and Penalties [Secs.13 to 15]

3.4.1 Penalties

Sec.13 provides that if any person contravenes any provision of the Act, rules, regulation etc. or contravenes any condition subject to which the authorization is granted by RBI, he shall be liable for penalty upon adjudication, which may extend upto thrice the sum involved in such contravention where such amount is quantifiable or upto two lakh rupees where the amount is not quantifiable. If the contravention continues, the penalty of ₹ 500 per day after the first day during the period in which the contravention continues shall be imposed.

Again, Sec.13 provides that any adjudicating authority may, in addition to the penalty, direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government. It may further direct that the foreign exchange holdings, if any, of the persons committing the contravention or any part thereof, shall be retained outside India in accordance with the directions made in this behalf.

3.4.2 Enforcement of the Orders of Adjudicating Authority

Sec.14 provides that if a person fails to make full payment of the penalty imposed within a period of 90 days from the date on which the notice of payment of such penalty is served on him, he shall be liable to civil imprisonment. However, the defaulter shall not be arrested or detained in civil prison, unless he has been issued and served a notice by Adjudicating Authority calling upon him to show cause why he should not be committed to civil prison.

The Adjudicating Authority may issue a warrant for the arrest of a defaulter if it is satisfied by affidavit or otherwise that the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority with the intention of delaying the execution. The arrest warrant may be issued by the Adjudicating Authority if the defaulter fails to make an appearance in pursuance of the notice issued by him. The arrest warrant issued by an Adjudicating Authority may be executed by any other Adjudicating Authority within whose jurisdiction the defaulter may for the time being be found.

3.4.3 Power to Compound Contraventions

Sec.15 empowers the Directorate of Enforcement or Officers of the Directorate of Enforcement and Officers of the Reserve Bank as may be authorised by the Central Government in this behalf to compound the offences. Any contravention under Sec.13 may be compounded on an application made by the person committing such contravention within 180 days from the date of receipt

of application. Further, any contravention so compounded, relieves the accused person from further proceedings for that contravention.

Task Analyze various regulations of foreign exchange.

Note With effect from June 1,2000, Reserve Bank has permitted transactions entered into in Indian rupees by or with:

(i) a person who is a citizen of India, Nepal or Bhutan resident in Nepal or Bhutan;

(ii) a branch situated in Nepal or Bhutan of any business carried on by a company or a corporation incorporated under any law in force in India, Nepal or Bhutan;

(iii) a branch situated in Nepal or Bhutan of any business carried on as a partnership firm or otherwise, by a citizen of India, Nepal or Bhutan.

Notification No. GSR 404 (E) dated 3.5.2000

With effect from June 1, 2000, Reserve Bank has permitted any person from any Post Office, in accordance with any law or rules made thereunder for the time being in force, any foreign exchange in the form of postal orders or money orders.

Notification No. GSR 405 (E) dated 3.5.2000

3.5 Adjudication and Appeal [Secs.16-35]

Appointment of Adjudicating Authority

Sec.16 empowers the Central Government to appoint by notification in the Official Gazette as many Adjudicating Authorities as it may think fit for holding enquiries, for the purposes of Sec.13. The Central Government is, however, under obligation to specify the jurisdiction of the Adjudicating Authority. The Adjudicating Authority cannot hold any enquiry, unless a complaint is made in writing by an officer authorised by a general or special order of the central government.

The person alleged to have committed the contravention will be given a reasonable opportunity of being heard before imposing any penalty under Sec.13. The person against whom a complaint is made is entitled to present his case before the Adjudicating Authority himself or take the assistance of a legal practitioner or Chartered Accountant.

The Adjudicating Authority has been entrusted with powers of a civil court and all proceedings before it shall be deemed to be judicial proceedings within the meaning of Sec.193 and Sec.229 of the Indian Penal Code.

Appeal to Special Director (Appeals)

Sec.17 empowers the Central Government to appoint one or more special Directors to hear the appeals against the orders of the Adjudicating Authorities. The Central Government while issuing notification to this effect shall also specify the matter and places over which the Special Director (Appeals) have jurisdiction.

Notes

An appeal to the Special Director (Appeals) may be made against the orders of the Assistant Directors or Deputy Director of Enforcement if they are acting as Adjudicating Authority. The appeal shall be filed within 45 days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved party.

The appeal shall be filed in the prescribed form and the manner accompanied by the prescribed fees. The Special Director (Appeals) may however extend time limit for filing an appeal if he is satisfied that there was sufficient reason for not filing the appeal in time. On receipt of an appeal, the Special Director (Appeals) after hearing the parties may pass such orders as he thinks fit confirming, modifying or setting aside the order appealed against. Copies of the orders of the Special Director (Appeals) shall be sent to the parties concerned and to the concerned Adjudicating Authority. The Special Director (Appeals) shall have the powers of a civil court and the proceeding before him shall be deemed to be judicial proceedings.

Establishment of Appellate Tribunal

Sec.18 empowers the Central Government to establish Appellate Tribunal by a notification in the Official Gazette to hear appeals against the orders of Adjudicating Authorities and special Director (Appeals).

Powers of Appellate Tribunal and Special Director (Appeals)

Sec.28 provides for powers of the Appellate Tribunal and Special Director (Appeals). These are summarised as under.

1. The Appellate Tribunal and Special Director (Appeals) while disposing of an appeal, shall not be bound by the Code of Civil Procedure but will be guided by the principles of natural justice and other provisions of the Act.
2. The Appellate Tribunal and the Special Director (Appeals) shall have, for the purpose of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit, in respect of the following matters:
   (a) summoning and enforcing the attendance of any person and examining him on oath;
   (b) requiring the discovery and production of documents;
   (c) receiving evidence on affidavits;
   (d) subject to the provisions of Secs.123 and 124 of the Indian Evidence Act, 1872 requisitioning any public record or document or copy of such record or document from any office;
   (e) issuing commissions for the examination of witnesses or documents;
   (f) reviewing its decisions;
   (g) dismissing a representation of default or deciding it *ex parte;*
   (h) setting aside any order of dismissal of any representation for default or any order passed by it *ex parte;* and
   (i) any other matter which may be prescribed by the Central Government.
3. An Order made by the Appellate Tribunal or the Special Director (Appeals) under this Act shall be executable by the Appellate Tribunal or the Special Director (Appeals) as a decree of civil court and, for this purpose, the Appellate Tribunal and the Special Director (Appeals) shall have all powers of a civil court.

Distribution of Business among Benches

Notes

Sec.29 provides that where Benches are constituted, the Chairperson may, from time to time, by notification, make provisions as to the distribution of the business of the Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with by each Bench.

Power of Chairperson to Transfer Cases

Sec.30 provides that on the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairperson may transfer any case pending before one Bench, for disposal, to any other Bench.

Decision to be by Majority

Sec.31 provides that if the members of a Bench consisting of two members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairperson who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other members of the Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

Members, etc. to be Public Servants

Sec.33 provides that the Chairperson, Members and other officers and employees of the Appellate Tribunal, the Special Director (Appeals) and the Adjudicating Authority shall be deemed to be public servants within the meaning of Sec.21 of the Indian Penal Code.

Civil Court not to have Jurisdiction

Sec.34 provides that no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Authority or the Appellate Tribunal or the Special Director (Appeals) is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the Act.

Appeal to High Court

Sec.35 provides that any person aggrieved by any decision or order to the Appellate Tribunal may file an appeal to the High Court. Such appeal must be filed within 60 days from the date of communication of the decision or order of the Appellate Tribunal.

3.6 Directorate of Enforcement

Secs.36 to 38 make provisions as regards Directorate of Enforcement. Sec.36 provides that the Central Government shall establish a Directorate of Enforcement with a director and such other officers or class of officers as it thinks fit, who shall be called officers of Enforcement, for the purposes of this Act. Subject to such conditions and limitations as the Central Government may impose, an officer of Enforcement may exercise the powers and discharge the duties conferred or imposed on him under this Act.

Under Sec.37, the Director of Enforcement and other officers not below the rank of an Assistant Director shall take up for investigation on the contravention of any provisions of Sec.13. In addition, the Central Government may by notification authorize any officer or class of officers in

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the Central Government, State Government, Reserve Bank of India, not below the rank of under-secretary to Government of India to investigate any such contravention. The officer so appointed shall exercise the like powers which are conferred on the income-tax authorities under the Income-tax Act, 1961, subject to such conditions and limitation as the Central Government may impose. Similarly, Sec.38 provides for empowering other officers with the same powers as are mentioned in Sec.37.

3.7 Miscellaneous Provisions

Sec.42 makes a provision in the case of contravention by companies where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

However such a person would not be liable to punishment if he proves that the contravention took place without his knowledge or that he exercised due diligence to prevent such contravention.

Further, where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention on and shall be liable to the proceeded against and punished accordingly.

Task "Members of the Appellate Tribunal are public servant". Justify

Case Study

Intervention on Global Economy

On 2nd and 3rd December 2004, the BIS hosted a meeting of Deputy Governors of central banks from major emerging market economies to discuss foreign exchange market intervention. While few developed countries have actively intervened within the last decade, the outstanding exception being Japan, intervention has been commonplace in the emerging market community.

There are several reasons why developed countries no longer actively intervene. One is that research and experience suggest that the instrument is only effective (at least beyond the very short term) if seen as foreshadowing interest rate or other policy adjustments. Without a durable and independent impact on the nominal exchange rate, intervention is seen as having no lasting power to influence the real exchange rate and thus competitive conditions for the tradable sector. A second reason is that large-scale intervention can undermine the stance of monetary policy. A third reason is that private financial markets have enough capacity to absorb and manage shocks - so that there is no need to "guide" the exchange rate.

Yet emerging market countries do intervene - presumably because they believe the instrument to be an effective tool in the circumstances and for the situations they face.

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The difference in view is brought home by the unprecedented scale of foreign exchange reserve accumulation by the emerging market group in recent years. Between the end of 2001 and the end of 2004, global foreign exchange reserves grew by over US$ 1600 billions, reflecting reserve accumulation by emerging market economies in Asia. Many observers from developed economies have publicly attributed the comparatively weak appreciation of Asian currencies against a rapidly depreciating US dollar to such intervention. Hence there does seem to be a common belief that intervention by emerging market economies has significantly altered the path of the real exchange rate for long enough to matter – even if such a view runs counter to received wisdom about intervention in the markets for major currencies.

This meeting threw some new light on these issues. Some favour of the discussion can be gleaned from the central bank papers reproduced in this volume, along with overview papers prepared by BIS staff. Four central questions are outlined below; it will be clear that many important issues remain to be resolved.

Is intervention more effective in emerging markets?

The wide range of different objectives behind intervention in practice makes assessment difficult - especially empirical assessment that uses data from different episodes and different countries where policy objectives may vary. In flexible exchange rate cases, the objectives of intervention are particularly varied, a point which emerges clearly from the Moreno paper and the individual country papers in this volume. Reasons for intervention cited by central banks that do not target the exchange rate include: to slow the rate of change of the exchange rate; to dampen exchange rate volatility (in some cases to satisfy an inflation target); to supply liquidity to the forex market; or to influence the level of foreign reserves. The paper from South Africa provides an example of objectives that are both subsidiary to the main objective and conditional on prevailing circumstances (in this case, the process of reserve accumulation being used to help dampen volatility when that is convenient). Other country papers show that varying mixtures of objectives are quite commonplace.

Many central banks would argue that their main aim is to limit exchange rate volatility rather than to meet a specific target for the level of the exchange rate. Yet others would counter that it is better to abstain from intervention in the foreign exchange market: such a stance would, they contend, make investors more aware of the need to hedge their own exposures, and this would help the market in hedging instruments to develop. The papers from Israel, Mexico, Poland and Thailand are particularly relevant in this regard. There is indeed some evidence that exchange rate volatility has fallen a lot in some countries where the central bank has not intervened in recent years. The papers from Korea and Peru highlight the existence of a policy trade-off where there are reasons to intervene to dampen volatility yet intervention may involve moral hazard with respect to market development.

The survey reported in Mihaljek's paper shows that many emerging market central banks view intervention as effective in influencing the exchange rate consistent with their objectives. Part of this may be attributable to cases in which fixed or targeted exchange rate regimes are in place: under such a regime, monetary policy actions are primarily dictated by what is needed to achieve and maintain the exchange rate target, intervention in the foreign exchange market is automatic or nearly so, and the exchange rate peg has proved reasonably durable. The papers from Hong Kong SAR and Saudi Arabia illustrate the point.

Formal econometric research has usually thrown doubt on the conclusion of effectiveness of intervention in flexible exchange rate cases although, as noted, such research often conflates interventions for different purposes. In addition, the effectiveness of intervention

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is likely to depend on the specific circumstances – studies of effectiveness on average do not answer the question of when intervention is likely to be successful.

Disyatat and Galati's paper surveys the available empirical evidence, and presents new evidence for the Czech koruna (the methodology requires detailed daily data on intervention and option prices, which were only available for the Czech Republic). The authors' new estimates tentatively suggest the existence of a cumulative effect from repeated intervention (although the mechanism is not clear). In the group of countries surveyed, there are several examples of repeated interventions over lengthy periods. In this connection, the paper from Venezuela makes the interesting point that intervention might have diminishing power with repetition.

It remains possible that greater apparent effectiveness of intervention in emerging market cases simply reflects different structural characteristics. Emerging market economies tend to have less substitutability of assets across currency boundaries, and the authorities tend to have greater financial – and certainly regulatory – weight relative to their private markets. Mihaljek's paper shows clearly that emerging market economies typically hold very large reserves compared with market turnover, even if interventions are not in general large relative to turnover. And several of the country papers describe the application of regulatory measures to obtain influence over the exchange rate.

Questions

1. What do you think intervention is effective for emerging market? (***Hint:*** Interventions slow down the change in exchange rate and supply liquidity to the forex market which is crucial for the emerging markets.)
2. What is the effect of intervention on global economy? (***Hint:*** It provides more opportunities for controlling exchange rates and substituting assets across currency boundaries.)

Source: BIS paper no 24

3.8 Summary

- 'The exchange control in India was introduced on September 3, 1939 as a war time measure in the early period of Second World War under the powers conferred by the Defence of India Rules.
- The emergency powers were subsequently replaced by the Foreign Exchange Regulations Act, 1947 which came into operation on March 25, 1947.
- This Act witnessed comprehensive revision in the wake of the changed needs of the economy during the post-independence period and was replaced by the Foreign Exchange Regulations Act, 1973 known as FERA.
- The onset of the era of liberalization of the external sector of the economy and the industrial licensing followed by Partial Convertibility of Rupee and full convertibility on current account necessitated the need for further extensive amendments in the FERA which were brought about by the Foreign Exchange Regulations (Amendment) Act, 1993.
- FERA has been replaced by Foreign Exchange Management Act (FEMA), 1999.
- FEMA has been brought to consolidate and amend the law relating to foreign exchange. The basic objective of this act is to facilitate external trade and payments and to promote the orderly development and maintenance of foreign exchange market in India.
- The role of authorized person, the provisions of contravention and penalties and the procedures of adjudication and appeal and the power of directorate of enforcement dealt at great length in this act.

3.9 Keywords

Notes

Currency: This expression includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers' cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instrument as may be notified by the Reserve Bank.

Export: Outflow of goods and inflow of foreign currency.

Foreign Exchange Management Act: Foreign Exchange Management Act is to facilitate external trade and payments and to promote the orderly development and maintained of foreign exchange in India.

Import: Import with its grammatical variations and cognate expressions, means bringing into India any goods or services.

3.10 Self Assessment

Choose the appropriate answers:

1. FERA stands for:

   (a) Foreign Exchange Revenue Act (b) Foreign Exchange Regulation Act

   (c) Foreign Exchange Regional Act (d) None

2. In which year FEMA replaces the FERA

   (a) 1973 (b) 1974

   (c) 1998 (d) 1999

3. Means of Indian currency

   (a) Currency which is expressed or drawn in yen

   (b) Currency which is expressed or drawn in dollar

   (c) Currency which is expressed or drawn in Euro

   (d) Currency which is expressed or drawn Indian rupees

4. PIO stands for:

   (a) Pakistan Indian Organization (b) Pakistan Indian Origin

   (c) Person of Indian Origin (d) None

5. If the contravention continues, the penalty of ₹ .... after the first day during the period in which the contravention continue shall be imposed.

   (a) ₹ 300 per day (b) ₹ 400 per day

   (c) ₹ 500 per day (d) ₹ 200 per day

6. IPC stands for:

   (a) International Personal Computer (b) Indian Personal Computer

   (c) International Penal Code (d) Indian Penal Code

7. Which section provides that any person aggrieved by any decision or order to the Appellate Tribunal may file an appeal to the High Court.

   (a) Sec.35 (b) Sec.34

   (c) Sec.36 (d) Sec.38

Notes

8. Directorate of Enforcement make provisions under
   (a) Secs.34 and 36 (b) Secs.36 and 38
   (c) Secs.38 and 40 (d) Secs.32 and 34

State whether the following statements are true or false:

9. Foreign currency means any currency same as Indian currency.
10. An authorized person is allowed to credit the account of any person without any corresponding remittance from any place outside India.
11. Sec.7 deals with export of goods and services.
12. Sec.5 explains dealings in current account transactions.
13. Sec.15 empowers the Directorate of enforcement.
14. The arrest warrant may be issued by the adjudicating authority if the defaulter fails to make an appearance in pursuance of the notice issued by him.

3.11 Review Questions

1. What are the duties and powers of an 'authorized person' under FEMA, 1999?
2. What are the obligations of an exporter of goods and services out of India? Explain.
3. Define an 'authorised person'. When can the authority of an 'authorised person' be revoked?
4. Can anyone file a suit against officer of the government exercising powers under FEMA?
5. Describe the penalties prescribed under FEMA for contravention of its provisions.
6. Can an appeal be filed against the order of the Adjudicating Authority? If yes, then with whom shall the appeal be filed and within what period?
7. State the powers of Special Director (Appeals) and of the Appellate Tribunal in disposing off the appeals.
8. Write short note on:
   (a) Foreign Exchange
   (b) Currency
   (c) Indian Currency
   (d) Foreign Currency
   (e) Security
   (f) Overseas Corporate Body
9. Enumerate some of the more important Regulations made by Reserve Bank of India under FEMA.
10. State the penalties prescribed under FEMA for contravention of its provisions.

Answers: Self Assessment

Notes

1.	(b)	2.	(d)
3.	(d)	4.	(c)
5.	(c)	6	(d)
7.	(a)	8.	(b)
9.	False	10.	False
11.	True	12.	True
13	True	14.	True

3.12 Further Readings

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, 2007.

S.S Gulshan, *Business Law,* Third Edition, Excel Books, New Delhi, 2006.

S.S Gulshan, *Mercantile Law,* Third Edition, Excel Books, New Delhi, 2006.

Online links

http://www.netlawman.co.in/acts/foreign-exchange-management-act-1999.php

http://www.rbi.org.in/scripts/Fema.aspx

http://www.rbi.org.in/Upload/Notification/Pdfs/16716.pdf

http://www.taxmanagementindia.com/Site-Map/FEMA/List_Act_FEMA.asp

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Unit 4: Information Technology Act, 2000

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Objectives

After studying this unit, you will be able to:

- Discuss Right to Information Act
- Explain the benefits of RTI
- Describe Information Technology Act

Introduction

In the earlier unit, you came to know about the FEMA Act. In this unit, you will study about the information related laws.

The Right to Information (RTI) Act has been in existence for over a year. But ironically, this Act which is full of significance in creating conditions for good governance, accountability of the government and promoting people's basic rights to know about government's decisions, actions or lack of actions and policies, remains hardly known to people for whose benefit it was introduced in the first place. Legislations centred on RTI are in full force in many countries of the world specially in the ones which are developed and ruled democratically.

4.1 Right to Information Act

Notes

Right to information is a part of fundamental rights under Article 19 (1) of the Constitution. Article 19 (1) says that every citizen has freedom of speech and expression. As early as in 1976, the Supreme Court said that people can not speak or express themselves unless they know. India is a democracy and people are the masters. Therefore the masters have the rights to know how the Govts., meant to serve them, are functioning.

In Indian democratic system, the right of every citizen to know information is no doubt a revolutionary step. Since long the officials in the name of administrative secrecy hesitated to disclose information and there by kept in darkness to general public about important decision of Govt. & other administrative bodies. This has widened the path of corruption in manifold. The main aim of this act is to eradicate the existing practice of concealing facts & events and to empower every citizen to exercise their legal right in obtaining information under RTI Act, 2005.

The ideal objectives of the RTI Act are to promote transparency and accountability in the working of public authority and to set up a practical regime for giving citizens access to information under the control of public authorities.

RTI Act, 2005 was implemented in our country on 15th June, 2005 and became operational on 12.10.2005. The act extends to the whole of India except the State of Jammu and Kashmir.

4.1.1 What Rights are available under RTI Act, 2005?

Right to Information Act, 2005 empowers every citizen to:

1. Ask any questions from the Government or seek any information.
2. Take copies of any Govt. documents.
3. Inspect any Govt. documents.
4. Inspect any Govt. works.
5. Take samples of materials of any Govt. work.

Coverage of the Act: The RTI Act covers all level of Govt. – Center, State, District and Local self Governing Bodies like Panchyat and Municipal bodies. It also covers NGOs – that are financed substantially with public funds provided by Govt. Every citizen of India are empowered to seek information from public authority. Information must be shared for the interest of public as the purpose of this Act is to evolve an interface between public authority and citizen. Since the Act imposes liability on public authority, it should not be misinterpreted rather it makes the administration more responsive and removes sloth. Maximum possible information must be disclosed voluntarily. For this openness and change of attitude is required.

4.1.2 Salient Features of Right to Information Act

Salient features of Right to Information Act are:

1. A citizen has a right to seek information from a Public Authority which is held by the Public Authority or which is held under its control.
2. The right to seek information from a Public authority is not absolute. Sections 8 and 9 enumerate the categories of information which are exempt from disclosure.
3. Public authorities to designate Public Information Authorities and Assistant Public Information Officers within 100 days of the enactment.

Notes

4. Application for seeking information is to be made to an officer of the Public Authority who is State Public Information Officer. He is responsible to deal with requests of information/ assist persons seeking information.
5. The Act makes it obligatory for every Public Authority to make *suo-motu* disclosure in respect of the particulars of its Organization, functions, duties etc. as provided in section 4 of the Act.
6. Transfer of a request by a Public authority to another public authority wherein the subject matter/information is held by the latter.
7. A Citizen should make an Application to the State Public Information Officer in writing in English or Hindi or in the official language of the area in which application is made.
8. The Application is to accompany a Demand Draft/Banker Cheque/Indian Postal Order of ₹ 10 payable to the Accounts Officer of public authority as fee prescribed.
9. No prescribed form of application for seeking information. It can be made on plain paper with Name and complete postal address of the applicant.
10. The information seeker is not required to give reasons for seeking information.
11. Time limit-30 days/48 Hours/45 Days
12. If an application is not supplied information within the prescribed time or not satisfied with the information provided, he may prefer an appeal to the first Appellate Authority who is an officer senior in rank to the Public Information Officer.
13. No fees for making an Appeal
14. Creation of an independent non judicial machinery State Information Commission to decide 2nd stage appeals.
15. Legal framework of exercise of powers by Commission defined in the Act.
16. Two tier appellate Forum: 1. Appeal to departmental officer senior to the PIO, 2. To the Commission.
17. If Appellant Authority fails to pass an order on the appeal with in the prescribed period, if the appellant is not satisfied with the order of the First Appeal Authority, he may prefer a Second Appeal with the State Information Commission within 90 days from the date on which the decision should have been made by the First Appellant Authority or was actually received by the Appellant.
18. Provision of Complaint if the Public Information Officer fails to satisfy or it is a case of refusal access to any information requested under the Act or it is a case of over charging etc. The complaint can be made to the State Information Commission.
19. The Commission decides the appeals and conveys its decision to the Appellant/ Complainant and First Appellant Authority.

4.2 Benefits of the RTI

The various benefits of the RTI are:

1. Enhances transparency, credibility and legitimacy of public authority.
2. Increases efficiency, vitality, alertness which are the major ingredients for smooth & effective functioning of public authority.
3. Effective information flow helps citizen to secure their right and entitlement.

4. Encourages public authority to be sensible and to make optimum use of limited fiscal resources.
5. Reminds public authorities their power and duty including channels of supervision and accountability.
6. Free flow of information can tackle any disaster there by enables sustained development and growth.

Note **World Intellectual Property Organisation (WIPO)**

Disputes arising out of the Domain Name System can be resolved by the concerned parties by referring to the World Intellectual Property Organisation (WIPO), which incidentally, is the first body to resolve disputes by online arbitration. The registration with ICANN confers authority on WIPO. WIPO has confirmed the efficacy of online arbitration in a number of cases. The first Indian case was that of Bennett, Coleman & Co. Ltd. concerning the two domain names held by it, viz., "economictimes.com" and "timesofindia.com". The whole process of arbitration took place online and the decision was sent online. The total time taken was just 45 days in this case, as against the long time taken in court proceedings.

4.3 Information Technology Act

In May 2000, at the height of the dot-com boom, India enacted the IT Act and became part of a select group of countries to have put in place cyber laws. In all these years, despite the growing crime rate in the cyber world, only less than 25 cases have been registered under the IT Act, 2000 and no final verdict has been passed in any of these cases as they are now pending with various courts in the country.

Although the law came into operation on October 17, 2000, it still has an element of mystery around it. Not only from the perception of the common man, but also from the perception of lawyers, law enforcing agencies and even the judiciary.

The prime reason for this is the fact that the IT Act is a set of technical laws. Another major hurdle is the reluctance on the part of companies to report the instances of cyber crimes, as they don't want to get negative publicity or worse get entangled in legal proceedings. A major hurdle in cracking down on the perpetrators of cyber crimes such as hacking is the fact that most of them are not in India. The IT Act does give extra-territorial jurisdiction to law enforcement agencies, but such powers are largely inefficient. This is because India does not have reciprocity and extradition treaties with a large number of countries.

The Indian IT Act also needs to evolve with the rapidly changing technology environment that breeds new forms of crimes and criminals. We are now beginning to see new categories and varieties of cyber crimes, which have not been addressed in the IT Act. This includes cyber stalking, cyber nuisance, cyber harassment, cyber defamation and the like. Though Section 67 of the Information Technology Act, 2000 provides for punishment to whoever transmits or publishes or causes to be published or transmitted, any material which is obscene in electronic form with imprisonment for a term which may extend to two years and with fine which may extend to twenty five thousand rupees on first convection and in the event of second may extend to five years and also with fine which may extend to fifty thousand rupees, it does not expressly talk of cyber defamation. The above provision chiefly aim at curbing the increasing number of child pornography cases and does not encompass other crimes which could have been expressly brought within its ambit such as cyber defamation.

Notes

Example: In *Yahoo! Inc. v. Akash Arora,* the plaintiff, who was the registered owner of the domain name "Yahoo.com" succeeded in obtaining an injunction from the Delhi High Court restraining the defendant and his agents from dealing in service or goods on the internet or otherwise under the domain name "Yahooindia.com" or any other trade mark or domain name which was deceptively similar to the plaintiff's trade mark "Yahoo".

4.4 Objectives of the Act

The objectives of the Act as reflected in the preamble to the Act are:

(i) to provide legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication, commonly referred to as "electronic commerce", which involves the use of alternatives to paper-based methods of communication and storage of information;

(ii) to facilitate electronic filing of documents with the government agencies;

(iii) to facilitate electronic storage of data in place of paper-based methods of storage of data.

(iv) to amend the Indian Penal Code, the Indian Evidence Act, 1872, the Banker's Books Evidence Act, 1891, and the Reserve Bank of India Act, 1934, and

(v) to provide for matters connected therewith or incidental thereto.

Task Right to Information Act shall be helpful for common man. How they get benefited to use this Act?

4.5 Commencement and Application

It extends to the whole of India and save as otherwise provided in this Act, it applies to any offence or contravention thereunder committed outside India by any person.

This Act is not applicable to the following:

(i) a negotiable instrument (other than a cheque) as defined in Sec.13 of the Negotiable Instruments Act, 1881;

(ii) a power-of-attorney as defined in Sec.1A of the Power of Attorney Act, 1882;

(iii) a trust as defined in Sec.3 of the Indian Trust Act, 1882;

(iv) a will as defined in Sec.2(h) of the Indian Succession Act, 1925 including any other testamentary disposition by whatever name called;

(v) any contract for the sale or conveyance of immovable property or any interest in such property;

(vi) any such class of documents or transactions as may be notified by the Central Government in the Official Gazette.

Did u know? Internet Corporation for Assigned Names and Numbers (ICANN). ICANN was formed in 1999 as a private, nonprofit coporation to manage the Domain Name System.

4.6 Digital Signature

Notes

Authentication of electronic records. Authentication is a process used to confirm the identity of a person or to prove the integrity of information. The authentication of message involves determining its source and verifying that it has not been modified or replaced in transit. Subject to the provisions of section 3 any subscriber may authenticate an electronic record by affixing his digital signature.

The "hash function" means an algorithm mapping or translation of one sequence of bits into another, generally smaller set known as "hash result" such that an electronic record yields the same hash result every time the algorithm is executed with the same electronic record as its input making it computationally infeasible (a) to derive or reconstruct the original electronic record from the hash result produced by the algorithm; (b) that two electronic records can produce the same hash result using the algorithm.

Example: The Rediff Communications Ltd had registered the domain name "Rediff.com" with Network Solutions Inc. in February 1997. In January 1999, Cyberbooth the defendant registered the domain name "Rediff.com" with National Solutions Inc. The plaintiff alleged that the defendant had adopted the word "Rediff" as part of its trading style deliberately to pass off its business as that of the plaintiff. The Bombay High Court considered that both the plaintiff and defendant had a common field of activity, operated on the internet, provided information of a similar nature and similar facilities such as sale of books, chat line and opinion polls. The court restrained the defendant from using the said domain name.

4.7 Electronic Governance [Secs.4 to 16]

Legal Recognition of Electronic Records (Sec.4)

Where any law provides that information or any other matter shall be in writing or in the type, written or printed form, then notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied if such information or matter is (a) rendered or made available in an electronic form; and (b) accessible so as to be usable for a subsequent reference.

Legal Recognition of Digital Signatures (Sec.5)

Where any law provides that information or any other matter shall be authenticated by affixing the signature or any document shall be signed or bear the signature of any person then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of digital signature affixed in such manner as may be prescribed by the Central Government.

The expression "signed" as used above shall, with reference to a person, means affixing of his handwritten signature or any mark on any document and the expression "signature" shall be construed accordingly.

Use of Electronic Record and Digital Signatures in Government and its Agencies (Sec.6)

Where any law provides for the following:

(a) the filing of any form, application or any other document with any office, authority, body or agency owned or controlled by the appropriate Government in a particular manner;

(b) the issue or grant of any licence, permit, sanction or approval by whatever name called in a particular manner;

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(c) the receipt or payment of money in a particular manner, then, such requirement shall be deemed to have been satisfied if such filing, issue, grant, receipt or payment, as the case may be, is effected by means of such electronic form as may be prescribed by the appropriate Government.

Did u know? The Delhi High Court restrained an IT company from using "bisleri.com" as a domain name for its website, following a suit by Aqua Minerals Ltd – the makers of the Bisleri brand of mineral water.

4.8 Secure Electronic Records and Secure Digital Signatures [Secs.14 to 16]

Secure Electronic Record (Sec.14)

Where any security procedure has been applied to an electronic record at a specific point of time, then such record shall be deemed to be a secure electronic record from such point of time to the time of verification.

Secure Digital Signature (Sec.15)

If, by application of a security procedure agreed to by the parties concerned, it can be verified that a digital signature, at the time it was affixed, was – (a) unique to the subscriber affixing it; (b) capable of identifying such subscriber; (c) created in a manner or using a means under the exclusive control of the subscriber and is linked to the electronic record to which it relates in such a manner that if the electronic record was altered the digital signature would be invalidated, then such digital signature shall be deemed to be a secure digital signature.

Security Procedure (Sec.16)

The Central Government shall for the purposes of this Act prescribe the security procedure having regard to commercial circumstances prevailing at the time when the procedure was used, including – (a) the nature of the transaction; (b) the level of sophistication of the parties with reference to their technological capacity; (c) the volume of similar transaction engaged in by other parties; (d) the availability of alternatives offered to but rejected by any party; (e) the cost of alternative procedures; and (f) the procedures in general use for similar types of transactions or communications.

4.9 Digital Signature Certificates [Secs. 35 to 39]

Certifying Authority to issue Digital Signature Certificate (Sec.35)

Any person may make an application to the Certifying Authority for the issue of a Digital Signature Certificate in such form as may be prescribed by the Central Government. Such an application is to accompany such fee not exceeding ₹ 25000 as may be prescribed by the Central Government, to be paid to the Certifying Authority.

Representations upon Issuance of Digital Signature Certificate (Sec.36)

A Certifying Authority while issuing a Digital Signature Certificate shall certify that: (a) it has complied with the provisions of this Act and the rules and regulations made thereunder; (b) it has published the Digital Signature Certificate or otherwise made it available to such person relying

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on it and the subscriber has accepted it; (c) the subscriber holds the private key corresponding to the public key, listed in the Digital Signature Certificate; (d) the subscriber's public key and private key constitute a functioning key pair; (e) the information contained in the Digital Signature Certificate is accurate, and (f) it has no knowledge of any material fact, which, if it had been included in the Digital Signature Certificate would adversely affect the reliability of the representation made in (a) to (d) above.

Revocation of Digital Signature Certificate (Sec.38)

A Certifying Authority may revoke a certificate issued by it: (a) where the subscriber or any other person authorised by him makes a request to that effect; or (b) upon the death of the subscriber; or (c) upon the dissolution of the firm or winding up of the company where the subscriber is a firm or a company.

Task "Digital signature technique is good for security purpose". Comment.

4.10 Cyber Regulations Appellate Tribunal

Establishment of Cyber Appellate Tribunal (Sec.48)

The Central Government shall, by notification, establish one or more appellate tribunals to be known as the Cyber Regulations Appellate Tribunal.

Composition of Cyber Appellate Tribunal (Sec.49)

The Tribunal shall consist of one person only, known as the presiding officer and be appointed, by notification, by the Central Government.

Qualifications for Appointment as Presiding Officer of the Tribunal (Sec.50)

A person shall not be qualified for appointment as Presiding officer unless he: (a) is, or has been, or is qualified to be, a judge of a High court, or (b) is or has been a member of the India Legal Service and is holding or has held a post in Grade I of that service for at least 3 years.

Term Office (Sec.51)

The Presiding officer shall hold office for a term of 5 years from the date on which he enters upon his office or until he attains the age of 65 years, whichever is earlier.

Salary, Allowances and other Terms and Conditions of Service of Presiding Officer (Sec.52)

The salary and allowances payable to, and the other terms and conditions of service including pension, gratuity and other retirement benefits of the presiding officer shall be such as may be prescribed. However, neither the salary and allowances nor the other terms and conditions of service of the Presiding officer shall be varied to his disadvantage after appointment.

Resignation and Removal (Sec.54)

The Presiding officer may by notice in writing addressed to the Central Government, resign his office. The Central Government, may, by order, remove the Presiding officer on the ground of proved misbehaviour or incapacity.

Orders Constituting Appellate Tribunal to be final and not to Invalidate its Proceedings (Sec.55)

No order of the Central Government appointing any person as the presiding officer shall be called in question. Further, no act or proceeding before the Tribunal shall be called in question on the ground merely of any defect in the constitution of the Tribunal.

Staff of the Cyber Appellate Tribunal (Sec.56)

The Central Government shall provide the Tribunal with such officers and employees as that Government may think. These employees and officers shall discharge their functions under general superintendence of the Presiding officer.

Appeal to Cyber Regulations Appellate Tribunal (Sec.57)

Any person aggrieved by an order made by controller or an adjudicating officer may prefer an appeal to the Tribunal. However, no such appeal shall lie from an order made by an adjudicating officer with the consent of the parties. Every appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the controller or the adjudicating officer is received by the person aggrieved. On receipt of an appeal, the Tribunal may, after giving the parties an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

Procedure and Powers of the Tribunal (Sec.58)

The Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure. Instead, it shall be guided by the principles of natural justice and subject to the other provisions of this and of any rules. Also, the Tribunal shall have powers to regulate its own procedure including the place at which it shall have its sittings.

Right to Legal Representation (Sec.59)

The appellant may either appear in person or authorise one or more legal practitioners or any of its officers to present his or its case before the Tribunal.

Limitation (Sec.60)

The provisions of the Limitation Act, 1963 shall, as for as may be, apply to an appeal made to the Tribunal.

Civil Court not to have Jurisdiction (Sec.61)

No court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an adjudicating officer or the Tribunal is empowered to determine. Further, no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

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Appeal to High Court (Sec.62)

Any person aggrieved by any decision or order of the Tribunal may file an appeal to the High Court within 60 days from the date of communication of the decision or order to him on any question of fact or law arising out of such order.

Compounding of Contraventions (Sec.63)

Any contravention under this Part may, either before or after the institution of Adjudication proceedings, be compounded by the controller or the adjudicating officer, as the case may be. However, such sum shall not exceed the maximum amount of the penalty which may be imposed for the contravention so compounded.

The benefit of compounding shall not be available to a person who commits the same or similar contravention within a period of 3 years from the date on which the contravention was previously compounded.

Caselet

IT Act and other allied Laws

Integrating IT Act with Other Allied Laws. In 1996, the Companies Act, 1956 was amended by inserting s. 610A. This section provides for the admissibility of micro films, facsimile copies of documents, computer printouts and documents on computer media as documents and as evidence.

In July 2000, the Central Government Constituted an E-Corporate Business Working Group to synergise the provision of the two Acts. The Group is paying special attention to the provisions relating to authentication of electronic records, legal recognition of electronic records, digital signature, retention of electronic records, security procedure and certifying procedures of the Information Technology Act 2000.

Also, the Group will have a relook at all forms and returns under the Companies Act, 1956 in order to make them computer savvy and technology friendly with provisions of secret-code for subscriber and acceptor. Also, the Department of Company Affairs is in the process of fine-tuning the forms and returns to make them computer friendly. Provisions relating to investor protection and auditing of electronic balance sheets are also being brought in conformity with the IT Act.

Also, the Department of Company Affairs has decided that all companies registered under the Companies Act, 1956 will be allotted a Corporate Identity Number (CIN) to make corporate governance investor friendly, corporate friendly and compatible with the provisions of IT Act, 2000.

Added to this, the functions of the Director General of Investigation and Research (DGI&R) and MRTP Act, 1969, proposed Competition Law are also being harmonised with the IT Act, in keeping with the practices prevailing in this regard in countries like UK, USA, France, Germany and Australia.

4.11 Offences [Sec.65 to 78]

Tampering with Computer Source Document (Sec.65)

Whoever knowingly or intentionally conceals, destroys or alters or intentionally or knowingly causes another to conceal, destroy or alter any computer source code used for a computer,

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(or computer program, or computer system or computer network), when the computer source code is required to be kept or maintained by law for the time being in force, shall be punishable with imprisonment up to 3 years, or with fine which may extend up to ₹ 2 lakh, or with both.

The expression "computer source code" means the listing of programs, computer commands, design and layout and program analysis or computer resource in any form.

Hacking with Computer System (Sec.66)

Whoever with the intent to cause or knowing that he is likely to cause wrongful loss or damage to the public or any person destroys or deletes or alters any information residing in a computer resource or diminishes its value or utility or affects it injuriously by any means, commits hacking.

Publishing of Information which is Obscene in Electronic Form (Sec.67)

Whoever publishes or transmits or causes to be published in the electronic form, any material which is lascivious or appeals to the prurient interest or if its effect is such as to tend to deprave and corrupt persons who are likely, to read, see or hear the matter, shall be punished on first conviction with imprisonment of either description for a term which may extend to 5 years or with fine which may extend to ₹ 1 lakh. In the event of a second or subsequent conviction the imprisonment may extend to 10 years and the fine may extend to ₹ 2 lakhs.

Power of the Controller to give Directions (Sec.68)

The controller may, by order, direct a Certifying Authority or any employee of such authority to take such measures or cease carrying on such activities as specified in the order if those are necessary to ensure compliance with the provisions of the Act, rules or any regulations made thereunder. Any person who fails to comply with any such order shall be guilty of an offence and shall be liable on conviction to imprisonment for a term not exceeding 3 years or to a fine not exceeding ₹ 2 lakhs or both.

Directions of Controller to a Subscriber to extend Facilities to Decrypt Information (Sec.69)

If the controller is satisfied that it is necessary or expedient so to do in the interest of the sovereignty or integrity of India, the security of the state, friendly relations with foreign states or public order or for preventing incitement to the commission of any cognizable offence, for reasons to be recorded in writing by order, direct any agency of the government to intercept any information transmitted through any computer resource. In such a case, the subscriber or any person in charge of the computer resource shall extend all facilities and technical assistance to decrypt the information. If he fails to provide the necessary assistance, then he shall be punished with an imprisonment for a term which may extend to 7 years.

Protected System (Sec.70)

The appropriate government may declare any computer, computer system or computer network to be a protected system. It may authorise persons to have access to the protected system. Any person who secures access or attempts to secure access to a protected system without authority from the appropriate government shall be punished with imprisonment of either description for a term which may extend to 10 years and shall also be liable to fine.

Penalty for Misrepresentation (Sec.71)

Whoever makes any misrepresentation to, or suppresses any material fact from, the controller or the certifying Authority for obtaining any licence or Digital Signature Certificate, shall be punished with imprisonment for a term which may extend to 2 years, or with fine which may extend to ₹ 1 lakh, or with both.

Breach of Confidentiality and Privacy (Sec.72)

Any person, (empowered under the Act) who has secured access to any electronic record, book, register, correspondence, information, document or other material, and he, without the consent of the person concerned, discloses the same to any other person shall be punished with imprisonment for a team which may extend to 2 years, or with fine which may extend to ₹ 1 lakh, or with both.

Penalty for Publishing Digital Signature Certificate False in Certain Particulars (Sec.73)

No person shall publish a Digital Signature Certificate or otherwise make it available to any other person with the knowledge that (a) the Certifying Authority listed in the certificate has not issued it; or (b) the subscriber listed in the certificate has not accepted it, or (c) the certificate has been revoked or suspended unless such publication is for purpose of verifying a digital signature created prior to such suspension or revocation.

Publication for Fraudulent Purpose (Sec.74)

Whoever knowingly creates, publishes or otherwise makes available a Digital Signature Certificate for any fraudulent or unlawful purpose shall be punished with imprisonment for a team which may extend to 2 years, or with fine which may extend to ₹ 1 lakh, or with both.

Act to Apply for Offence or Contravention Committed Outside India (Sec.75)

The provisions of this Act shall apply also to any offence or contravention committed outside India by any person irrespective of his nationality. For this application, it is necessary that the act or conduct constituting the offence or contravention involves a computer, computer system or computer network located in India.

Confiscation (Sec.76)

Any computer, computer system, floppies, compact disks, tape drives or any other accessories related thereto, in respect of which provision of this Act, rules, order or regulations made thereunder has been or is being contravened, shall be liable to confiscation.

Penalties and Confiscation not to Interfere with other Punishments (Sec.77)

No penalty imposed or confiscation made under this Act shall prevent the imposition of any other punishment to which the person affected thereby is liable under any other law for the time being in force.

Power to Investigate Offences (Sec.78)

Notwithstanding anything contained in the Code of Criminal Procedure, a police officer not below the rank of Deputy Superintendent of Police shall investigate any offence under this Act.

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Note **Rules Framed under the Act**

The Ministry of Information Technology has issued the following:

1. ***The Information Technology (Certifying Authorities) Rules, 2000.*** The Central Government has made these rules regulating the application and other guidelines for Certifying Authorities. These rules deal with (a) Manner of authentication by Digital Signature (b) Creation of Digital Signature (c) Verification of Digital Signature (d) Digital Signature Certificate Standard, (e) Eligibility Criteria for licensing of Certifying Authorities. Only individuals with a capital of ₹ 5 crores or more and companies with a net worth of not less than ₹ 50 crores can apply for licences. Foreign equity cannot exceed 49% (f) Licence and fees obligations of Certifying Authorities (g) Security procedures and guidelines for Certifying Authorities (h) Generation and Issue of Digital Signature Certificate (i) Access to confidential information.

2. ***The Cyber Regulations Appellate Tribunal (Procedure) Rules, 2000.*** These rules provide for the procedure for filing applications, fees, pleadings, hearings and related matters.

4.12 Shortcomings of the Information Technology Act, 2000

The Act does not cover certain aspects of e-commerce. These are:

1. The Act deals only with the commercial and criminal areas of law as affected by information technology and do not deal with certain other issues, such as intellectual property rights, (i.e., copyright, trade marks and patents). Thus infringement of copyright on e-commerce will be governed by the Copyright Act, 1957.

2. The Act does not address itself to internet related issues such as domain names and cyber squatting. Thus under IT Act, neither any protection for domain names nor action against cybersquatting is available. There have arisen many disputes about domain names globally, including infringement, concurrent claims and cybersquatting. In USA, these issues are tackled by the US Anti-Cybersquatting Consumer Protection Act, 1999. This Act is a powerful deterrent to cybersquatting, as it provides for the levy of damages upto US$ 300,000 per mark against the guilty parties. In India, however, cybersquatting can be opposed by relying on the provisions of the Trade Marks Act, 1999.

3. The Act is not applicable to negotiable instruments, power of attorney, trusts, testamentary dispositions (wills), contracts for sale or conveyance of immovable property or any interest in such property. The non-applicability of the Act to negotiable instruments would result in e-commerce in India being limited to payment systems that are non-traditional or credit card based. The banks cannot extend their services to the online medium of payments.

4. The IT Act, 2000 is silent as regards taxation of goods and services traded through e-commerce.

5. The IT Act makes no provision for jurisdictional aspects of electronic contracts, i.e., jurisdiction of courts and tax authorities.

6. No provision has been made for payment of stamp duty on electronic documents.

Task

In your opinion, what modifications & improvements can be done in the information technology act to make it more comprehensive so as to cover all the crimes & penalties for the same keeping in view the latest modifications in technology?

Case Study

Bennett, Coleman & Co. Ltd.

Bennett, Coleman & Co. Ltd. held two domain names "economictimes.com" and "timesofindia.com" for its respective newspapers 'The Economic Times' and 'The Times of India". The Bennett, Coleman & Company filed two complaints, one against Steven S Lalwani and the second against Long Distance Telephone Company who had got sites registered as "theeconomictimes.com" and "thetimesofindia.com". The traffic to these sites was redirected to other sites of Lalwani and the Long Distance Telephone Company. The complainant claimed that the registration and use of the domain names by Lalwani and the Long Distance Telephone Company was in bad faith. The defendants suggested that any misleading impression would be dispelled by the different design of the website.

Question

What should be the court order in this case in your opinion? (***Hint:*** Court give decision in favour of Bennet Coleman & Co. Ltd.)

4.13 Summary

- The Information Technology Act, 2000 has been passed to give effect to the said resolution and to promote efficient delivery of Government services by means of reliable electronic records.
- In the case of immovable property, certain documents are required to be compulsory registered with competent authorities of the government.
- Hence, these documents are excluded. Authentication of electronic records is a process used to confirm the identity of a person or to prove the integrity of information.
- The private key and the public key are unique to the subscriber and constitute a functioning key pair.
- Every appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the controller or the adjudicating officer is received by the person aggrieved.
- IT Act excludes the provisions related to the negotiable instruments like promissory notes, bills of exchanges, cheques, etc
- IT Act has been passed to promote efficient delivery of the Government services by means of reliable electronic records.
- The Controller shall be the repository of all Digital Signature Certificates issued under this Act.

4.14 Keywords

APIO: Assistance Public Information Officers

CIC: Central Information Commission

Decryption: Decryption is the reverse process of converting encoded data to its original un-encoded form, plaintext.

Digital Signatures: a message signed with a sender's private key can be verified by anyone who has access to the sender's public key, thereby proving that the sender signed it and that the message has not been tampered with. This is used to ensure authenticity.

Encryption: Encryption is a process of coding information which could either be a file or mail message in into cipher text a form unreadable without a decoding key in order to prevent anyone except the intended recipient from reading that data.

Information Technology: Hardware and software that perform data processing tasks, such as capturing, transmitting, storing, retrieving, manipulating or displaying data.

PIO: Public Information Officers

RTI: Right to Information

4.15 Self Assessment

Fill in the blanks:

1. .... is a part of fundamental rights under Article 19 (1) of the Constitution.
2. RTI .... transparency & credibility of public authority.
3. Effective information flow helps citizen to secure their .... and ....
4. IT Act facilitates electronic storage of data in place of .... methods of storage of data.
5. IT Act provides legal recognition for transactions carried out by means of .... and other means of ....
6. RTI extends to .... of India.
7. A trust is defined in the ....
8. Legal recognition of electronic records come under ....
9. Secure digital signature come under ....
10. Right to legal representation comes under ....
11. Hacking with computer system comes under ....
12. IT Act, 2000 was passed which is based on the .... Model law on electronic Commerce.

State whether the following statements are true or false:

13. RTI Act, 2005 was implemented in our country on 15th June, 2005
14. The Indian IT Act also needs to evolve with the rapidly changing technology environment that breeds new forms of crimes and criminals.

15. Information Technology Act apply more than 43 countries in the world.
16. Authentication is not a process used to confirm the identity of a person.
17. Any person may make an application to the Certifying Authority for the issue of a Digital Signature Certificate.
18. A Certifying Authority may not revoke a certificate.
19. Every appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the controller or the adjudicating officer is received by the person aggrieved.
20. No person shall publish a Digital Signature Certificate.
21. IT Act excludes the provisions related to the negotiable instruments like promissory notes, bills of exchanges, cheques, etc.
22. IT Act has been passed to promote efficient delivery of the Government services by means of reliable electronic records.

4.16 Review Questions

1. Describe the objectives of IT Act, 2000.
2. Describe the provisions as regards secure electronic records and secure digital signatures.
3. Who can grant a licence to issue Digital Signature Certificates? Give the requirements a person must complete for getting the licence.
4. Explain available rights under RTI Act, 2005.
5. What do you mean by digital signature?
6. Who is authorised to issue a Digital Signature Certificate? What type of representations are made by the Certifying Authority at the time of issue of a Digital Signature Certificate?
7. Describe the process of digital signature certificate.
8. Explain some offences in detail.
9. In which cases can the licence to issue Digital Signature Certificates be suspended or revoked?
10. Write explanatory notes on the following:
    (a) Tampering with computer source documents;
    (b) Hacking with computer system;
    (c) Protected system;
    (d) Breach of confidentiality and privacy;
    (e) Offences by companies

Answers: Self Assessment

1. Right to information
2. enhances
3. right, entitlement
4. paper-based
5. electronic data interchange, electronic communication
6. whole
7. Indian Trust Act, 1882

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8. electronics governance
9. Section 15
10. Section 59
11. Section 66
12. UNCITRAL
13. True
14. True
15. True
16. False
17. True
18. False
19. True
20. True
21. True
22. True

4.17 Further Readings

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, 2007.

S.S Gulshan, *Business Law,* Third Edition, Excel Books, New Delhi, 2006.

S.S Gulshan, *Mercantile Law,* Third Edition, Excel Books, New Delhi, 2006.

Online links

http://cybercrime.planetindia.net/it-act-2008.htm

http://www.legalserviceindia.com/cyber/itact.html

http://www.rtiindia.org

Unit 5: The Competition Act, 2002

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Objectives

After studying this unit, you will be able to:

- Discuss various term related to Competition Act
- Explain prohibition of anti-competitive agreements
- State miscellaneous provisions
- Describe competition commission of India

Introduction

In the earlier unit, you came to know about the information technology Act . In this unit, you will study about the Competition Act, 2002.

The Competition Act, 2002 extends to the whole of India except the State of Jammu and Kashmir. It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint. It received the assent of the President of India on 13th January, 2003. The Preamble to the Act reads that it is an Act to provide, keeping in view of the economic development of the country, (i) for the establishment of a Commission to prevent practices having adverse effect on competition, (ii) to promote and sustain competition in markets, (iii) to protect the interests of consumers and (iv) to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.

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5.1 Definitions

Sec.2 defines various expressions used in the Act. Unless the context otherwise requires, these expressions are defined as below.

Acquisition: It means, directly or indirectly, acquiring or agreeing to acquire – (1) Shares, voting rights or assets of any enterprise; or (2) Control over management or control over assets of any enterprise.

Agreement: It includes any arrangement or understanding or action in concert – (1) Whether or not, such arrangement, understanding or action is formal or in writing; or (2) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

Cartel: It includes an association of producers, sellers, distributors, traders or service providers who, by arrangement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or trade in goods or provision of services.

Chairperson: It means the Chairperson of the Commission appointed under Sec.8(1).

Commission: It means the Competition Commission of India established under Sec.7(1).

Director General: It means the Director General appointed under Sec.16 (1) and includes any Additional, Joint, Deputy or Assistant Director General appointed under that section.

Enterprise: It means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the (i) production, storage, supply, distribution, acquisition or control of articles of goods, or (ii) the provision of services, of any kind, or (iii) in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries. Further such unit or division or subsidiary may be located at the same place where the enterprise is located or at a different place or at different places.

Member: It means a Member of the Commission appointed under Sec.8 and includes the Chairperson.

Practice: It includes any practice relating to the carrying on of any trade by a person or an enterprise.

Public Financial Institution: It means a public financial institution specified under Sec.4A of the Companies Act, 1956 and includes a State Financial, Industrial or Investment Corporation.

Relevant Market: It means the market which may be determined by the Commission with reference to the relevent product market or the relevant geographic market or with reference to both the markets.

Relevant Geographic Market: It means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogeneous and can be distinguished from the conditions prevailing in the neighboring areas.

Relevant Product Market: It means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.

Shares: It means shares in the share capital of a company carrying voting rights and includes– (i) any security which entitles the holder to receive shares with voting rights; (ii) stock except where a distinction between stock and shares is expressed or implied.

Statutory Authority: It means any authority, board, corporation, council, institute, university or any other body corporate, established by or under any Central, State, or Provincial Act for the purposes of regulating production or supply of goods or provision of any services or markets therefore or any matter connected therewith or incidental thereto.

Trade: It means any trade, business, industry, profession or occupation relating to the production, supply, distribution, storage or control of goods and includes the provision of any services.

Turnover: It includes value of sale of goods or services.

5.2 Prohibition of Anti-competitive Agreements

Sec.3 provides for prohibition of entering into anti-competitive agreements. Thus no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. Any agreement entered into in contravention of this provision shall be void.

Activities having adverse effect on competition. Further, this section also specifies certain activities which shall be presumed to have an appreciable adverse effect on competition. Thus any (i) agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or (ii) practice carried on, or decision taken by any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services shall be presumed to have an appreciable adverse effect on competition of it: (a) directly or indirectly determines purchase or sale prices; (b) limits or controls production, supply, markets, technical development, investment or provision of services; (c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods and services, or number of customers in the market or any other similar way; (d) directly or indirectly results in bid rigging or collusive bidding.

Factors which cause adverse effect on competition. Sec.19 enumerates the factors which are to be kept in mind by the Commission while determining whether an agreement has an appreciable adverse effect on competition or not under s.3.

Tasks Do the following practices affect competition adversely:

1. A manufacturer of pressure cookers requires the purchasers, as a condition of such purchase, to purchase containers separators along with the pressure cookers.
2. A dealer agreed to issue new gas connections with the sale of gas stoves only.
3. A dealer selling scooters quotes its price as inclusive of the cost of the helmet and comprehensive insurance policy and gives no indication that the purchase of helmet or securing the insurance would be optional for the buyers of the scooters.
4. A bank requires a person to keep a fixed deposit while allotting him a locker.
5. A dealer compels and pressurizes the purchaser of a refrigerator to take a post-warranty service contract at the time of purchase of the fridge as a condition of such purchase.

[***Hint.*** All the cases involve anti-competition agreements].

5.3 Prohibition of abuse of Dominant Position

Sec.4 prohibits abuse of dominant position by any enterprise. There shall be an abuse of dominant position, if an enterprise: (a) directly or indirectly, imposes unfair or discriminatory (i) condition in purchase or sale of goods or service; or (ii) price in purchase or sale (including predatory price) of goods or service; or (b) limits or restricts (i) production of goods or provision of services or

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market therefore; or (ii) technical or scientific development relating to goods or services to the prejudice of consumers; or (c) indulges in practice or practices resulting in denial of market access; or (d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or (e) uses its dominant position in one relevant market to enter units, or protect, other relevant market.

The expression 'dominant position' means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market in its favour.

Task Vikas is a manufacturer of mechanical goods stipulated to his retailers that they should not sell the goods below the minimum price, nor above the maximum price nor with variation in the stipulated price. Does this amount to resale price maintenance?

5.4 Regulation of Combinations (Secs. 5 and 6)

Sec.5 deals with combination of enterprises and persons. The acquisition of one or more enterprises by one or more persons or acquiring of control or merger or amalgamation of enterprises under certain circumstances specified below shall be construed as combination. These circumstances are:

(a) ***Acquisition of control, shares, voting rights or assets:*** Any acquisition where (i) the parties to the acquisition, being the acquirer and the enterprise, whose control, shares, voting rights or assets has been acquired or are being acquired jointly have (A) either in India, the assets of the value of more than ₹ 1000 crores or turnover more than ₹ 3000 crores; or (B) in India or outside India, in aggregate, the assets of the value of more than US $ 500 m or turnover more than US $ 1500 m; or (ii) the group, to which the enterprise whose control, shares, assets or voting rights have been acquired or are being acquired, would belong after the acquisition, jointly have or would jointly have – (A) either in India, the assets or the value of more than ₹ 4000 crores or turnover more than ₹ 12000 crores; or (B) in India or outside India, in aggregate, the assets of the value of more than US $ 2 billions or turnover more than US $ 6 billions.

(b) ***Acquisition of control over production, distribution, or trading:*** Acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, if (i) the enterprise over which control has been acquired along with the enterprise over which the acquirer already has direct or indirect control jointly have – (A) either in India, the assets of the value of more than ₹ 1000 crores or turnover more than ₹ 3000 crores; or (B) in India or outside India, in aggregate, the assets of the value of more than US $ 500 millions or turnover more than US $ 1500 millions; or (ii) the group, in which enterprise whose control has been acquired, or is being acquired, would belong after the acquisition jointly have or would jointly have (A) either in India, the assets of the value of more than ₹ 4000 crores or turnover more than ₹ 12000 crores; or (B) in India or outside India, in aggregate, the assets of the value of more than US $ 2 billions or turnover more than US $ 6 billions.

(c) ***Merger or Amalgamation:*** Any merger or amalgamation in which (i) the enterprise remaining after merger or the enterprise created as a result of the amalgamation, as the case may be, have (A) either in India, the assets of the value of more than ₹ 1000 crores or turnover more than ₹ 3000 crores; or (B) in India or outside India, in aggregate, the assets

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of the value of more than US $ 500 millions or turnover more than US $ 1500 millions or (ii) the group, to which the enterprise remaining after the merger or the enterprise created as a result of the amalgamation, would belong after the merger or the amalgamation, as the case may be, have or would have (A) either in India, the assets of the value of more than ₹ 4000 crores or turnover more than ₹ 12000 crores; or (B) in India or outside India, the assets of the value of more than US $ two billions or turnover more than six billions US $.

Sec.6, *inter alia,* provides that no person or enterprise shall enter into a combination which is likely to cause or causes an appreciable adverse effect on competition within the relevant market in India. Such a combination, if entered into, shall be void.

Exemption: Any person or enterprise, who or which proposes to enter into a combination, may, at his or its option, give notice to the commission, disclosing the details of the proposed combination, within seven days of: (a) approval of the proposal relating to merger or amalgamation referred to in Sec.5 by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be. (b) execution of any agreement or other document for acquisition or acquiring of control referred to in Sec.5.

Sec.44 provides for penalty for making false statements or omission to furnish material information by a person, being a party to a combination.

5.5 Competition Commission of India

Establishment of Commission

Sec.7 provides for the establishment of the Competition Commission of India. The Commission shall be a body corporate by the aforesaid name having perpetual succession and a common seal with power to acquire, hold and dispose of property. The place of head office of the commission shall be decided by the Central Government. However, the commission can establish offices at other places in India.

Duties of Commission

Sec.18 provides that it shall be the duty of the Commission to (i) eliminate practices having adverse effect on competition, (ii) promote and sustain competition, (iii) protect the interests of consumers and (iv) ensure freedom of trade carried on by other participants, in markets in India.

Powers and Functions of Commission

With a view to perform the duties as enumerated in Sec.18 above, the Commission is conferred with certain powers. These are:

1. Inquiring into certain agreements (Sec.19)
2. Inquiring whether an enterprise enjoys dominant position (Sec.19)
3. Inquiring into acquisition, control and combination (Sec.20)
4. Power to grant interim relief (Sec.33)
5. Power to award compensation (Sec.34)
6. Power to regulate its own procedure (Sec.36)
7. Power to review its own orders (Sec.37)

Notes

Benches of Commission

Sec.22 contains provisions relating to constitution of Benches of the Commission. It provides as follows:

1. The jurisdiction, powers and authority of the Commission may be exercised by Benches thereof.
2. The Benches shall be constituted by the Chairperson and each Bench shall consist of not less than two Members.
3. Every Bench shall consist of at least one Judicial Member.

Procedure for Deciding a Case where Members of a Bench differ in Opinion

Sec.24 provides that if the Members of a Bench differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairperson who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other Members and such point or points shall be decided according to the opinion of the majority of the Members who have heard the case, including those who first heard it.

Jurisdiction of Bench

Sec.25 provides that an enquiry shall be initiated or a complaint be instituted or a reference be made under this Act before a Bench within the local limits of whose jurisdiction – (a) the respondent, or each of the respondents, where there are more than one, at the time of the initiation of enquiry or institution of the complaint or making of reference, as the case may be, actually and voluntarily resides, or carries on business, or personally works for gain; or (b) any of the respondents, where there are more than one, at the time of the initiation of the enquiry or institution of complaint or making of reference, as the case may be, actually and voluntarily resides or carries on business or personally works for gain provided that in such case either the leave of the Bench is given, or the respondents who do not reside, or carry on business, or personally work for gain, as aforesaid, acquiesce in such institution; or (c) the cause of action, wholly or in part, arises.

5.6 Enquiry into certain Agreements and Dominant Position of Enterprise and Combinations

Enquiry into certain Agreements and Dominant Position of Enterprises

Sec.19 provides that the Commission may enquire into any alleged contravention of the provisions contained in Secs.3 or 4 either on its own motion or on (a) receipt of a complaint from any person, consumer or their association or trade association, or (b) a reference is made to it by the Central Government or a State Government or a statutory authority.

Enquiry into Combination by Commission

Sec.20 provides that the Commission may, upon its own knowledge or information relating to acquisition or acquiring of control or merger or amalgamation under Sec.5, enquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India.

Procedure for Enquiry on Complaints under Sec.19

Sec.19 provides as follows:

1. On receipt of a complaint or a reference from the Central Government or a State Government or a statutory authority or on its own knowledge or information, under Sec.19, if the Commission is of the opinion that there exists a *prima facie* case, it shall direct the Director General to cause an investigation to be made into the matter.
2. The Director General shall, on receipt of the direction submit a report on his findings within such period as may be specified by the Commission.
3. Where on receipt of a complaint under Sec.19, the Commission is of the opinion that there exists no *prima facie* case, it shall dismiss the complaint and may pass such orders as it deems fit, including imposition of costs, if necessary.
4. The Commission shall forward a copy of the report to the parties concerned or to the Central Government or the State Government or the statutory authority, as the case may be.
5. If the report of the Director General relates on a complaint and such report recommends that there is no contravention of any of the provisions of this Act, the complainant shall be given an opportunity to rebut the findings of the Director General.
6. If, after hearing the complainant, the Commission agrees with the recommendation of the Director General, it shall dismiss the complaint.
7. If, after hearing the complainant, the Commission is of the opinion that further enquiry is called for, it shall direct the complainant to proceed with the complaint.

Procedure for Investigation of Combination

Sec.29 provides as follows:

1. ***Issue of Notice:*** Where the Commission is of the opinion that a combination is likely to cause, or has caused an appreciable adverse effect on competition within the relevant market in India, it shall issue a notice to show cause to the parties to combination calling upon them to respond within thirty days of the receipt of the notice, as to why investigation in respect of such combination should not be conducted.
2. ***Commission:*** If it is *prima facie* of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall, within seven working days from the date of receipt of the response of the parties to the combination, direct the parties to the said combination to publish details of the combination within ten working days of such direction, in such manner, as it thinks appropriate, for bringing the combination to the knowledge or information of the public and persons affected or likely to be affected by such combination.
3. ***Written Objection:*** The Commission may invite any person or member of the public, affected or likely to be affected by the said combination, to file his written objections, if any, before the Commission within fifteen working days from the date on which the details of the combination were published under (2).

Task How will you decide a case where the members of a bench differ in their opinion? Suggest.

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5.7 Miscellaneous Provisions

Power to Grant Interim Relief

Sec.33 provides as follows:

1. Where during an enquiry before the Commission, it is proved to the satisfaction of the Commission, by affidavit or otherwise, that an act in contravention of Sec.3 or Sec.4 or Sec.6 has been committed and continues to be committed or that such act is about to be committed, the Commission may, by order, grant a temporary injunction restraining any party from carrying on such act until the conclusion of such enquiry or until further orders, without giving notice to the opposite party, where it deems it necessary.
2. Where during the enquiry before the Commission it is proved to the satisfaction of the Commission by affidavit or otherwise that import of any goods is likely to contravene Sec.3 or Sec.4 or Sec.6, it may, by order, grant a temporary injunction restraining any party from importing such goods until the conclusion of such enquiry or until further orders, without giving notice to the opposite party, where it deems it necessary and a copy of such order granting temporary injunction shall be sent to the concerned authorities.

Power to Award Compensation

Sec.34 provides as follows:

1. Without prejudice to any other provisions contained in this Act, any person may make an application to the Commission for an order for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered, by such person as a result of any contravention of the provisions of Sections 3 to 6 having been committed by such enterprise.
2. The Commission may, after an enquiry made into the allegations mentioned in the application made under (1), pass an order directing the enterprise to make payment to the applicant, of the amount determined by it as realizable from the enterprise as compensation for the loss or damage caused to the applicant as a result of any contravention of the provisions of Sections 3 to 6 having been committed by such enterprise.

Appearance before Commission

Sec.35 provides that a complainant or defendant or the Director General may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of his or its officers to present his or its case before the Commission.

Review of Orders of Commission

Sec.37 provides that any person aggrieved by an order of the Commission from which an appeal is allowed by this Act but no appeal has been preferred, may, within thirty days from the date of the order, apply to the Commission for review of its order and the Commission may make such order thereon as it thinks fit. However, the Commission may entertain a review application after the expiry of the said period of thirty days, if it is satisfied that the applicant was prevented by sufficient cause from preferring the application in time.

Rectification of Orders

Notes

Sec.38 provides as follows:

1. With a view to rectifying any mistake apparent from the record, the Commission may amend any order passed by it under the provisions of this Act.
2. Subject to the other provisions of this Act, the Commission may make (a) an amendment under (1) of its own motion; (b) an amendment for rectifying any such mistake which has been brought to its notice by any party to the order.

Execution of Orders of Commission

Sec.39 provides that every order passed by the Commission under this Act shall be enforced by the Commission in the same manner as if it were a decree or order made by a High Court or the principal civil court in a suit pending therein and it shall be lawful for the Commission to send, in the event of its inability to execute it, such order to the High Court or the principal civil court, as the case may be, within the local limits of whose jurisdiction,

(a) in the case of an order against a person referred to in Sec.2, the registered office or the sole or principal place of business of the person in India or where the person has also a subordinate office, that subordinate office, is situated;

(b) in the case of an order against any other person, the place, where the person concerned voluntarily resides or carries on business or personally works for gain, is situated, and thereupon the court to which the order is so sent shall execute the order as if it were a decree or order sent to it for execution.

Appeal

Sec.40 provides that any person aggrieved by any decision or order of the Commission may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Commission to him on one or more of the grounds specified in Sec.100 of the Code of Civil Procedure, 1908. However, the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Task

A manufacturer of electrical goods stipulated to his retailers that they should not sell the goods below the minimum price, nor above the maximum price nor with variation in the stipulated price. Does this amount to resale price maintenance? [***Hint.*** Yes, it does].

5.8 Finance, Accounts and Audit

Grants by Central Government

Sec.50 provides that Central Government may after due appropriation made by Parliament by law in this behalf, make to the Commission grants of such sums of money as the Government may think fit for being utilized for the purposes of this Act.

Notes

Constitution of Fund

Sec.51 provides as follows:

1. There shall be constituted a fund to be called the "Competition Fund" and there shall be credited thereto:

   (a) all Government grants received by the Commission;

   (b) the monies received as costs from parties to proceedings before the Commission;

   (c) the fees received under this Act;

   (d) the interest accrued on the amounts referred to in clauses (a) to (c).

2. The Fund shall be applied for meeting (a) the salaries and allowances payable to the Chairperson and other Members and the administrative expenses including the salaries, allowances and pension payable to the Director General, Additional, Joint, Deputy or Assistant Directors General, the Registrar and officers and other employees of the Commission; (b) the other expenses of the Commission in connection with the discharge of its functions and for the purposes of this Act.

3. The Fund shall be administered by a committee of such Members of the Commission as may be determined by the Chairperson. The committee (3) shall spend monies out of the Fund for carrying out the objects for which the Fund has been constituted.

Accounts and Audit

Sec.52 provides that the Commission shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India. The accounts of the Commission shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Commission to the Comptroller and Auditor-General of India.

The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Commission shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General of India generally has, in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Commission. The accounts of the Commission as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Task Suggest how you will rectify the orders.

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Case Study

Reliance

Reliance Industries, the largest shareholder in Reliance Energy, has voted in favour of entrusting itself with the power to appoint the majority of directors on the REL board.

Earlier these powers were vested with Mr Anil Ambani, REL Chairman and Managing Director.

According to sources, RIL was among the 97.24-per cent REL shareholders who voted in favour of the changes to its Articles of Association, a set of rules that govern day-to-day workings of a company, through a postal ballot. The result of which was announced today.

The altered Article envisages that so long as the Reliance Group of Companies holds 26 per cent or more of REL's paidup voting equity share capital, it will have the right to appoint majority of REL's directors on the board of the company.

Reliance Industries had earlier said that it had not sought in any withdrawal of powers conferred on Mr Anil Ambani. It had also said that RIL had not been consulted by REL before the proposed re-amendment of the relevant articles of association. The move to alter the articles of association was seen as part of the ongoing differences between the Ambani brothers over control of the ₹ 99,000 crores Reliance Group, of which REL is a subsidiary.

REL had, by way of a special resolution, asked shareholders to mail their votes through postal ballot for a change in its Articles of Association.

The company had sought permission to change Article 131 (a), 131 (a) (ii) and 131 (aa), which allowed Mr Anil Ambani the power to appoint one-third or majority of the total directors on REL's board, choose the Vice-Chairman of the company and even decide the tenure of the Chairman, Vice-Chairman and the directors appointed by him.

REL sought to vest these powers with its prime shareholder, Reliance Industries.

Question

Why does Reliance want alteration in Reliance Energy's articles? (***Hint:*** due to the conflict between the ambani brother.)

5.9 Summary

- The Competition Act, 2002 extends to the whole of India except the State of Jammu and Kashmir.
- It shall come into force on such as the Central Government may, by notification in the Official Gazette, appoint. India has responded to globalization by opening up its economy, removing controls and resorting to liberalization.
- For this it is necessary that the Indian market should prepare itself competition from within the country and outside.
- The Monopolistic and Restrictive Trade Practice Act, 1969 became obsolete in certain respects in the light of international economic developments relating more particularly to competition laws.
- The Objective of the act is to prevent adverse effect on competition, to promote and sustain competition, to protect interest of c consumers, to ensure freedom of trade carried on by other participants in Indian market, incidental and connected matters.

Notes

- The act prohibits anti-competitive agreements, abuse of dominant position and regulates combination. Competition Commission of India may inquire into alleged contravention on the receipt of information from person/consumer/trade/association with fees or any reference by Central/State Government or Statutory body.
- An appeal can be made to Competition Appellate Tribunal (CAT) within 60 days of CCI orders, thereafter to Supreme Court within 60 days of CAT order.
- Sec.40 provides that any person aggrieved by any decision or order of the Commission may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Commission to him on one or more of the grounds specified in Sec.100 of the Code of Civil Procedure, 1908.
- The accounts of the Commission as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

5.10 Keywords

Acquisition: A corporate action in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm.

Agreement: It includes any arrangement or understanding or action in concert, whether or not, such arrangement, understanding or action is formal or in writing.

Cartel: It includes an association of producers, sellers, distributors, traders or service.

CAT: Competition Appellate Tribunal

Merger: The combining of two or more entities into one, through a purchase acquisition or a pooling of interests.

Shares: Shares are the best investment available over a long period of time. The growth of share prices comfortably out-paces inflation most years because the best share prices represent the growth in earnings of the best companies. Although the stock market is seen as "high risk" this depends very much on timing and the sort of shares you invest in.

Turnover: Turnover often refers to inventory or accounts receivable

5.11 Self Assessment

Choose the appropriate answer:

1. CCI stands for:

   (a) Consumer Commission of India (b) Competition Commission of India

   (c) Competition Collaboration of India (d) Computer Competition of India

2. Director General appointed under.

   (a) Sec.8(1) (b) Sec.16(2)

   (c) Sec.8(2) (d) Sec.16(1)

3. Value of sales of goods or service includes in

   (a) Product (b) Service

   (c) Turnover (d) Profit

4. Any agreement between enterprises or persons referred

   (a) Bid-rigging (b) Bid-singing

   (c) Bid-locking (d) None

5. Design registered under the

   (a) Design Act, 2003 (b) Design Act, 2001

   (c) Design Act, 2000 (d) Design Act, 2002

6. A market comprising the area in which the conditions of competition for supply of goods known as:

   (a) Relevant Product Market (b) Relevant Geographic Market

   (c) Relevant Market (d) None

7. Commission shall maintain proper accounts and other relevant records and prepare an annual statement of accounts under section.

   (a) 51 (b) 53

   (c) 54 (d) 52

8. CCI established under

   (a) Sec.7 (b) Sec.9

   (c) Sec.8 (d) Sec.6

9. All of the following are the power and functions of commission EXCEPT?

   (a) Power to award compensation (b) Power to review its own orders

   (c) Inquiring into certain agreements (d) Power to reject the orders

10. Prohibition of entering into anti-competitive agreement comes under

    (a) Sec.2 (b) Sec.6(2)

    (c) Sec.2 (1) (d) Sec.3

5.12 Review Questions

1. Describe the provisions as regards prohibition of anti-competitive agreements.
2. What are the circumstances under which combination is construed?
3. Explain the provisions relating to regulation of combinations.
4. Is there any restrictions and other terms and conditions of service of Chairperson and other members?
5. Describe the provisions as regards 'Benches of Commission' and 'Distribution of business of Commission amongst Benches'.
6. Explain the power if the Competition Commission to enquires into anti-competitive agreements and dominant position of enterprises.
7. Under what situations, the Central Government can order division of enterprise enjoying dominant position?
8. Describe the provisions as regards duties of the Director General to investigate contravention of the provision of the Act.

Notes

9. What are the consequences for a person who contravenes the orders of the Commission?
10. Enumerate the factors which the Commission has to keep in mind while determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market.

Answers: Self Assessment

1.	(b)	2.	(d)
3.	(c)	4.	(a)
5.	(c)	6.	(b)
7.	(d)	8.	(a)
9.	(d)	10.	(d)

5.13 Further Readings

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, 2007.

S.S Gulshan, *Business Law,* Third Edition, Excel Books, New Delhi, 2006.

S.S Gulshan, *Mercantile Law,* Third Edition, Excel Books, New Delhi, 2006.

Online links

http://www.competition-commission-india.nic.in/faq.htm

http://www.legalserviceindia.com/article/l131-Competition-Act.html

http://theviewspaper.net/the-competition-act-and-its-relevance/

Unit 6: Law of Negotiable Instruments

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Objectives

After studying this unit, you will be able to:

- Discuss meaning of negotiable instrument
- Describe promissory notes and features of promissory note
- Explain law relating to paying and collector banker
- Define bill of exchange

Introduction

In the earlier unit, you came to know about the law of sales of goods. In this unit, you will study about the law of negotiable instruments.

In this unit, you will study law relating to negotiable instruments is primarily contained in the Negotiable Instruments Act, 1881, which came into force on 1st March, 1882. Bills of exchange, cheques and promissory notes have been dealt with in considerable detail in this Act.

Notes

The term 'instrument' means 'any written document by which a right is created in favour of some person'. The word 'negotiable' has a technical meaning whereby rights in an instrument can be transferred by one person to another.

6.1 Negotiable Instrument

An 'Instrument' as referred to in the Act is a legally recognised written document, whereby rights are created in favour of one and obligations are created on the part of another. The word 'negotiable' means transferable from one person to another either by mere delivery or by endorsement and delivery, to enable the transferee to get a title in the instrument. An instrument may possess the characteristics of negotiability either by statute or by usage. Promissory note, bill of exchange and cheque are negotiable instruments by statute as they are so recognised by Sec.13. There are certain instruments which are recognised as negotiable instruments by usage. Thus, bank notes, bank drafts, share warrants, bearer debentures, dividend warrants, scripts and treasury bills are negotiable by usage. An instrument is called 'negotiable' if it possesses the following features:

1. ***Freely transferable.*** Transferability may be by (a) delivery, or (b) by endorsement and delivery.
2. ***Holder's title free from defects.*** The term 'negotiability' means that not only is the instrument transferable by endorsement and/or delivery, but that its holder in due course acquires a good title notwithstanding any defects in a previous holder's title. A holder in due course is one who receives the instrument for value and without any notice as to the defect in the title of the transferor.
3. ***The holder can sue in his own name.*** Another feature of a negotiable instrument is that its holder in due course can sue on the instrument in his own name.
4. A negotiable instrument can be transferred infinitum, i.e., can be transferred any number of times, till its maturity.
5. ***A negotiable instrument is subject to certain presumptions.*** An instrument, which does not have these characteristics, is not negotiable, but is assignable, i.e., the transferee takes it subject to all equities and liabilities of the transferor.

6.2 Important Terms and Essential of Negotiable Instrument

Ambiguous Instrument (Sec.17)

An ambiguous instrument is one which may be construed either as a promissory note or as a bill of exchange. Regarding such instruments, Sec.17 provides that the holder may, at this election treat it as either and the instrument shall be thenceforward treated accordingly. Thus, a bill of exchange drawn by a person upon himself may be construed as a promissory note.

Inchoate Stamped Instruments (Sec.20)

An inchoate instrument means an instrument that is incomplete in certain respects. Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein but not exceeding the amount covered by the stamp.

Notes

Capacity of Parties to the Negotiable Instrument

The capacity of a party to draw, accept, make or endorse a negotiable instrument is coextensive with his capacity to enter into contract. Thus, Sec.11 of the Indian Contract Act, 1872, if negatively interpreted prohibits minors, persons of unsound mind and persons forbidden under any other Act like insolvency to make a valid contract.

Essential Elements of a Negotiable Instrument

After discussing the characteristics of different negotiable instruments, it is with profit that we can sum up the essential elements of a negotiable instrument. These are as follows:

1. It must be in writing, which includes, typing, computer print out or engraving.
2. The instrument must be signed by the person who is the maker (in the case of a promissory note) or a drawer (as in the case of a bill of exchange or a cheque).
3. There must be an unconditional promise (as in the case of a promissory note) or order (as in the case of a bill of exchange or cheque) to pay.
4. The instrument must involve payment of a certain sum of money only and nothing else.
5. The instrument must be payable at a time which is certain to arrive. If it is payable 'when convenient' the instrument is not a negotiable one. However, if the time of payment is linked to the death of a person, it is nevertheless a negotiable instrument as death is certain, though the time thereof is not.
6. In case of a bill or cheque, the Drawee must be named or described with reasonable certainty.
7. The instrument must be such or in such a state that it can be transferred like cash by mere delivery (as in the case of a bearer instrument) or by delivery and endorsement (as in the case of an order instrument).

6.3 Promissory Notes and Bills of Exchange

6.3.1 Promissory Note

A promissory note is an instrument in writing (not being a bank or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person or to the bearer of the instrument (Sec.4). The following are two illustrations of promissory notes.

Example: "We have received a sum of ₹ 9,000 from Shri R.R. Sharma. This amount will be repaid on demand. We have received this amount in cash." This is a promissory note.

Where A signs instruments in the following terms:

(i) "I promise to pay B or order ₹ 500."

(ii) "I acknowledge myself to be indebted to B in ₹ 1000, to be paid on demand, for value received."

But, the following are NOT promissory notes:

(i) "Mr B, I.O.U. (I owe you) ₹ 1000."

(ii) "I am liable to pay you ₹ 500".

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(iii) "I promise to pay B ₹ 500 and all other sums which shall be due to him."

(iv) "I promise to pay B ₹ 500, first deducting thereout any money which he may owe me."

(v) "I promise to pay B ₹ 1500 on D's death, provided he leaves me enough to pay that sum."

(vi) "I promise to pay B ₹ 500 seven days after my marriage with C."

(vii) "I promise to pay B ₹ 500 and to deliver to him my white Maruti Car 1 January next."

Example: A promises to pay B ₹ 500 provided C leaves sufficient money in favour of A after C's death. It is not a promissory note.

Note **Specimen of a Promissory Note**

₹ 10,000 New Delhi – 1100 01

Jan. 10, 2006

On demand [or six months after date] I promise to pay X or order the sum of rupees ten thousand with interest at 12 per cent per annum only for value received.

To X Sd/-A

Address……………. Stamp

Parties to a Promissory Note

1. ***The maker*** – the person who makes the note promising to pay the amount stated therein.
2. ***The payee*** – the person to whom the amount of the note is payable.
3. ***The holder*** – is either the original payee or any other person in whose favour the note has been endorsed.
4. ***The endorser*** – the person who endorses the note in favour of another person.
5. ***The endorsee*** – the person in whose favour the note is negotiated by indorsement.

Task Are the following instruments duly signed by A promissory notes? (i) "I am liable to X to a sum of ₹ 1000 which is to the paid in instalments for rent" (ii) "I acknowledge myself to be indebted to X by ₹ 500 to be paid on demand for value received". (iii) "I promise to pay ₹ 5000 and give a Maruti Car to P." [***Hint:*** (i) It is only an admission of liability and does not involve any promise to constitute a promissory note (s.4). (ii) It is a promissory note. (iii) A promissory note must contain a promise to pay a certain sum of money only. Therefore, it is not a promissory note.]

6.3.2 Bill of Exchange

A 'bill of exchange' is defined by Sec.5 as 'an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person, or to the bearer of the instrument'.

Notes

Note **Specimen of a Bill of Exchange**

₹ 10, 000 New Delhi – 110 016

Jan. 13, 2006

Six months after date pay to A or order/bearer the sum of ten thousand rupees only for value received.

To X Sd/-Y

Address ………… Stamp

…………

Here Y is the drawer, A is the payee and X is the drawee. X will express his willingness to pay 'accepting' the bill by writing words somewhat as below across the face of the bill:

ACCEPTED

Sd-X Jan. 16, 2006.

The specimen given above is of a usance bill, payable after a specified period of time. A bill of exchange may be drawn payable 'at sight', i.e., on demand or payable 'after certain time after sight' also.

Note There are only two parties – the maker (debtor) and the payee (creditor) in promissory note, and there are three parties – the drawer, the drawee and the payee although drawer and payee may be the same person in bill of exchange

Parties to a Bill of Exchange

The parties of bill of exchange are:

1. ***Drawer:*** The person to whom the amount of the bill is payable.
2. ***Drawee:*** The person on whom the bill is drawn. Thus, drawee is the person responsible for acceptance and payment of the bill. In certain cases however a stranger may accept the bill on behalf of the drawee.
3. ***Payee:*** The person to whom amount of the bill is payable. It may be the drawer himself or any other person.
4. ***Holder:*** It is the original payee but where the bill has been endorsed, the endorsee. In case of a bearer bill, the bearer or possessor is the holder.
5. ***Endorser:*** It is the person who endorses a bill.
6. ***Endorsee:*** It is the person to whom the bill is negotiated by endorsement.
7. Drawee in case of need.
8. Acceptor for honour.

Notes

6.3.3 Distinction between a Promissory Note and a Bill of Exchange

	Promissory Note	Bill of Exchange
1.	There are only two parties – the maker (debtor) and the payee (creditor).	There are three parties – the drawer, the drawee and the payee although drawer and payee may be the same person.
2.	A note contains an unconditional promise by the maker to pay the payee.	It contains an unconditional order to the drawee to pay according to the drawer's directions.
3.	No prior acceptance is needed.	A bill payable 'after sight' must be accepted by the drawee or his agent before it is presented for payment.
4.	The liability of the maker or drawer is primary and absolute.	The liability of the drawer is secondary and conditional upon non-payment by the drawee.
5.	No notice of dishonour need be given.	Notice of dishonour must be given by the holder to the drawer and the intermediate endorsers to hold them liable thereon.
6.	The maker of the note stands in immediate relation with the payee.	The maker or drawer does not stand in immediate relation with the acceptor or drawee.

Task

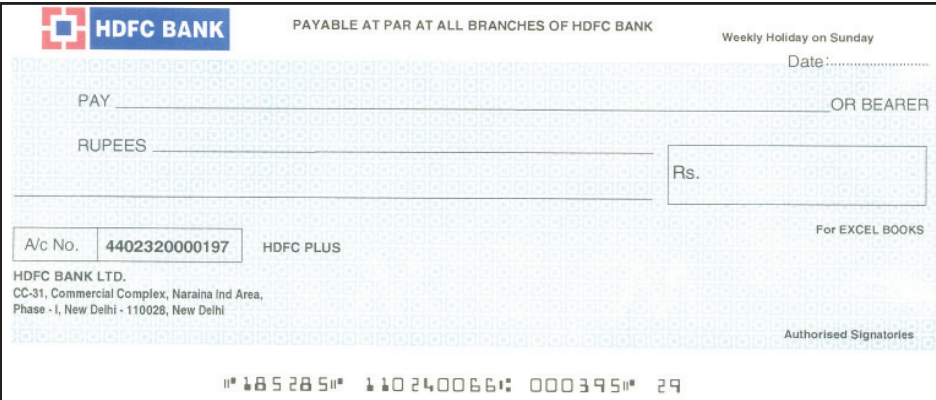
D draws a bill of exchange on A, payable to P. Who is liable to P (i) until acceptance is made by A; (ii) if A does not accepts the bill of exchange; (iii) A accepts the bill of exchange? [***Hint:*** (i) and (ii) D is liable to P. (iii) A is liable to P.]

6.4 Cheques

A cheque is the usual method of withdrawing money from a current account with a banker. Savings bank accounts are also permitted to be operated by cheques provided certain minimum balance is maintained. A cheque, in essence, is an order by the customer of the bank directing his banker to pay on demand, the specified amount, to or to the order of the person named therein or to the bearer. Sec.6 defines a cheque. The Amendment Act, 2002 has substituted new section for Sec.6. It provides that a 'cheque' is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic from.

'A cheque in the electronic form' means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature and asymmetric crypto system.

6.4.1 Specimen of a Cheque



Every bank has its own printed cheque forms which are supplied to the account holders at the time of opening the account as well as subsequently whenever needed. These forms are printed on special security paper which is sensitive to chemicals and makes any chemical alterations noticeable. Although, legally, a customer may withdraw his money even by writing his directions to the banker on a plain paper but in practice bankers honour only those orders which are issued on the printed forms of cheques.

6.4.2 Requisites of a Cheque

The requisites of cheques are:

1. ***Written instrument.*** A cheque must be an instrument in writing. Regarding the writing materials to be used, law does not lay down any restrictions and therefore cheque may be written either with (a) pen (b) typewriter or may be (c) printed.

2. ***Unconditional order.*** A cheque must contain an unconditional order. It is, however, not necessary that the word order or its equivalent must be used to make the document a cheque. Generally, the order to bank is expressed by the word "pay". If the word "please" precedes "pay" the document will not be regarded as invalid merely on this account.

3. ***On a specified banker only.*** A cheque must be drawn on a specified banker. To avoid any mistake, the name and address of the banker should be specified.

4. ***A certain sum of money.*** The order must be only for the payment of money and that too must be specified. Thus, orders asking the banker to deliver securities or certain other things cannot be regarded as cheques. Similarly, an order asking the banker to pay a specified amount with interest, the rate of interest not specified, is not a cheque as the sum payable is not certain.

5. ***Payee to be certain.*** A cheque to be valid must be payable to a certain person. 'Person' should not be understood in a limited sense including only human beings. The term in fact includes 'legal persons' also. Thus, instruments drawn in favour of a body corporate, local authorities, clubs, institutions, etc., are valid instruments being payable to legal persons.

6. ***Payable on demand.*** A cheque to be valid must be payable on demand and not otherwise. Use of the words 'on demand' or their equivalent is not necessary. When the drawer asks the banker to pay and does not specify the time for its payment, the instrument is payable on demand (Sec.19).

7. ***Dating of cheques.*** The drawer of a cheque is expected to date it before it leaves his hands. A cheque without a date is considered incomplete and is returned unpaid by the banks.

Notes

The drawer can date a cheque with the date earlier or later than the date on which it is drawn. A cheque bearing an earlier date is antedated and the one bearing the later date is called post-dated. A post-dated cheque cannot be honoured, except at the personal risk of the bank's manager, till the date mentioned. A post-dated cheque is as much negotiable as a cheque for which payment is due, i.e., the transferee of a post-dated cheque, like that of the cheque on which payment is due, acquires a better title than its transferor, if he is a holder in due course. A cheque that bears a date earlier than six months is a stale cheque and cannot be claimed for.

Task Analyze the parties involved in bill of exchange.

6.5 Holder and Holder in due Course

According to Sec.8, a holder of negotiable instruments is "a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

A 'holder in due course', on the other hand, is "a person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title (Sec.9). Thus, where a person receives a negotiable instrument without consideration, he may be a holder but will not be called a holder in due course. Besides, the title of holder of a negotiable instrument is always subject to the title of its transferor whereas a holder in due course acquires a better title than that of its transferor. So where a lost negotiable instrument is transferred to a person who takes it, say, without consideration and thus becomes the holder, he will not be entitled to enforce his claim against its real owner. But, if he is a holder in due course as per Sec.9, he will be able to establish his claim even against the real owner of that instrument.

Privileges of a Holder in due Course

A holder in due course is given certain additional privileges under the Act, which are not available to a holder.

1. ***Privilege against inchoate stamped instruments.*** According to Sec.20, a person, who signed and delivered to another a stamped but otherwise inchoate (incomplete) instrument, is stopped from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him provided the amount filled is covered by the stamp affixed.

2. As per Sec.3, every prior party to a negotiable instrument, i.e., the maker or drawer, the acceptor and all the intermediate endorsers continue to remain liable to the holder in due course until the instrument is duly satisfied.

3. ***Fictitious drawer or payee.*** Where a bill of exchange is drawn by a fictitious person and is payable to his order, the acceptor cannot be relieved from his liability to the holder in due course. The holder in due course shall, however, have to prove that the instrument was endorsed by the same hand as drawer's signature (Sec.42).

4. When a negotiable instrument is made, drawn accepted or transferred without consideration and the negotiable instrument gets into the hands of a holder in due course, then the plea of absence of consideration cannot be raised against him or against any subsequent holder deriving title from him (Sec.43).
5. Where an instrument is negotiated to a holder in due course, the parties to the instrument cannot escape liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sec.46).
6. ***Right of an endorsee from a holder in due course.*** Not only that the title of the holder in due course is not subject to the defect in previous holder's title but once that instrument passes through the hands of a holder in due course, it is purged of all defects. Any person acquiring it takes it free of all defects, unless he was himself a party to the fraud (Sec.53).

6.6 Negotiation of a Negotiable Instrument

Meaning of Negotiation

The transfer of an instrument by one party to another so as to constitute the transferee a holder thereof is called 'negotiation'.

Negotiation and Assignment

Both the assignment and negotiation involve the transfer of the right to receive the payment of debt. However, the rights, which the transferee of an instrument by negotiation acquires are substantially superior to those of an assignee. When an instrument is negotiated, its transferee gets good title irrespective of the defective title, if any, of the transferor.

Example: A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.

Endorsement

An endorsement is the mode of negotiating a negotiable instrument. A negotiable instrument payable otherwise than to bearer can be negotiated only by indorsement and delivery. An endorsement according to Sec.15, is "when the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same and is called the endorser". The person to whom the instrument is endorsed is called the endorsee. Usually the endorsement is on the back of the instrument; though it may be even on the face of it. Where no space is left on the instrument, the endorsement may be made on a slip of paper attached to it. This attached slip of paper is called 'Allonge'.

Example: A cheque is payable to 'X or order', and 'X' merely signs on the back of it. This will constitute endorsement in blank. Where an endorsement in blank is subsequently followed by an endorsement in full, the endorser in full will be liable to his immediate endorsee and parties deriving title from him, but not to others (s.55).

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Example: A cheque is endorsed in blank by 'X'. Y, the holder of the cheque, may convert this 'blank endorsement' into 'endorsement in full' by say, adding the words 'Pay Z or order', above 'X's signature. Y, in this case cannot be held liable on the cheque, if it is dishonored.

Forged Endorsement (Sec.85)

In case an instrument is endorsed in full, it cannot be endorsed or negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable. Thus, if such an instrument is negotiated by way of a forged endorsement, the endorsee will acquire no title even though he be a purchaser for value and in good faith, because the endorsement is nullity. But where the instrument has been endorsed in blank, it can be negotiated by mere delivery and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to the instrument.

Example: A bill is endorsed, "pay to X or order". X endorses it in blank and it comes into the hands of Y, who simply delivers it to A. A forges Y's endorsement and transfers it to B. B, as the holder, does not derive his title through the forged endorsement to Y, but through the genuine endorsement of X and can claim payment from any of the parties to the instrument in spite of the intervening forged endorsement.

6.7 Presentment

Presentment of a negotiable instrument is made for two purposes: (i) for acceptance and (ii) for payment.

Before discussing the presentment for payment, it is necessary to refer to the maturity of the instrument.

Maturity (Secs.21-25)

Cheques are always payable on demand but other instruments like bills, notes, etc., may be made payable on a specified date or after the specified period of time. The date on which payment of an instrument falls due is called maturity (Sec.22). Therefore most of the provisions relating to presentment for payment are linked with the maturity of the instrument. Sec.21 provides that a note or bill 'at sight' or 'on presentment' is payable on demand. It is due for payment as soon as it is issued. Therefore the question of maturity arises only in the case of a note or bill payable 'After sight' or 'After date' or at a certain period after the happening of an event which is certain to happen.

Presentment for Payment

A negotiable instrument must be presented for payment to the maker, acceptor or drawee thereof, as the case may be, by the holder or his agent. In case of default, the parties to the instrument other than the maker, acceptor or drawee are not liable to such holder (Sec.64). The presentment for payment must be made during the usual hours of business, and at a banker's premises, during banking hours (Sec.65).

Task Discuss the various effects of endorsement.

6.8 Dishonour

Notes

Dishonour of a Bill

A bill of exchange may be dishonoured either by non-acceptance or by non-payment. A negotiable instrument is said be dishonoured by non-payment when the maker, acceptor or drawee, as the case may be, makes default in payment upon being duly required to pay the same (Sec.92). The effect of dishonour of a negotiable instrument whether by non-acceptance or non-payment is to render the drawer and all the endorsers liable to the holder. However, their liability can be invoked only if the holder gives them notice of such dishonour. The drawer is liable only if the instrument is dishonoured by non-payment.

When a negotiable instrument is dishonoured by non-acceptance or non-payment, the holder must give notice of dishonour to the drawer and all other parties whom he seeks to make liable.

Task

D draws a bill of exchange on A, payable to P. P transfers it to X, X to Y and Y to Z. The bill is dishonoured. Who has to give notice of dishonour to whom? Who may transmit the notice to the other parties? [***Hint:*** On dishonour, Z may give notice to Y; and Y may transmit the notice to the other parties (s.95).]

Noting

Noting is a convenient method of authenticating the fact of dishonour. Where an instrument is dishonoured, the holder, besides giving the notice as referred to above, should get the bill or promissory note 'noted' by the notary public. The notary public presents the instrument, notes down in his register the date of its dishonour and the reason, if any, given by the acceptor. If the instrument has been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary's charges should be mentioned. 'Noting' must be made within a reasonable time after dishonour. The holder may cause such dishonour to be noted by the notary public upon the instrument or upon a paper attached thereto or partly upon each (Sec.99). Every notary is required to have and use a seal, and an act can only be deemed a notarial act if it is done by a notary under his signature and official seal.

Protesting (Sec.100)

The protest is the formal notarial certificate attesting the dishonour of the bill and based upon the noting. After the noting has been made, the formal protest may be drawn up by the notary at his leisure. When the protest is drawn up it relates back to the date of noting.

Task

D draws a cheque for ₹ 5,000 though he had a credit balance of ₹ 1,000 only. No notice of dishonour is given to *D*. Can he avoid liability on the cheque? [***Hint:*** *D* cannot avoid liability on the cheque. (s.98).]

6.9 Crossing of Cheques

Meaning of Crossing

Crossing is a unique feature associated with a cheque affecting to a certain extent the obligation of the paying banker and also its negotiable character. It is a peculiar method of modifying the

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instrument to the banker for payment of the cheque. Crossing on cheque is a direction to the paying banker by the drawer that payment should not be made across the counter. The payment on a crossed cheque can be collected only through a banker. Sec.123 defines crossing as, "Where a cheque bears across its face an addition of the words 'and company' or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words, 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally." A cheque that is not crossed is a called an open cheque.

Significance of Crossing

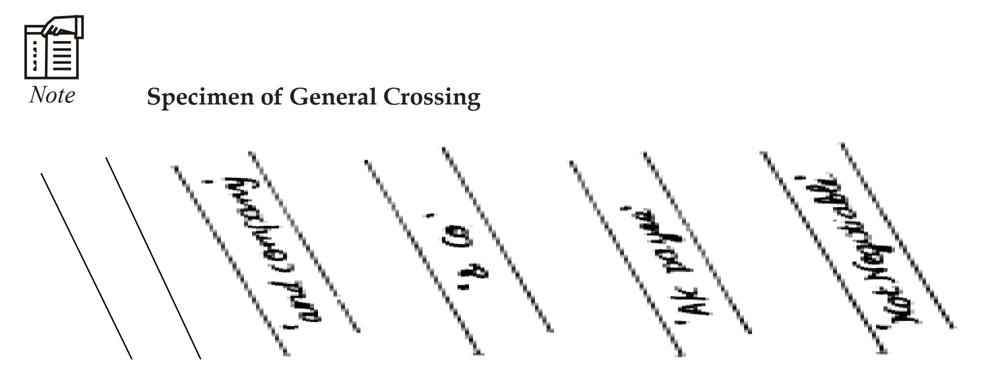
As payment cannot be claimed across the counter on a crossed cheque, crossing of cheques serves as a measure of safety against theft or loss of cheques in transit. By crossing a cheque, a person, who is not entitled to receive its payment, is prevented from getting the cheque encashed at the counter of the paying banker.

Types of Crossing

Crossing may be either (1) General or (2) Special. The term general crossing implies the addition of two parallel transverse lines.

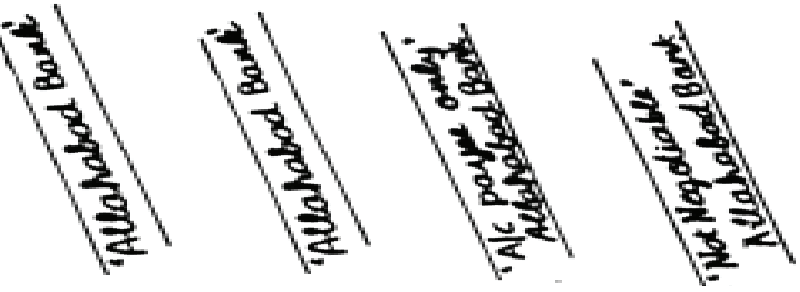
Note

Specimen of General Crossing



'Special Crossing' implies the specification of the name of the banker on the face of the cheque. Sec.124 in this regard reads: "Where a cheque bears across its face, an addition of the name of banker, either with or without the words 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be paid to that banker". The drawing of two parallel lines is not necessary in case of a specially crossed cheque. The object of special crossing is to direct the drawee banker to pay the cheque only if it is presented through the particular bank mentioned therein. Thus, it makes the cheques more safer.

Specimen of Special Crossing



Task P gives a cheque to L on 2 April and L goes to the bank on 25 June. By that time the bank had gone into liquidation. L demands payment of the cheque from P. Would he succeed? [***Hint:*** L would not succeed. There has been an unreasonable delay in the presentment of the cheque. L can participate in the insolvency of the bank as an unsecured creditor.]

6.10 Paying Banker

The 'paying banker' is a term used to denote the position and duties of the drawee-banks in paying the cheques of their customers. Thus, 'paying banker' is a banker upon whom a cheque is drawn.

Payment in due Course

What is a payment in due course is defined in Sec.10 and has been given above. The following conditions must be satisfied before a payment of a negotiable instrument can be called as a payment in due course:

1. Payment must be in accordance with the apparent tenor of the instrument. It is necessary that a payment to constitute a payment in due course should be made at or after maturity. A payment before maturity is not a payment in due course.

Example: Payment of a post dated cheque is not a payment in due course.

2. Payment must be made in good faith and without negligence. When there exists suspicious circumstances and the paying banker fails to make any enquiry as to them, the payment is not in due course. So payment is not in due course, where a banker makes payment on a cheque materially altered, without exercising due care.

3. Payment must be made to the person in possession of the instrument. A payment is not a payment in due course if it is made to a person entitled to receive it. A thief is not said to be in possession of the instrument.

4. Payment must be made under circumstances which do not afford a reasonable ground for believing that a person is not entitled to receive payment of the amount mentioned therein. So, where a peon of a company presents a cheque for a big amount on behalf of the company, which is contrary to the past experience, the banker should conduct proper enquiry before making payment on such a cheque.

5. Payment must be made in money only. Payment must be made in money only unless the payee agrees to accept payment in some other form (e.g., bill of exchange or promissory note). Money includes bank notes or currency notes but excludes cheque, bills of exchange, promissory notes and goods.

Thus, under Sec.10, payment in due course means payment in accordance with the apparent tenor of the instrument made in good faith and without negligence.

Task Consider the validity of the following documents as a promissory note: "I promise to pay P or bearer a sum of ₹ 5000 less charges involved in documentation of accounts' signed M.

Notes

Limouzines India Ltd.

Deepak is a client of City Limouzines India Ltd. He received a cheque of amount ₹ 6000 dated as 2nd Sept. 2009 from City Limouzines India Ltd, & deposited same cheque on 7th Sept. 2009 in his Bank, which has been bounced with narration "Insufficient Balance".

He called on City Limouzines India Ltd help line for same, but didn't get any satisfactory response from help line, He called on "Toll Free/24X7 Helpline: 23814792" at 2:16 PM on dated 12th Sept. 2009 a lady picked the call and she didn't show any interest to resolve his query/concern, she hanged the phone with stating that "We will dispatch a letter after 20th Sep then check."

Deepak states that, as per his knowledge and as per company websites "City Limouzines" India Ltd. and ISO approved company. But I am unable to understand that how a cheque of amount ₹ 6000 get bounced with narration "Insufficient Balance"? I sent mail regarding same on given e mail ID "info@citylimouzines.com" but till date I am not getting any revert from company.

It is very serious case; if company is going to Fraud then it will impact all investors. Thinking this, he lodges a complaint the consumer court requesting them to take legal action against City Limouzines India Ltd.

Questions

1. Analyse the legal actions which should be taken by the Consumer court for the protection of Investors.
2. What penalties should be forced on the company?
3. Every now & then, there are cases of cheque bouncing & dishonour. What precautions & remedies would you suggest for the investors to get them protection from such fraud companies?

6.11 Summary

- The Negotiable Instrument Act, 1881 came into force on 1st March 1881. It extends to the whole of India except the State of Jammu & Kashmir.
- The term Negotiable Instrument consists of two parts viz.; Negotiable and Instrument.
- The word 'negotiable' means transferable by delivery and the word 'instrument ' mean written documents by which a right is created in favour of some person.
- It means an instrument possessing the quality of Negotiability is entitled to be called negotiable instrument.
- As per the instructions issued by the Reserve Bank of India (9-9-1992) it would be safer for the drawer to cross a cheque "not negotiable" with the words "account payee" added to it.
- The courts of law have held that "an account payee" crossing is a direction to the collecting banker as to how the proceeds are to be applied after receipt.
- The banker can disregard the direction only at his own risk and responsibility.

6.12 Keywords

Bill of Exchange: A bill of exchange is an instrument in writing containing an unconditional to the order of a certain person or to the bearer of the instrument.

Cheque: A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable.

Endorser: The person who endorses the note in favour of another person.

Endorsee: The person in whose favour the note is negotiated by endorsement

Holder: It is either the original payee or any other person in whose favour the note has been endorsed.

Negotiable Instrument: Means a promissory note, bill of exchange or cheque payable either to order or to bearer.

Payee: The person to whom the amount of the note is payable.

Promissory Note: A promissory note is an instrument in writing containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

Time bills: Also called as usance bills, are bills payable at a fixed period after date or sight of the bills.

6.13 Self Assessment

State whether the following statements are true or false:

1. A negotiable instrument need not be in writing.
2. Signature of the maker is not required in the case of a promissory note.
3. Bills in set are used in foreign trade transactions.
4. It is not necessary to put any date in the case of promissory notes payable on demand.
5. A cheque must always be crossed to make it a valid instrument.
6. One can get a post-dated cheque encashed across the bank counter at any time.
7. The life of a cheque is three months from the date of issue.
8. All types of bills are entitled for three days of grace.
9. A post dated cheque is valid and negotiable
10. Maturity date is not required to be determined in the case of cheques.

Fill in the blanks:

11. .... is one who receives the instrument for value and without any notice as to the defect in the title of the transferor.
12. An .... is one which may be construed either as a promissory note or as a bill of exchange.
13. An inchoate instrument means an instrument that is .... in certain respects.
14. A .... is “a person who for consideration became the possessor of a promissory note, bill of exchange or cheque.

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15. An …………… is the mode of negotiating a negotiable instrument
16. A negotiable instrument is said be ……………… by non-payment.
17. The ……………… is the formal notarial certificate attesting the dishonour of the bill and based upon the noting.
18. A cheque having the cross mark such as 'X' is not generally regarded as a …………….
19. …………… is a banker upon whom a cheque is drawn.

6.14 Review Questions

1. What do you mean by negotiable instruments?
2. Name the instruments which are recognized as negotiable instruments by the Negotiable Instruments Act, 1881.
3. What is a bill of exchange? Describe its characteristics. How does a promissory note differ from a bill of exchange?
4. "A cheque is a bill of exchange drawn on a banker". Comment
5. Define the term 'holder', 'holder for value' and 'holder in due course'.
6. What do you mean by negotiation? How it differs from assignment?
7. Explain the provisions relating to 'Noting' and 'Protesting' of a bill which has been dishonoured by the acceptor.
8. Describe briefly the meaning of 'general' and 'special' crossing and "crossing after the issue of a cheque".
9. "Issue of a cheque that bounces is an offence". Comment.
10. What are the provisions of the Negotiable Instruments Act, 1881, regard international law concerning negotiable instruments?

Answers: Self Assessment

1. False
2. False
3. True
4. True
5. False
6. False
7. False
8. False
9. True
10. False
11. A holder in due course
12. ambiguous instrument
13. incomplete
14. holder in due course
15. endorsement
16. dishonoured
17. protest
18. paying banker
19. Crossed cheque

6.15 Further Readings

Notes

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, India, 2007

S.S Gulshan, *Business Law,* Third Edition, Excel Books, New Delhi, 2006

S.S Gulshan, *Mercantile Law,* Third Edition, Excel Books, New Delhi, 2006

Online links

http://www.ebcwebstore.com/product_info.php?products_id=726

http://www.legalindia.in/the-negotiable-instruments-act-1881-2

http://www.law.cornell.edu/ucc/3/overview.html

http://www.sudhirlaw.com/Business4.html

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Unit 7: Companies Act, 1956

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Objectives

After studying this unit, you will be able to:

- Discuss meaning of Companies Act, 1956
- Explain kinds of companies

Introduction

In the earlier unit, you came to know about the Foreign Exchange Management Act and Negotiable Instruments Act. In this unit, you will study about the Companies Act, 1956.

Indian company law was originally founded in the 18th century, based on the English Company Law. It was only in the later half of the 19th century that a Committee under the Chairmanship of H C Bhaba was formed to revise the Indian Companies Act with particular reference to its bearing on the trade and industry. The Companies Act, 1956 was introduced in the Parliament based on the recommendations of the Committee. It has been amended many times since then.

Since the Companies Act, 1956 forms the backbone of the industry, it is imperative that each business manager should have knowledge of the Act.

Notes

7.1 Meaning of Company Act, 1956

The Companies Act, 1956 defines the word 'company' as a company formed and registered under the Act or an existing company formed and registered under any of the previous company laws (s.3). This definition does not bring out the meaning and nature of the company into a clear perspective. Also s.12 permits the formation of different types of companies. These may be (i) companies limited by shares, (ii) companies limited by guarantee and (iii) unlimited companies. The vast majority of companies in India are with limited liability by shares. Therefore, it is advisable to define the term 'company' keeping in mind this type of company. In India, the Companies Act, 1956, is the most important piece of legislation that empowers the Central Government to regulate the formation, financing, functioning and winding up of companies. The Act contains the mechanism regarding organisational, financial, and managerial and all the relevant aspects of a company. It empowers the Central Government to inspect the books of accounts of a company, to direct special audit, to order investigation into the affairs of a company and to launch prosecution for violation of the Act. These inspections are designed to find out whether the companies conduct their affairs in accordance with the provisions of the Act, whether any unfair practices prejudicial to the public interest are being resorted to by any company or a group of companies and to examine whether there is any mismanagement which may adversely affect any interest of the shareholders, creditors, employees and others. If an inspection discloses a *prima facie* case of fraud or cheating, action is initiated under provisions of the Companies Act or the same is referred to the Central Bureau of Investigation.

The Companies Act is administered by the Central Government through the Ministry of Corporate Affairs and the Offices of Registrar of Companies, Official Liquidators, Public Trustee, Company Law Board, Director of Inspection, etc. The Registrar of Companies (ROC) controls the task of incorporation of new companies and the administration of running companies.

Under the Companies Act, 1956, the term 'company' means " a company formed and registered under the Act or an existing company i.e. a company formed or registered under any of the previous company laws". The basic objectives underlying the law are :

1. A minimum standard of good behaviour and business honesty in company promotion and management.
2. Due recognition of the legitimate interest of shareholders and creditors and of the duty of managements not to prejudice to jeopardise those interests.
3. Provision for greater and effective control over and voice in the management for shareholders.
4. A fair and true disclosure of the affairs of companies in their annual published balance sheet and profit and loss accounts.
5. Proper standard of accounting and auditing.
6. Recognition of the rights of shareholders to receive reasonable information and facilities for exercising an intelligent judgement with reference to the management.
7. A ceiling on the share of profits payable to managements as remuneration for services rendered.
8. A check on their transactions where there was a possibility of conflict of duty and interest.
9. A provision for investigation into the affairs of any company managed in a manner oppressive to minority of the shareholders or prejudicial to the interest of the company as a whole.
10. Enforcement of the performance of their duties by those engaged in the management of public companies or of private companies which are subsidiaries of public companies

Notes

by providing sanctions in the case of breach and subjecting the latter also to the more restrictive provisions of law applicable to public companies.

The Companies Act, 1956 has been amended from time to time in response to the changing business environment.

Advantages of a Corporate Entity

1. The member may sell his share in the company, thus withdrawing himself and making someone else a member to whom he transfers shares. Thus, shares in a company are transferable.
2. As a natural consequence of transferability of shares, the company has what is commonly known as perpetual succession.
3. With the withdrawal or death of a member of a company, the latter does not come to an end. The life of the company is independent of the lives of the members of the company.
4. Members may come and members may go, the company continues until it is dissolved.
5. Members have limited liability.

7.2 Salient Feature of a Company

Following are the features of a company:

1. ***Incorporated association:*** It should be incorporated under Companies Act.
2. ***Artificial person:*** A company is created with the sanction of law and is not itself a human being, it is therefore, called artificial; and since it is clothed with certain rights and obligations, it is called a person. A company is accordingly an artificial person.
3. ***Separate legal entity:*** Unlike partnership, company is distinct from the persons who constitute it. Section 34 (2) says that on registration, the association of persons becomes a body corporate by the name contained in the memorandum. Lord Macnanghtan in the famous case of *Salomon v. Salomon & Co. Ltd.* (1877) AC 22 observed that:

   A company is at law a different person altogether from the subscribers…..; and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers and the same hands receive the profits, the company is at law not the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided in the Act.

   The facts of the famous Salomon's case were as follows:

   Salomon carried on business as a leather merchant. He sold his business for a sum of £30,000 to a company formed by him along with his wife, a daughter and four sons. The purchase consideration was satisfied by allotment of 20,000 shares of £1 each and issue of debentures worth £10,000 secured by floating charge on the company's assets in favour of Mr Salomon. All the other shareholders subscribed for one share of £1 each. Mr Salomon was also the managing director of the company. The company almost immediately ran into difficulties and eventually became insolvent and winding up commenced. At the time of winding up, the total assets of the company amounted to £6,050; its liabilities were £10,000 secured by the debentures issued to Mr Salomon and £8,000 owing to unsecured trade creditors. The unsecured sundry creditors claimed the whole of the company's assets, viz. £6,050 on the ground that the company was a mere alias or agent for Salomon.

   Held: The contention of the trade creditors could not be maintained because the company being in law a person quite distinct from its members, could not be regarded as an 'alias' or

agent or trustee for Salomon. Also the company's assets must be applied in payment of the debentures as a secured creditor is entitled to payment out of the assets on which his debt is secured in priority to unsecured creditors.

Example:

1. ***In Lee v. Lee Air Farming Limited*** (1960) 3 All ER 429 PC, a company was formed for the purpose of manufacturing aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company and by the articles was appointed governing director of the company and chief pilot. Lee was killed while piloting the company's aircraft and his widow claimed compensation for his death under the Workmen Compensation Act. The company opposed the claim on the ground that Lee was not a 'worker' as the same person could not be employer and the employee.

   Held: There was a valid contract of service between Lee and the company and Lee was, therefore, a worker. Mrs Lee's contention was upheld.

2. ***In Bacha F. Guzdar v. The Commissioner of Income-tax, Bombay*** [AIR (1955) SC 74], the facts of the case were as follows:

   The plaintiff (Mrs Guzdar) received certain amounts as dividend in respect of shares held by her in a tea company. Under the Indian Income-tax Act, agricultural income is exempted from payment of income-tax. As income of a tea company is partly agricultural, only 40 per cent of the company's income is treated as income from manufacture and sale and, therefore, liable to tax. The plaintiff claimed that the dividend income in her hands should be treated as agricultural income up to 60 per cent, as in the case of a tea company, on the ground that dividends received by shareholders represented the income of the company.

   Held: By the Supreme Court, that though the income in the hands of the company was partly agricultural yet the same income when received by Mrs Guzdar as dividend could not be regarded as agricultural income.

4. ***Limited liability:*** The company being a separate person, its members are not as such liable for its debts. Hence, in the case of a company limited by shares, the liability of members is limited to the nominal value of shares held by them. Thus, if the shares are fully paid up, their liability will be nil. However, companies may be formed with unlimited liability of members or members may guarantee a particular amount. In such cases, liability of the members shall not be limited to the nominal or face value of the shares held by them. In case of unlimited liability companies, members shall continue to be liable till each paise has been paid off. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount, i.e., he shall be liable to contribute upto the amount guaranteed by him.

   Unlimited liability of a member of a limited liability company. In the following cases, a shareholder or member shall lose the privilege of limited liability:

   (a) Where members of the company are reduced below the statutory minimum, viz., 7 in case of a public company and 2 in case of a private company and the company carries on the business for more than 6 months while the members are so reduced, every person who is a member during the time that it so carries on business after those 6 months and is aware of the fact that it is operating with fewer than the requisite number shall be personally liable for the whole of the debts contracted during that time (s.45).

   (b) Where in the course of winding up, it appears that any business of the company has been carried on with intent to defraud creditors, the Court may declare the persons who were knowingly parties to the transaction personally liable without limitation of liability for all or any of the debts or other liabilities of the company (s.542).

Notes

5. ***Separate property:*** Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in *Bacha F. Guzdar v. The Commissioner of Income-tax, Bombay* (Supra). The Supreme Court held that a shareholder is not the part owner of the company or its property, he is only given certain rights by law, e.g., to vote or attend meetings, to receive dividends. Similarly, in *R.F. Perumal v. H. John*, it was observed that no member can claim himself to be owner of the company's property during its existence or on its winding up. In still another case, it was observed that even where a shareholder held almost entire share capital, he did not even have an insurable interest in the property of the company. It was the case of *Macaure v. Northern Assurance Co. Ltd.* and the facts were as follows:

   'Macaure' held all except one share of a timber company. He had also advanced substantial amount to the company. He insured the company's timber in his personal name. On timber being destroyed by fire his claim was rejected for want of insurable interest. The Court applying principle of separate legal entity held that the insurance company was not liable.

6. ***Transferability of shares:*** Since business is separate from its members in a company form of organisation, it facilitates the transfer of member's interests. The shares of a company are transferable in the manner provided in the Articles of the company (s.82). However, in a private company, certain restrictions are placed on such transfer of shares but the right to transfer is not taken away absolutely.

7. ***Perpetual existence***: A company being an artificial person cannot be incapacitated by illness and it does not have an allotted span of life. The death, insolvency or retirement of its members leaves the company unaffected. Members may come and go but the company can go forever. The saying "King is dead, long live the King" very aptly applies to the company form of organisation.

8. ***Common seal***: A company being an artificial person is not bestowed with a body of natural being. Therefore, it has to work through its directors, officers and other employees. But, it can be held bound by only those documents which bear its signature. Common seal is the official signature of a company.

9. ***Company may sue and be sued in its own name:*** Another fallout of separate legal entity is that the company, if aggrieved by some wrong done to it may sue or be sued in its own name. In *Rajendra Nath Dutta v. Shibendra Nath Mukherjee* (1982) (52 Comp. Cas. 293 Cal.), a lease deed was executed by the directors of the company without the seal of the company and later a suit was filed by the directors and not the company to avoid the lease on the ground that a new term had been fraudulently included in the lease deed by the defendants. Held that a director or managing director could not file a suit, unless it was by the company in order to avoid any deed which admittedly was executed by one of the directors and admittedly also the company accepted the rent. The case as made out in the plaint was not made out by the company but by some of the directors of the company and the company was not even a plaintiff. If the company was aggrieved, it was the company which was to file the suit and not the directors. Therefore, the suit was not maintainable.

Company Distinguished from Partnership

Distinction between partnership and the company incorporated under the Companies Act, 1959, is as follows:

1. ***Legal status:*** A partnership firm has no existence apart from its members. A company is a separate legal entity distinct from its members.

2. ***Mutual agency:*** Partnership is founded on the idea of mutual agency – every partner is an agent of the rest of the partners. A member of a company is not an agent of other members.

3. ***Liability of members***: Liability of a partner is unlimited, i.e., even his own personal assets are liable for the debts of the firm. Liability of a member or shareholder of a limited company is limited to the extent of the amount remaining unpaid on shares held by him or the amount of guarantee as mentioned in the memorandum of association of the company.
4. ***Transfer of interes***t: A partner cannot transfer his interest without the consent of all other partners. A shareholder, subject to restrictions contained in the articles can freely transfer his share.
5. ***Duration of existence:*** Unless there is a contract to the contrary, the death, retirement or insolvency of a partner results in the dissolution of the firm. A company enjoys a perpetual succession. Death or retirement or insolvency of a member does not affect the existence of a company.
6. ***Minimum membership:*** The minimum number of persons required to form a partnership is 2. The minimum number required to form a private company is 2 and in the case of a public company the minimum number should be 6.
7. ***Maximum membership***: A partnership cannot be formed with persons exceeding 20. The number is limited to 10 in the case of a banking business. In the case of a public company there is no limit to the maximum numbers of members. However, a private company cannot have more than 50 members.
8. ***Audit:*** The audit of the accounts of a firm is not compulsory, whereas the audit share counts of a company is mandatory.
9. ***Registration:*** in partnership is optional whereas registration is compulsory for a Company.
10. ***Contract***: A partner cannot contract with his firm a shareholder can make contract with the Company.

The difference is probably going to depend on corporation and partnership laws in the state where they are located. A corporation is basically a group of people who have filed for a special status with their state's corporation commission. This allows them not to be personally liable for the acts of the corporation. The corporate form has many components that one must consider like: corporate formalities (most corporations must meet annually, and keep very meticulous records), taxation, management (can be more centralized and delegated), issuing shares (ownership in the company) an other business related problems. It's difficult for me to be more specific because I don't know what state. A partnership is a group of people who merely decide to go into business together. Their liability is based on their investment many times. In a partnership, partners are also owners and managers of the partnership. They can be held personally liable in many situations; however some prefer this to a corporate because it is so easy to form. The bare bone is that these two are different types of groups of people that are formed to conduct business. They don't necessarily use the corporate commission to do this. In a partnership, partners are also owners and managers of the partnership. They can be held personally liable in many situations; however some prefer this to a corporate because it is so easy to form. The bare bone is that these two are different types of groups of people that are formed to conduct business. A company is established by a single person on support of others. It is boss- worker coordination in company, where as in a partnership two or more people come together to establish the firm and there is no single boss.

7.3 Lifting the Corporate Veil

The advantages of incorporation are allowed to be enjoyed only by those who want to make an honest use of the 'company'. In case of a dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identifies the persons (members) who are behind the scene and are responsible for the perpetration of fraud.

Notes

Following are some such cases:

1. For the protection of revenue. The Court may not recognise the separate existence of a company where the only purpose for which it appears to have been formed is the tax-evasion or circumvention of tax obligation.

Example: D was a rich man having dividend and interest income. He wanted to avoid surtax. For this purpose, he formed four private companies, in all of which he was the majority shareholder. The companies made investments and whenever interest and dividend incomes were received by the companies, D applied to the companies for loans which were immediately granted and never repaid. In a legal proceeding the corporate veils of all the companies were lifted and the incomes of the companies treated as if they were of 'D' *[In re Dinshaw Maneckjee Petit* (1927) Bom. 371].

2. Where the company is acting as agent of the shareholders, then the shareholders will be held liable for its acts. There may be an express agreement to this effect or such agreement may be implied from the facts of a particular case.

3. Where a company has been formed by certain persons to avoid their own valid contractual obligation, the court may proceed on the assumption as if no company existed.

Example: A sold his business to B and agreed not to compete with him for a given number of years within reasonable local limits. A, desirous of re-entering business, in violation of the contractual obligation, formed a private company with majority shareholdings. B filed a suit against A and the private company and the court granted an injunction restraining A and his company with going ahead in the competing business *(Gilford Motor Co. v. Horne* (1933) 1 Ch. 935).

4. Where a company has been formed for some fraudulent purpose or is a 'sham', the court will lift the corporate veil to identify the perpetrator of the fraud.

Example: In Delhi Development Authority v. Skipper Construction Company (P) Ltd. [1996] 4 SCALE 202, the skipper construction company failed to pay the full purchase price of a plot to DDA. Instead construction was started and space sold to various persons. The two sons of the directors who had business in their own names claimed that they had separated from the father and the companies they were running had nothing to do with the properties of their parents. But no satisfactory proof in support of their claim could be produced. Held, that the transfer of shareholding between the father and the sons must also be treated as a sham. The fact that the director and members of his family had created several corporate bodies did not prevent the court from treating all of them as one entity belonging to and controlled by the director and his family.

5. Where a company formed is against public interest or public policy, for the purpose of determining the character of the members, the Court may lift the corporate veil.

Example: C company was floated in London for marketing tyres manufactured in Germany. The majority of C's shares were held by the German nationals residing in Germany. During World War I, C company filed a suit against D company for the recovery of trade debt. The D company contended that C company was an alien enemy company (Germany being at war with England at that time) and that the payment of the debt would be a trading with the enemy. The Court agreed with the contention of the defendants *[Daimler Co. Ltd. v. Continental Tyre and Rubber Co.*, (1916) 2AC 307].

6. Where device of incorporation is used for some illegal or improper purpose *[PNB Finance Ltd. v. Shital Prasad Jain* (1983) 54 Comp. Cas 66 (Delhi)]. S, the financial advisor of a financing public limited company was given a loan of ₹ 15 lakhs by the company to purchase immovable properties in Delhi. A pronote with regard to the same was also executed by S.

S diverted the amount of the loan to three public limited companies floated by him and his son. These companies, in turn, applied the amount in purchasing immovable properties at New Delhi. The Delhi High Court refrained the defendants from in any manner alienating, transferring, disposing of or encumbering the properties in question.

7. Where the number of members falls below the statutory minimum (i.e., seven in the case of a public company and two in the case of a private company) and the company continues to carry on business for more than six months while the number is so reduced. In such a case, every person who is a member of the company during the time that it so carries on business after those six months and has knowledge of that fact, shall be severally liable to the creditors for the payment of the company's debts contracted during that period. Such a member can be sued severally (i.e., directly) by the creditors of the company. Both the privileges of limited liability and that of the separate legal entity are lost. The creditors are permitted to look behind the company to the shareholders for the satisfaction of their claims (s.45).

8. Where prospectus includes a fraudulent misrepresentation. In case of a prospectus containing fraudulent misrepresentation as to a material fact, Ss. 62 and 63 make the promoters, directors, etc., personally liable not only in damages but they may even be prosecuted in terms of fine upto ₹ 50,000 or imprisonment upto 2 years or both.

9. Where a negotiable instrument is signed by an officer of a company on behalf of the company without mentioning the name of the company thereon, he is personally liable to the holder of the instrument, unless the company has already made the payment on the instrument [s.147 (4) (c)].

10. Holding and Subsidiary Companies (Ss. 212-213). In the eyes of law, the holding company and its subsidiaries are separate legal entities. However, in the following cases, a subsidiary company may lose its separate identity to a certain extent:

    (a) Where at the end of its financial year, a company has subsidiaries, it may lay before its members in general meeting not only its own accounts, but also a set of group accounts showing the profit or loss earned or suffered by the holding company and its subsidiaries collectively and their collective state of affairs at the end of the year;

    (b) The Central Government, where it feels desirable, may direct the holding and subsidiary companies to synchronize their financial years;

    (c) The Court may, on the facts of a case, treat a subsidiary company as merely a branch or department of one large undertaking owned by the holding company.

11. Investigation into related companies. Section 239 provides that if it is necessary for the satisfactory completion of the investigation into the affairs of a company, the Inspector appointed to investigate may look into the affairs of another related company in the same management or group.

12. For investigation of ownership of a company. The separate legal entity may be disregarded under s.247. This Section authorises the Central Government to appoint one or more Inspectors to investigate and report on the membership of any company for the purpose of determining the true persons who are financially interested in the company and who control or materially influence its policy.

13. Where in the course of winding up of a company, it appears that any business of the company has been carried on, with intent to defraud creditors of the company, or any other persons, or for any fraudulent purpose, the court on the application of the Liquidator, or any creditor or contributory of the company, may, if it thinks proper, declare that any persons who are knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct (s.542).

Notes

7.4 Types of Companies

Companies can be classified into three categories according to the mode of incorporation. If a company is incorporated by a charter granted by the monarch, it is called a Chartered Company and is regulated by that charter.

Example: The East India Company came into being by the grant of a Royal Charter. Such type of companies do not exist in India.

A company which is created by a special Act of the Legislature is called a Statutory Company and is governed by the provisions of that Act. The State Bank of India and the Industrial Finance Corporation of India are two examples of statutory companies. A company brought into existence by registration of certain documents under the Companies Act, 1956 is called Registered Company.

The liability of members of a registered company may be limited or unlimited (s.12). It may be limited by shares, or by guarantee or by both (i.e., shares and guarantee).

A company limited by shares is a registered company having the liability of its members limited by its memorandum of association to the amount, if any, unpaid on the shares respectively held by them. The amount remaining unpaid on the shares can be called up at any time – during the lifetime of the company or at the time of winding up. However, a shareholder cannot be called upon to pay more than the amount remaining unpaid on his shares. His personal assets cannot be called upon for the payment of the liabilities of the company, if nothing remains to be paid on the shares purchased by him. Such a company is also known as a 'Share Company.'

A company limited by guarantee is one having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Such a company is also known as 'guarantee company'. The liability of the members of a guarantee company is limited by a stipulated sum mentioned in the memorandum. The guaranteed amount can be called up by the company from the members only at the time of winding up if the liabilities of the company exceed its assets.

A pure 'guarantee company' does not have a share capital. The working funds, if required, are raised from source like fees, donations, subsidy, endowments, grants, subscriptions and the like. Such a company is generally formed for the purpose of promotion of art, science, culture, charity, sport, commerce or for some similar purpose.

A company limited by shares as well as by guarantee is a hybrid form of company which combines elements of the guarantee and the share company. Such a company raises its initial capital from its shareholders; while the normal working funds are provided form other sources such as fees, charges, subscription, etc. Every member of such a company is subject to a two-fold liability, i.e., the guarantee which may become effective in the winding up of the company and the liability to pay up to the nominal amount of his share which may become effective during the lifetime of the company or at the time of winding up.

An unlimited company is a company not having any limit on the liability of its members. The members of such a company are liable, in the event of its being wound up, to the full extent of their fortunes to meet the obligations of the company. However, the members are not liable to the company's creditors. The company, being a separate legal entity from the persons who constitute it, is liable to its creditors. If the creditors cannot obtain payment from the company, they may petition the court for the winding up of the company. The Liquidator will then call upon the members to contribute to the assets of the company without limitation of their liability for the payment of the debts of the company.

Private and Public Companies

Notes

Either of the above kinds of companies (i.e., a limited liability company and an unlimited liability company) may be private or public (s.12).

A private company can be formed by merely two persons by subscribing their names to the Memorandum of Association. It means a company which has a minimum paid-up capital of one lakh rupees or such higher paid up capital as may be prescribed; and by its Articles:

(i) restricts the rights of its members to transfer shares;

(ii) limits the number of its members to fifty, excluding its employee-members or past employee-members; provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purpose of this definition, be treated as a single member;

(iii) prohibits an invitation to the public to subscribe to its shares and debentures; and

(iv) Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

A public company means a company which (a) is not a private company; (b) has a minimum paid-up capital of ₹ 5 lakhs or such higher paid-up capital as may be prescribed; (c) is a private company which is a subsidiary of a company which is not a private company. Section 12 prescribes the minimum number of members as seven who have to subscribe their names to the memorandum of association but there is no restriction with regard to the maximum number of members of a public company. A public company may or may not invite public to subscribe to its share capital. In case, it decides to invite public to subscribe to its share capital, then it has to issue a prospectus. In case, it decides not to invite public to subscribe to its share capital and arranges the capital privately then it need not issue a prospectus; it has simply to submit a statement in lieu of prospectus with the Registrar of Companies at least three days before it can make allotment of shares. The articles of such a company do not contain provisions restricting the right of members to transfer their shares. Under the Securities (Contracts) Regulation Act, 1956, shares and debentures of public companies only are capable of being dealt in on a stock exchange.

Listed Public Company [s. 2 (23)]. It means a public company which any of its securities has listed on any recognised stock exchange.

Distinction between Private and Public Company

Following are the main points of distinction between a private and a public company:

1. In the case of a private company minimum number of persons to form a company is two while it is seven in the case of a public company.
2. In case of a private company the maximum number of members must not exceed fifty whereas there is no such restriction on the maximum number of members in case of a public company.
3. In private company the right to transfer shares is restricted, whereas in case of public company the shares are freely transferable.
4. A private company cannot issue a prospectus, while a public company may, through prospectus, invite the general public to subscribe for its shares or debentures.
5. A private company can commence business immediately after receiving the certificate of incorporation, while a public company can commence business only when it receives a certificate to commence business from the Registrar.

Notes

6. A private company need not hold a statutory meeting but a public company must hold a statutory meeting and file a statutory report with the Registrar.
7. The directors of a private company are not required to file with the Registrar written consent to act as directors or sign the memorandum of association or enter into a contract for their qualification shares. But the directors of a public company must file with the Registrar their written consent to act as directors, must sign the memorandum and must enter into a contract for their qualification shares.
8. Directors of a private company may be appointed by a single resolution, but it is not so in case of a public company.
9. Directors of a private company are not required to retire by rotation, but in case of a public company, at least two-third of the directors must retire by rotation.
10. The number of directors in a private company may be increased to any extent without the permission of the Central Government, but in case of a public company if the number of directors is to be more than twelve then the approval of the Central Government is necessary.
11. Two members have to be personally present to form the quorum in a private company but in a public company this number is five members.
12. In a private company, there are no restrictions on managerial remuneration.
13. In addition to the above, a private company enjoys some special privileges. A public company enjoys no such privileges.
14. A private company cannot issue share warrants.

7.5 Conversion of Private Company into a Public Company

Section 44 provides for conversion of a private company into a public company. The procedure is:

(1) The company in general meeting must pass a special resolution altering its articles in such a manner that they no longer include the provisions of s.3(1) (iii) which are required to be included in the articles of a private company. On the date of the passing of the resolution, the company ceases to be a private company and becomes a public company.

(2) Within thirty days of the passing of the special resolution altering the articles, the company shall file with the Registrar (i) a printed or type-written copy of the special resolution and (ii) a prospectus or a statement in lieu of prospectus.

If default is made in filing the resolution and the prospectus or the statement in lieu of prospectus, the company and every officer in default shall be liable to a fine upto ₹ 5,000 for every day of default.

(3) If the number of members is below seven, steps should be taken to increase it to at least seven whilst the number of directors should be increased to at least three, if there are only two directors.

(4) The word ‘Private’ is to be deleted before the word ‘Limited’ in the name.

7.6 Conversion of Public Company into a Private Company

There is no direct or express provision in the Act for the conversion of a public company into a private company except a reference in the proviso to s.31(1). A public company having a share

capital and membership within the limits imposed upon private companies by s.3(1) (iii), may become a private company by following the procedure as given:

(1) The company in general meeting has to pass special resolution for altering the articles so as to include therein the necessary restrictions, limitations and prohibitions and to delete any provision inconsistent with the restrictions. For instance, a private company has to put certain restrictions on the right of members to transfer their shares.

(2) The word 'Private' should be added before 'Limited'.

(3) The approval of the Central Government to the alteration in the articles for converting a public company into a private company should be obtained.

(4) Within one month of the date of the receipt of the order of approval, a printed copy of the altered articles must be filed with the Registrar.

(5) With thirty days of the passing of the special resolution, a printed or type-written copy thereof should be filed with the Registrar.

7.7 Holding and Subsidiary Companies

Where a company has control over another company, it is known as the Holding Company and the company over which control is exercised is called the Subsidiary Company. A company is deemed to be under the control of another if:

(1) that other controls the composition of its Board of Directors; or

(2) the other company holds more than half in nominal value of its equity share capital (where a company had preference shareholders, before commencement of this Act, enjoying voting rights with that of equity shareholders, for the purpose of control, holding company should enjoy more than half of the total voting power);

(3) it is a subsidiary of a third company which itself is a subsidiary of the controlling company. For example, where company 'B' is a subsidiary of company 'A' and company 'C' is a subsidiary of company 'B', then company 'C' shall be a subsidiary of company 'A'. If company 'D' is a subsidiary of company 'C', then company 'D' shall also be a subsidiary of company 'B' and consequently also of company 'A'.

7.8 One-man Company

A member may hold virtually the entire share capital of a company. Such a company is known as a 'one-man company'. This can happen both in a private company and a public company. The other member/members of the company may be holding just one share each. Such other members may be just dummies for the purpose of fulfilling the requirements of law as regards minimum membership [*Salomon v. Salomon & Co. Ltd.*].

7.9 Non-trading Company or Association not for Profit

As we shall see later, the name of a limited company must end with the word 'limited' in the case of a public company and with 'private limited' in the case of a private limited company (s.13). But, s.25 permits the registration, under a license granted by the Central Government, of associations not for profit with limited liability without using the word 'limited' or 'private limited' to their names on certain conditions. Such a company must have the objects of promoting commerce, arts, science, religion, charity or any other useful object and must apply its profits, if any, or other income in promoting its object and must prohibit payment of any dividend to its members. As soon as it obtains a license and is registered accordingly, it will have the same

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privileges and obligations that a limited company has under the Act. This licence is revocable by the Central Government and on revocation, the Registrar will put 'Limited' or 'Private Ltd.' against the company's name in the Register maintained by him. But before taking such a step, the Central Government has to give a written notice of its intention to revoke the licence and also an opportunity to be heard in the matter.

It is worth noting that even a partnership firm can be a member of such a company, in its own name. But on dissolution of the partnership, its membership of the company will come to an end [s.25 (4)].

7.10 Government Company

Section 617 defines a Government Company as any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government Company.

Government Companies are as much governed by the provisions of the Companies Act as any other company; but by virtue of s.620 the Central Government may direct that any of the provisions of the Act will not apply to them or shall apply only with such exceptions, modifications and adaptations as may be notified by the Government. However, the Central Government cannot exempt the Government Companies from the provisions of Ss.619 and 619-A which specifically deal with such companies.

Section 619 provides that the auditor of a Government Company shall be appointed or reappointed by the Central Government on the advice of the Comptroller and Auditor-General of India. The ceilings on the number of audits to be undertaken by an auditor under s.224 are equally applicable to audit of Government Companies. The Comptroller and Auditor General of India have the power to direct the manner in which the accounts are to be audited and to give instructions to the auditor in regard to any matter relating the performance of his functions. He is also empowered to get a supplementary test audit of accounts conducted by persons authorised by him. The auditor of the Government Company has to submit a copy of his audit report to the C.&A.G.I. who has the right to comment upon, or supplement the audit report in such manner as he thinks fit. Such comments or supplementary audit report must be placed before the annual general meeting of the company at the same time and in the same manner as the auditor's report.

Section 619-A provides that the Central Government must place before both House of Parliament an annual report on the working and affairs of each Government Company to be prepared within three months of its annual general meetings, together with a copy of the audit report and any comments upon or supplement to, such audit report, made by the C.& A.G.I. Where a State Government is a participant in a Government Company, this report has, likewise, to be placed before the State Legislature.

Section 619-B provides that the provisions of s.619 as stated above also apply to a company in which the Central Government or any State Government or any Government Corporation hold either singly or jointly not less than 51% of the paid-up share capital.

7.11 Foreign Company

Foreign Company is a company incorporated in a country outside India and has a place of business in India.

However, where not less than 50% of the paid-up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more

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Indian bodies corporate, such company shall comply with such of the provisions of the Act as may be prescribed with regard to the business carried on by it in India.

Section 592 requires that every foreign company which establishes a place of business in India, must, within 30 days of the establishment of such place of business, file with the Registrar of Companies at New Delhi and also the Registrar of Companies of the State in which such place of business is situated: (a) A certified copy of the memorandum and articles of the company and if they are not in English, then a certified translation thereof; (b) the full address of the registered office of the company; (c) a list of the directors of the company and its secretary with full particulars of their nationality, address and business or occupation; (d) the names and addresses of one or more persons resident in India who are authorised to accept service of process or notice or other documents to be served on the company; and (e) the address of the principal place of business in India.

Section 593 provides that in case of any alteration in any of the above particulars, the company has to file with the Registrar of Companies a return of such alteration within the prescribed time.

Section 594 makes the application of the provisions regarding books of account to be kept by a company under s.209 to a foreign company so far as it concerns its business in India. The books of account must be kept at the principal office in India and three copies of balance sheet, profit and loss account and other documents must be delivered to the Registrar with a list in triplicate of all places of business in India.

Section 595 requires a foreign company to exhibit conspicuously on the outside of every office or place of business in India the name of the company and 'limited' or 'private limited,' if it is a limited company and the country in which it is incorporated in English as well as in the local languages in general use in the locality in which the office is situated. Also the prospectus issued in India must contain this information.

Section 596 provides the procedure for service of any process, notice or other documents on a foreign company and it shall be deemed to have been served, if addressed to any person whose name has been delivered to the Registrar of Companies under s.592.

Section 597 provides that the foreign company must also deliver the documents under s.592 to the Registrar of Companies, New Delhi.

Section 598 provides penalty for default in complying with any of the foregoing requirements. The company and every officer of the company who is in default shall be punishable with fine up to ₹ 10,000 and in the case of a continuing default with an additional fine up to ₹ 1000 for every day during which the default continues.

Section 599 provides that the foreign company which fails to comply with the foregoing provisions is prohibited from enforcing any contract by way of a suit, set-off or counter-claim, although it will be liable to be sued in respect of any contract it may have entered into.

Section 600 makes the application of the following Sections to a foreign company: Sections 124-145; 118; 209; 159-160; 209A; 601-608.

Section 584 provides for the winding up of a foreign company. Where a foreign company, which has been carrying on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Part X (Ss.582-590), notwithstanding the fact that the company has been dissolved or ceased to exist under laws of the country in which it was incorporated.

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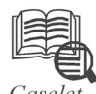

Caselet

Gurpreet Gill vs. Pumpkin Studio (P) Ltd. (2009)

The Board Meeting and the General Meeting held in the absence of proper and valid notice to the directors and/or shareholders shall be invalid and all the resolutions so passed are null and void. If the petitioner has been outsted as a Managing Director and the Respondent has been installed in his place, it shall amount to oppression. In the absence of evidence of service of notice upon either the Director or shareholders, the presumption about the minutes cannot be drawn in terms of Section 195 of the Companies Act, 1956.

In case of family owned company, the principal of partnership shall be application and when agreed ratio of directorship has been disturbed, then it shall amounts to oppression

7.12 Summary

- The word 'company' denotes an association of person to achieve some common objective. In Legal terminology, a company when incorporate becomes a legal person, and consequently, has certain distinguishing features.
- The most important feature is that a company is an entity district from its members and is an artificial person.
- A creditor of accompany connot file a suit against the member of the company for recovering the amount due. In a way, a veil is thrown around the members.
- This is known as the veil of corporate personality. But there are certain situations when the veil may be lifted and the company be identified with the members of the company.
- The Companies Act 1968 has made a provision for the registration of different types of companies. But most common of these are private companies and public companies.
- The whole process of formation of a company may be divided into four stages; namely, (i) promotion, (ii) registration, (iii) flotation, and (iv) commencement of business.
- The certificate of incorporation, issued by the registrar, signifies that a company with its own entity distinct from the members who constitute has come into existence.
- A public company has to obtain another certificate before it can commence business. This is known as certificate to commence business.
- Foreign Company is a company incorporated in a country outside India and has a place of business in India.

7.13 Keywords

Companies Act, 1956: The Act contains the mechanism regarding organisational, financial, and managerial and all the relevant aspects of a company.

Private Company: A private company can be formed by merely two persons by subscribing their names to the Memorandum of Association.

Public Company: A public company may or may not invite public to subscribe to its share capital.

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Registered Company: A company brought into existence by registration of certain documents under the Companies Act, 1956 is called Registered Company.

Statutory Company: A company which is created by a special Act of the Legislature is called a Statutory Company.

Unlimited Company: An unlimited company is a company not having any limit on the liability of its members.

7.14 Self Assessment

Fill in the blanks:

1. The .... contains the mechanism regarding organisational, financial, and managerial and all the relevant aspects of a company.
2. A company is created with the sanction of law and is not itself a human being, called ....
3. Companies may be formed with .... of members or members may guarantee a particular amount.
4. A company being an artificial person cannot be .... by illness and it does not have an allotted span of life.
5. .... provides that if it is necessary for the satisfactory completion of the investigation into the affairs of a company, the Inspector appointed to investigate may look into the affairs of another related company in the same management or group.
6. A pure '...................... does not have a share capital.
7. .... defines a Government Company as any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government Company.
8. The .... and Auditor General of India have the power to direct the manner in which the accounts are to be audited and to give instructions to the auditor in regard to any matter relating the performance of his functions.
9. .... provides that in case of any alteration in any of the above particulars, the company has to file with the Registrar of Companies a return of such alteration within the prescribed time.
10. .... makes the application of the provisions regarding books of account to be kept.

7.15 Review Questions

1. Discuss the meaning of Companies Act, 1956.
2. What are the different advantages of company?
3. "In the case of a company limited by shares, the liability of members is limited to the nominal value of shares held by them." Comment
4. Discuss different types of companies. What are the differences between private and public company?
5. Consider a public and a private company then compares it.

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6. Where a company has control over another company, it is known as the Holding Company and the company over which control is exercised is called the Subsidiary Company. Give example related to holding and subsidiary company

Answers: Self Assessment

1.	Company Act	2.	artificial
3.	unlimited liability	4.	incapacitated
5	Section 239	6.	guarantee company'
7.	Section 617	8.	Comptroller
9.	Section 593	10.	Section 594

7.16 Further Readings

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, India, 2007

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Unit 8: Formation of Company

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Objectives

After studying this unit, you will be able to:

- Discuss formation of company
- Explain memorandum of association
- Describe article of association

Introduction

In earlier unit you have studied about partnership and different types of company. A corporation is basically a group of people who have filed for a special status with their state's corporation commission. A partnership is a group of people who merely decide to go into business together. Their liability is based on their investment many times. The Companies Act, 1956 defines the word 'company' as a company formed and registered under the Act or an existing company formed and registered under any of the previous company law. In this unit we will study the formation of company and the process of formation of company. The whole process of formation of a company may be roughly divided, for convenience, into three parts. These are: (i) Promotion; (ii) Registration and (iii) Floatation.

8.1 Formation of a Company

The whole process of formation of a company may be roughly divided, for convenience, into three parts. These are: (i) Promotion; (ii) Registration and (iii) Floatation.

8.1.1 Promotion

Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company. The persons who assume the task of promotion are called promoters. The promoter may be an individual, syndicate, association, partnership or company.

Who is a Promoter?

This term has not been defined under the Act, although the term is used expressly in Ss. 62, 69, 76, 478 and 519.

Perhaps, the true test of whether a person is a promoter is whether he has a desire that the company be formed and is prepared to take some steps, which may or may not involve other persons, to implement it. However, persons assisting the promoters by acting in a professional capacity do not thereby become promoters themselves. The solicitor who drafts the Articles, or the accountant who values assets of a business to be purchased, are merely giving professional assistance to the promoters. If, however, he goes further than this, e.g., by introducing his client to a person who may be interested in purchasing shares in the proposed company, he would be regarded as promoter.

Duties and Liabilities of Promoters

Promoters have been described to be in fiduciary relationship (relationship of trust and confidence) with the company. This relationship of trust and confidence requires the promoter to make a full disclosure of all material facts relating to the formation of the company. He should not make any secret profit at the expense of the company he promotes, without the knowledge and consent of the company and if he does so, the company can compel him to account for it.

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Caselet

How to make Secret Profit?

A promoter is not forbidden to make profit but to make secret profit. In *Gluckstein v. Barnes*, a Syndicate of persons was formed to buy a property called 'Olympia' and re-sell this Olympia to a company to be formed for the purpose. The Syndicate first bought the debentures of the old Olympia company at a discount. Then they bought the company itself for £ 1,40,000. Out of this money provided by themselves the debentures were repaid in full and a profit of £ 20,000 made thereon. They promoted a new company and sold Olympia to it for £ 1,80,000. The profit £ 40,000 was revealed in the prospectus but not the profit of £ 20,000.

Held: Profit of £ 20,000 was a secret profit and the promoters of the company were bound to pay it to the company because the disclosure of this profit by themselves in the capacity of vendors to themselves in the capacity of directors of the purchasing company was not sufficient.

Disclosure to be made to whom? In *Erlanger v. New Sombrera Phosphate Co.*, it was held that the disclosure should be made to an independent and competent Board of Directors. This duty is not discharged if he makes the disclosure to the Board of Directors who are mere nominees of his own or are in his pay.

Where it is not possible to constitute an independent Board of Directors, the disclosure should be made to the whole body of persons who are invited to become shareholders and this can be done through the prospectus. Thus, the promoters have to ensure that 'the real truth is disclosed to those who are induced by the promoters to join the company.'

Liabilities of a promoter are:

1. ***For non-disclosure.*** In case a promoter fails to make full disclosure at the time the contract was made, the company may either: (i) rescind the contract and recover the purchase price where he sold his own property to the company, or (ii) recover the profit made, even though rescission is not claimed or is impossible, or (iii) claim damages for breach of his fiduciary duty. The measure of damages will be the difference between the market value of the property and the contract price.

2. ***Under the Companies Act.*** (i) Promoter is liable to the original allottee of shares for the mis-statements contained in the prospectus. It is clear that his liability does not extend to subsequent allottees. He may also be imprisoned for a term which may extend to 2 years or may be punished with fine upto ₹ 50,000 for such untrue statements in the prospectus (Ss.62 and 63). (ii) In the course of winding up of the company, on an application made by official Liquidator, the court may make a promoter liable for misfeasance or breach of trust (s.543). The court may also order for the public examination of the promoter (Ss.478 and 519).

Where there are more than one promoter, they are jointly and severally liable and if one of them is sued and pays damages, he is entitled to claim contribution from other or others. However, the death of a promoter does not relieve his estate from liability arising out of abuse of his fiduciary position.

8.1.2 Registration (Ss. 12 and 33)

Section 12 states that, "any seven or more persons or where the company to be formed will be a private company, two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration form an incorporated company, with or without limited

liability." Thus, the promoters will have to get together at least seven persons in the case of a public company, or two persons in the case of a private company to subscribe to the memorandum of association.

Section 33 states that the following three documents are required to be presented to the Registrar of Companies of the State in which the registered office of the company is to be situated, for the purpose of registration of a company:

(i) the memorandum of the company;

(ii) the articles, if any;

(iii) the agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or wholetime director or manager.

The documents in (i) and (ii) above are required to be signed by seven persons in the case of a public company and by two persons in the case of a private company. As we shall see later, certain types of companies need not frame their own Articles of Association; in that case "Regulations for Management of a Company Limited by shares" (given in Table A of Schedule I to the Act, 1956) may be adopted.

Section 33 also requires a declaration to be filed with the Registrar along with the Memorandum and the Articles. This is known as "Statutory Declaration of Compliance." It can be made by an advocate of Supreme Court or of a High Court, an attorney or pleader entitled to appear before a High Court, or a Company Secretary or a Chartered Accountant in wholetime practice in India, who is engaged in the formation of the company, or by a person named in the articles as a director, manager or secretary of the company. The declaration must certify that all requirements of the Act and Rules made thereunder in respect of registration have been complied with.

Section 266 requires that if the first directors are appointed by the articles then the following must be complied with before the registration of articles with the Registrar: (i) Written consent of those directors to act, signed by themselves, or by an agent duly authorised in writing; and (ii) an undertaking in writing signed by each such director to take from the company and pay for his qualification shares (if any), unless he has taken his qualification shares and paid or agreed to pay for them, or signed the Memorandum for a number of shares not less than the qualification shares.

Section 266 is applicable only to a public company having a share capital.

Availability of Name

Section 20 states that a company cannot be registered by a name, which in the opinion of the Central Government is undesirable. Therefore, it is advisable that promoters find out the availability of the proposed name of the company from the Registrar of Companies. For the purpose, three names in order of priority should be filed.

The following two documents, though not required to be filed for the purpose of registration, are usually delivered along with the aforesaid documents.

(i) The address of the registered office of the company (s.146).

(ii) Particulars regarding directors, manager and secretary, if any (s.303).

These two documents are required to be submitted within thirty days of registration of the company.

Certificate of Incorporation/Consequences of Incorporation

When the aforesaid documents have been filed with the Registrar and the necessary fees paid, the Registrar will, if he is satisfied, enter the name of the company on the Register of Companies maintained by him (s.33) and then will issue a Certificate of Incorporation under his signature in token of registration of the company on the date noted on it (s.34). This certificate serves the same purpose in the case of a company which a birth certificate does in the case of a natural person.

On registration, the company comes into existence as a legal person distinct from its members who constitute it from the earliest moment of the day of incorporation stated in the certificate of incorporation, with rights and liabilities similar to a natural person, competent to enter into contracts (s.34).

The certificate of incorporation is conclusive evidence that all the requirements of the Companies Act in respect of registration and of matters precedent and incidental thereto have been complied with. Accordingly, if memorandum is found to be materially altered after signature but before registration (Peel's case), or is signed by only one person for all the seven subscribers or the signatories be all infants (*Moosa Goolam Ariff v. Ebrahim Gulam Ariff*), the certificate would be nevertheless conclusive and would not affect the status and existence of the company as a legal person although such irregularities might give rise to claim between the subscribers.

This provision prevents the reopening of matters prior and contemporaneous to the registration and essential to it and it places the existence of the company as a legal person beyond doubt.

In the case of *Moosa v. Ebrahim*, the memorandum was signed by two adult persons and by a guardian of the other five members, who were minors. The Registrar, however, registered the company and issued a certificate of incorporation. The court held the certificate to be conclusive for all purposes.

In another case of *Jubilee Cotton Mills Ltd. v. Lewis*, the Registrar issued a certificate of incorporation on January 8th, but dated it January 6th, which was the date he received the documents. On January 6th, the company made an allotment of share to Lewis. Held, that the certificate was conclusive evidence of incorporation on January 6th and that the allotment was not void on the ground that it was made before the company was incorporated.

However, if a company has been incorporated with illegal objects, the illegal objects would not become legal by the issue of the certificate.

Section 36 states that, on registration, memorandum and articles of the company bind the company and its members to the same extent as if they respectively had been signed by the company and by the members and contained covenants on its and their part to observe all the provisions contained in the Memorandum and Articles.

8.1.3 Floatation

When a company has been registered and has received its certificate of incorporation, it is ready for 'floatation', that is to say, it can go ahead with raising capital sufficient to commence business and to carry it on satisfactorily.

We have seen earlier under 'classification of companies' that a private company is prohibited from inviting public to subscribe to its share capital. Therefore, when a private company is formed, the necessary capital is obtained from friends and relatives by private arrangement.

In the case of a public company also, the promoters may not invite public to subscribe to its share capital and may arrange the capital privately as in the case of a private company. In such a case, the intention of the promoters is to take advantages of incorporation not available to a private company, e.g., to have unlimited number of members, to confer unrestricted right to transfer

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shares on the members, etc. However, by far the largest number of public companies raise their capital in the very first instance by inviting public to subscribe to its share capital.

Section 70 makes it obligatory for every public company to take either of the following two steps:

(i) Issue a prospectus in case public is to be invited to subscribe to its capital, or

(ii) Submit a 'statement in lieu of prospectus' in case capital has been arranged privately. It must be done at least 3 days before allotment.

Certificate to Commence Business

We have mentioned earlier that one of the privileges of a private company is that it has neither to issue a prospectus nor to submit a statement in lieu of prospectus with the Registrar. It can go ahead with the allotment of shares without these formalities and, therefore, can commence business immediately after the certificate of incorporation has been obtained. Section 149 exempts a private company from obtaining a certificate to commence business.

However, in the case of every public company having share capital, it is absolutely necessary to obtain a certificate to commence business. This certificate can be obtained only after 'floatation' of the company.

The procedure for obtaining the certificate varies with the fact whether the company has issued a prospectus or not. If the company has issued a prospectus, then the procedure stated in s.149 (1) becomes applicable, and if it has not issued a prospectus, then the procedure as laid down in s.149 (2) shall apply.

Where the Company has issued a prospectus. S.149 (1) provides that if a company having a share capital has issued a prospectus, it shall not commence business or exercise any borrowing powers unless:

(a) shares upto the amount of the minimum subscription have been allotted by the company;

(b) every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, the same proportion as is payable on application and allotment on the shares, offered for public subscription;

(c) no money is, or may become, liable to be repaid to the applicants for shares or debentures offered for public subscription, for failure to apply for, or to obtain permission for the shares to be dealt in any recognised stock exchange;

(d) there has been filed with the Registrar a duly verified declaration by one of the directors or the secretary or, where the company has not appointed a secretary, a secretary in whole time practice in the prescribed form (Form No. 19) that clauses (a), (b) and (c) (mentioned above) have been complied with.

Where the company has not issued a prospectus. If a public company having share capital has not issued a prospectus, s.149 (2) requires that it shall not commence business or exercise its borrowing powers unless:

(a) it has filed with the Registrar a statement in lieu of prospectus;

(b) every director of the company has paid to the company on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, the same proportion as is payable on application and allotment on the shares payable in cash;

(c) there has been filed with the Registrar duly verified declaration by one of the directors or the secretary or where the company has not appointed a secretary, a secretary in whole time practice in the prescribed form (form No. 20), that clause (b), as stated above, has been complied with.

When the company has complied with these conditions, the Registrar will issue a certificate to commence business.

Penalty: If any public company having share capital commences business or exercises borrowing power without obtaining the certificate to commence business, then every person at fault is liable to a fine upto ₹5000 for every day of default.

The certificate to commence business entitles the company to commence business given in the main objects clause of the memorandum. No business given in the 'other objects' clause can be commenced without obtaining prior approval of the shareholder by special resolution. However, the Central Government may, on an application made by the Board of Directors allow a company to commence business in the 'other objects' clause, even if only ordinary resolution is passed by the company in general meeting.

Pre-incorporation and Provisional Contracts

We have mentioned earlier that a company is an artificial person and is capable of entering into contracts. The promoters may enter into contracts with third parties on behalf of the proposed company before obtaining the certificate of incorporation or after obtaining the certificate of incorporation but before obtaining the certificate to commence business. Thus, in the case of a public company following are the three situations when contracts may be entered into:

(i) contracts before incorporation,

(ii) contracts after incorporation but before obtaining the certificate to commence business and

(iii) contracts after obtaining the certificate to commence business.

However, in the case of a private company, as it is not required to obtain the certificate to commence business, there are only two situations, i.e., (i) contracts before incorporation; and (ii) contracts after incorporation.

Those contracts which are entered into by promoters for the intended company before registration of the company are known as pre-incorporation or preliminary contracts. Very often a company is formed to purchase an existing business or other property. In such circumstances, the promoters enter into contracts with the owners of the business or property to be acquired by the proposed company.

A pre-incorporation contract never binds a company since a person cannot contract before his (or its) existence and a company before incorporation has no legal existence. However, Ss.15(h) and 19 (e) of the Specific Relief Act, 1963 has provided some relief in this regard. It provides that when promoters of a company have, before its incorporation entered into a contract for the purpose of the company and such a contract is warranted by the terms of its incorporation, the contract may be specifically enforced by or against the company. It is, however, necessary that the company in such a case must have accepted the contract after its incorporation and communicated such acceptance to the other party to the contract. Contracts like preparation and printing of the Memorandum, Articles, etc., renting a premises, hiring secretarial staff are envisaged under the Act.

Liability of promoters vis-à-vis pre-incorporation contracts. An important question that needs to be tackled is what is the position of a promoter vis-à-vis preliminary contracts? If the company does not execute a fresh contract after incorporation and the contract is not one warranted for the purpose of incorporation of the company, what will be the legal position of the promoter who brings about such a contract?

In *Phonogram Ltd. v. Lane* (1982) Q.B. 938, it was observed that although a contract made before a company's incorporation cannot bind the company, it is not wholly devoid of legal effect,

even if all the persons who negotiated the contract are aware that the company has not yet been incorporated.

The contract takes effect as a personal contract with the persons who purport to contract on the company's behalf [*Kelner v. Baxter* (1866) LR 2 CP 174]. Promoters shall be liable to pay damages for failure to perform the promises made in the company's name. This shall be so even where the contract expressly provides that only the company's paid up capital shall be answerable for performance [*Scot v. Lord Ebury* (1867) LR 2 CP 255].

Provisional contracts. Those contracts which are entered into by a public company after obtaining the certificate of incorporation but before getting the certificate to commence business are known as provisional contracts [s.149(4)]. Such contracts are not binding on the company until the company is entitled to commence business and on that date they shall become binding, without any need for ratification.

If the company is unable to obtain the certificate to commence business, the provisional contracts will never become binding on it and no one can sue in respect of them.

As it shall be explained later, a company can do only such acts as by its memorandum it is expressly or impliedly authorised to do. Any transaction which is not so authorised is ultra vires (beyond the powers) and is null and void ab initio. Neither the company, nor the other party to the contract can enforce it.

Form of Contracts made by Companies

Section 46 provides that a company can, in general, contract in the same form as an individual. Thus, a contract which, if made between private persons, is required to be in writing, may be made on behalf of the company also in writing. It should be signed by a person acting under the express or implied authority of the company. Such contracts may also be varied or discharged in the same manner. Also, a contract which would be valid if made between private persons although made orally or by parol on behalf of the company by any person acting under express or implied authority. Such contracts could also be varied or discharged in the same manner.

Some contracts are required to be under seal and, therefore, s.147 requires every company incorporated under the Act to have a common seal upon which its name should be engraved in legible characters.

Under s.50, a company may obtain power through its articles to have an official seal, for use outside India. This is in addition to a common seal.

8.2 Winding up of Companies

Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called a 'liquidator', is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights. In simple words winding up means applying the assets of a company in the discharge of its liabilities and returning any surplus to those entitled to it, subject to the cost of doing so. The statutory process by which this is achieved is called 'liquidation'. Winding up of a company differs from insolvency of an individual inasmuch as a company cannot be made insolvent under the insolvency law. Besides, even a solvent company may be wound up.

Modes of Winding up

A company may be wound up in any of the following two ways: A. Compulsory winding up under an order of the Court. B. Voluntary winding up. C. A voluntary winding up under the supervision of the Court.

Winding up by the Court

Winding up by the Court, also called compulsory winding up, may be ordered in cases mentioned in Sec.433. The Court will make an order for winding up on an application by any of the persons enlisted in Sec.439.

Voluntary Winding up

Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up', In voluntary winding up, the company and its creditors are left to settle their affairs without going to the Tribunal for directions or orders if and when necessary. Winding up should not be confused with insolvency. Company may be solvent and running a prosperous business yet it may decide to be wound up voluntarily, e.g., in pursuance of a scheme of reconstruction or amalgamation.

A company may be wound up voluntarily: (1) if the company in general meeting passes an ordinary resolution for voluntary winding up where the period fixed by the Articles for the duration of the company has expired or the event has occurred on which under the Articles the company is to be dissolved; (2) if the company resolves by special resolution that it shall be wound up voluntarily (s.484).

Members' Voluntary Winding up

Members' Voluntary winding up is possible only when the company is solvent and is able to pay its liabilities in full. Following are the important provisions regarding members' voluntary winding up.

The procedure in a creditors' voluntary winding up is based upon the assumption that the company is insolvent. From the beginning, meetings of creditors are held in addition to those of the members.

8.3 Memorandum of Association

8.3.1 Meaning and Purpose

The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated. It tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. Thus, it defines as well as confines the powers of the company. If anything is done beyond these powers, that will be ultra vires (beyond powers of) the company and so void.

The memorandum serves a two-fold purpose. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities. Thus, the intending shareholder can find out the field in, or the purpose for which his money is going to be used by the company and what risk he is taking in making the investment. Also, any one dealing with the company, say, a supplier of goods or money, will know whether the transaction he intends to make with the company is within the objects of the company and not ultra vires its objects.

8.3.2 Form and Contents

Section 14 requires that the memorandum of a company shall be in such one of the Forms in Tables B, C, D and E in Schedule I to the Act, as may be applicable in the case of the company, or in Forms as near thereto as circumstances admit. Section 15 requires the memorandum to be

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printed, divided into paragraphs, numbered consecutively and signed by at least seven persons (two in the case of a private company) in the presence of at least one witness, who will attest the signature. Each of the members must take at least one share and write opposite his name the number of shares he takes. Section 13 requires the memorandum of a limited company to contain: (i) the name of the company, with 'limited' as the last word of the name in the case of a public company and 'private limited' as the last words in the case of a private company; (ii) the name of the State, in which the registered officer of the company is to be situated; (iii) the objects of the company, stating separately 'Main objects' and 'other objects'; (iv) the declaration that the liability of the members is limited; and (v) the amount of the authorised share capital, divided into shares of fixed amounts. These contents of the memorandum are called compulsory clauses and are explained below.

The name clause. The promoters are free to choose any suitable name for the company provided:

(a) The last word in the name of the company, if limited by shares or guarantee is 'limited' unless the company is registered under s.25 as an 'association not for profit' [s.13(1) (a) & s.25].

(b) In the opinion of the Central Government, the name chosen is not undesirable [s.20(1)].

The Department of Company Affairs has issued guidelines for deciding availability of names. However these are not exhaustive but only illustrative of what is considered an undesirable name under s.20.

Too similar name. In case of too similar names, the resemblance between the two names must be such as to be calculated to deceive. A name shall be said to be calculated to deceive where it suggests some connection or association with the existing company.

Example:

(i) In *Society of Motor Manufacturers and Traders Ltd. v. Motor Manufacturers and Traders Mutual Assurance Ltd.* (1925) 1 Ch. 675, the plaintiff company brought an action to restrain the defendant company to use the said name. But, Lawrence, J., held "any one who took the trouble to think about the matter, would see the defendant company was an insurance company and that the plaintiff society was a trade protection society and I do not think that the defendant company is liable to have its business stopped unless it changes its name simply because a thoughtless person might unwarrantedly jump to the conclusion that it is connected with the plaintiff society."

(ii) In *Asiatic Govt. Security Life Insurance Co. Ltd. v. New Asiatic Insurance Co. Ltd.* (1939) 9 Comp. Cas. 208, the court held the two names were not too identical and therefore did not restrain from using their name.

(iii) In *Ervind v. Buttercup Margarine Co. Ltd.* (1917), the plaintiff who carried on business under the name of the Buttercup Dairy Co. succeeded in obtaining an injunction against the defendant on the ground that the public might think that the two businesses were connected, since the word 'buttercup' was an unnecessary and fancy one.

(iv) In *Executive Board of the Methodist Church in India v. Union of India* (1985) 57 Comp. Cas. 443 (Bom), the Methodist Church in India sought registration of a company in the name of 'Methodist Church in India Trust Association'. There was already existing a company bearing the name Methodist Church in Northern India Trust Association (P) Ltd.' in Calcutta. The former secretary of the later's association informed the Registrar that the said company had not functioned since 1970; that no annual reports or minutes had been filed with the Registrar since 1970; and that some directors had died and some had left. The question was whether in these circumstances the Calcutta company was a bar to the registration of the new company.

Held, if a company is practically defunct, it is not a bar to registration of a new company with a similar name.

Use of certain key words as part of the name. The Department of Company Affairs has clarified that if a company used any of the following key words in its name, it must have a minimum authorised capital mentioned against the key words:

	Keywords	Required authorised capital (₹)
(i)	Corporation	5 crores
(ii)	International, Globe, Universal Continental, Inter-continental, Asiatic, Asia, being the first word of the name	1 crores
(iii)	If any of the words at (ii) above is used within the name (with or without brackets)	50 lakhs
(iv)	Hindustan, India, Bharat, being the first word of the name	50 lakhs
(v)	If any of the words at (iv) above is used within the name (with or without brackets)	5 lakhs
(vi)	Industries/Udyog	1 crore
(vii)	Enterprises, Products, Business, Manufacturing	10 lakhs

Publication of name (s.147). Every company shall:

(a) Paint or affix its name and the address of its registered office and keep the same painted or affixed, on the outside of every office or place of business in a conspicuous position in letters easily legible and in the language in general use in the locality.

Department of Company Affairs has clarified that exhibition of its name in English alone, without at the same time showing it in the local language will not be sufficient compliance with the requirements of the Section.

The words 'outside of every office' do not mean outside the premises in which the office is situated [*Dr. H.L. Batliwala Sons & Co. Ltd. v. Emperor* (1941) 11 Comp. Cas. 154 (Bom)]. Where office is situated within a compound, the display outside the office room though inside the building is sufficient.

(b) have its name engraven in legible characters on its seal.

(c) have its name and address of its registered office mentioned in legible characters in all business letters, bill heads, negotiable instruments, invoices, receipts, etc. of the company.

Penalty. If a company does not paint or affix its name and the address of its registered office in the prescribed manner, the company and every officer of the company who is in default shall be punishable with fine.

Also, every officer of a company or any person on its behalf who signs or authorises to be signed on behalf of the company any bill of exchange, hundi, promissory note or cheque, etc., wherein the name of the company is not mentioned in the prescribed manner, shall be personally liable to the holder of such bill of exchange, hundi, promisory note, cheque, etc., for the amount thereof unless it is paid the company. Personal Liability will, however, be not incurred in the following cases:

(a) The holder of a negotiable instrument, on which the company's name has been incorrectly stated, will not be able to enforce the personal liability under s.147(4) against the officer concerned if the error was due to the holder's own act [*Durham Fancy Goods Ltd. v. Michael Jackson (Fancy Goods) Ltd. and Another* (1968) 2 Q.B. 839].

(b) The word 'Limited' is abbreviated to 'Ltd.' (*P. Stacey & Co. v. Wallis* (1912) 28 T.L.R. 219.

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(c) There is an accidental omission of the word 'limited' [*Dermatine Co. v. Ashworth* (1905) 21 T.L.R. 510]. In this case, a bill of exchange was accepted on behalf of a limited company. The rubber stamp of the company was longer than the paper. As a result, the word 'limited' did not appear on the instrument. Held, the directors who accepted the bill of exchange were not personally liable because omission was neither deliberate nor of negligent origin. It was an obvious error of most trifling kind and the mischief aimed at by the Act did not here exist.

The Registered office clause [s.13(1) (b)]. This clause states the name of the State in which the registered office of the company will be situated. Every company must have registered office which establishes its domicile and it is also the address at which company's statutory books must normally be kept and to which notices and all other communications can be sent. The notice of the exact situation (address) of the registered office may be given to the Registrar within thirty days from the date of incorporation (s.146).

As in the case of publication of the company's name, s.147 also makes similar provisions regarding publication of the Registered Office of the company.

The objects clause [s.13 (1) (d)]. The objects clause defines the objects of the company and indicates the sphere of it activities. A company cannot do anything beyond or outside its objects and any act done beyond them will be ultra vires and void and cannot be ratified even by the assent of the whole body of shareholders. However, a company may do anything which is incidental to and consequential upon the objects specified and such act will not be ultra vires. Thus, a trading company has an implied power to borrow money, draw and accept bills of exchange.

Section 13, read along with Tables 'B', 'C', 'D' and 'E', requires the company to divide its objects clause into three parts: (a) Main objects of the company to be pursued by the company on its incorporation; (b) Objects incidental or ancillary to the attainment of the main objects; and (c) Other objects of the company not included in (a) and (b) above. A company, may on receipt of certificate to commence business, pursue any business given in the 'main objects'. In the case of companies (other than trading companies) with objects not confined to one State, the Memorandum must give the name of the State/(s) to whose 'territories the objects extend'. No business given in 'other objects' can, however, be commenced unless prior approval of shareholders with regard thereto is obtained by way of special resolution passed in general meeting [s.149 (2A)]. Where special resolution is not passed, the Central Government, may on an application made by the Board of directors, allow a company to commence business in the 'other objects', provided the votes cast in favour of the resolution exceed the votes cast against the resolution, if any [s.149(2B)].

The objects of the company must not be illegal, immoral or opposed to public policy or in contravention of the Act. For example, s.77 prohibits a company to purchase its own shares.

Liability clause [s.13 (2)]. This clause states the nature of liability of the members. In case of a company with limited liability, it must state that liability of members is limited, whether it be by shares or by guarantee. This means that in case of a company limited by shares, a member can be called upon at any time to pay to the company the amount unpaid on the shares held by him. In case of companies limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets of the company in the event of its winding up.

In the case of an unlimited company, this clause need not be given in the memorandum. In fact, the absence of this clause in the memorandum means that the liability of its members is unlimited.

As per s.45, under certain circumstances the liability of members of a limited company becomes unlimited.

The capital clause [s.13 (4) (c)]. This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value, i.e., the number of

shares into which the capital is divided and the amount of each share. If there are both equity and preference shares, then the division of the capital is to be shown under these two heads.

The association clause [s.13(4)(c)]. At the end of the memorandum of every company there is an association or subscription clause or a declaration of association which reads something like this:

"We, the several persons whose names and addresses and occupations are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association and we respectively agree to take the number of shares in the capital of the company set opposite our respective names".

Then follow the names, addresses, descriptions, occupations of the subscribers and the number of shares each subscriber has taken and his signature attested by a witness.

8.3.3 Doctrine of Ultra Vires

We have mentioned earlier that a company cannot go beyond its objects mentioned in its memorandum. The company's activities are confined strictly to the objects mentioned in its memorandum and if they go beyond these objects, then such acts will be ultra vires. The object of declaring such act as ultra vires is to protect the interests of shareholders and all others who deal with the company. Some points worth noting as regards doctrine of ultra vires are:

1. A company exists only for the objects which are expressly stated in its objects clause or which are incidental to or consequential upon these specified objects.
2. Any act done outside the express or implied objects is ultra vires.
3. The ultra vires acts are null and void ab initio. The company is not bound by these acts; and neither the company nor the other contracting party can sue upon it.

Example: (i) A company with the objects, namely (a) to make and sell or lend on hire railway carriages and wagons and all kinds of railway plant, fittings, machinery and rolling stock; (b) to carry on the business of mechanical engineers and general contractors; (c) to purchase, lease, work and sell, mines, minerals, land and buildings; (d) to purchase and sell as merchants timber, coal, metals or other materials. The company contracted to finance the construction of a railway bridge in Belgium and there was evidence that the agreement had been ratified by all the members. Later, the company repudiated the agreement and was sued for breach of contract. In its defence the company repudiated its lack of capacity to enter into a contract which was outside the scope of its objects clause. The other party brought an action for damages for breach of contract. His contentions were that the contract in question came well within the meaning of the words 'general contractors' and, was, therefore, within the powers of the company and secondly, that the contract was ratified by the majority of the shareholders.

Held, that the term general contractors must be taken to indicate the making generally of such contracts as were connected with the business of mechanical engineers. If the term 'general contractors' was so interpreted it would authorise the making of contracts of any and every description, such as, for instance, of fire and marine insurance and the memorandum in place of specifying the particular kind of business, would virtually point to the carrying on of business of any kind whatsoever and would, therefore, be altogether unmeaningful. Hence, the contract was entirely beyond the objects in the memorandum of association. [Ashbury Railway Carriage and Iron Co. v. Riche (1875) LR 7 HL 653].

(ii) The objects clause of a company included making of costumes, gowns and similar things within the clothing trade. However, it extended its activities to the manufacture of veneered panels and became indebted to three parties (a) builders of the veneered panels factory, (b) suppliers of veneers and (c) fuel merchants. In the meantime the company went into liquidation and rejected the claim of the three creditors. The creditors filed suits for the recovery of money.

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Held, the contention of the liquidator was correct as all the three contracts were clearly ultra vires.

4. In case a company is about to undertake an ultra vires act, the members of a company (even a single member) can get an order of injunction from the court restraining the company from going ahead with the ultra vires act.
5. If the directors have exceeded their authority and done something then such matter can be ratified by the general body of the shareholders, provided the company has the capacity to do so by its memorandum of association.

Example: Company has the power to borrow money, but the Articles of the company provide that in case the directors borrow more than ₹ 50,000, they should get prior approval by the company in general meeting. However, the directors can issue debentures to the extent of ₹ 75,000 without getting the approval from the shareholders.

The company in general meeting may ratify the act of directors as it is intra vires the company, though ultra vires the powers of the directors of the company.

6. Any property acquired by a company under an ultra vires transaction may be protected by the company against damage by third persons.
7. Directors and other officers can be held liable to compensate the company for any loss occasioned to it by an ultra vires act.
8. Directors and other officers shall be personally accountable to the third parties
9. Money or property gained through an ultra-vires transaction available in specie or capable of being identified shall be restituted (restored) to the other party.
10. In case, an ultra-vires loan, taken by a company is used for payment of its intra-vires debts, the lender of the ultra vires loan is substituted in place of the creditor who has been paid off and as such can recover the money.

8.3.4 Alteration of Memorandum

Section 16 provides that the company cannot alter the conditions contained in memorandum except in the cases and in the mode and to the extent express provision has been made in the Act. These provisions are explained herein below.

Change of name. Section 21 provides that the name of a company may be changed at any time by passing a special resolution at a general meeting of the company and with the written approval of the Central Government. However, no approval of the Central Government is necessary if the change of the name involves only the addition or deletion of the word 'private' (i.e., when public company is converted into a private company or vice versa).

If through inadvertence or otherwise, a company has been registered with a name which is identical with or too closely resembles with the name of an existing company, the company may change its name by passing an ordinary resolution and by obtaining the approval of the Central Government in writing (s.22).

The change of name must be communicated to the Registrar of Companies within 30 days of the change. The Registrar shall then enter the new name on the register in the place of the old name and shall issue a fresh certificate of incorporation with necessary alterations [s.23(1)]. The change of name becomes effective on the issue of fresh certificate of incorporation. The Registrar will also make the necessary alteration in the memorandum of association of the company [s.23(2)].

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However, change of name shall not affect any rights or obligations of the company or render defective any legal proceeding which might have been continued or commenced by or against the company by its former name may be continued by or against the company by its new name [s.23(3).]

Within 30 days of the passing of the special resolution, a printed or a type written copy of the resolution should be sent to the Registrar of Companies.

Change of registered office. The procedure depends on whether the change is within the jurisdiction of same registrar of companies (s. 146) or whether the shifting is to the jurisdiction of another registrar of companies in the same state (s. 146 and s. 17A). This may include:

(a) Change of registered office from one premises to another premises in the same city, town or village. The company may do so anytime. A resolution passed by the Board of directors shall be sufficient. However, notice of the change should, within 30 days after the date of the change, be given to the Registrar who shall record the same (s.146).

(b) Change of registered office from one town or city or village to another town or city or village in the same State (s.146). In this case, the procedure is :

    (i) a special resolution is required to be passed at a general meeting of the shareholders;

    (ii) a copy of it is to be filed with the Registrar within 30 days.

    (iii) Within 30 days of the removal of the registered office, notice of the new location has to be given to the Registrar who shall record the same.

(c) Shifting of the registered office from one place to another within the same state (s.17A) The shifting of the registered office by a company from the jurisdiction of one registrar of companies to the jurisdiction of another registrar of companies within the same state shall (in addition to requirements under s. 146) also require confirmation by the Regional Director. For this purpose, an application is to be made in the prescribed form and the confirmation shall be communicated within four weeks. Such confirmation is required to be field within two months with the registrar of companies who shall register and certify the same within one month. Such certificate shall be conclusive evidence of the compliance of all requirements under the Act.

(d) Change of registered office from one state to another state.

Section 17 provides for the shift of the registered office from one State to another and such shift involves alteration of memorandum. The change of registered office from one locality to another in the same city or from one city to another in the same State does not involve alteration of memorandum.

The shift of the registered office from one State to another can be done by a special resolution which is required to be confirmed by the Central Government. The Central Government, before confirming the resolution, will satisfy itself that sufficient notice has been given to every creditor and all other persons whose interests are likely to be affected by the alteration, including the Registrar of Companies and the Government of the State in which the registered office is situated. Also, the Central Government will give an opportunity to members and creditors of the company, the Registrar and other persons interested in the company to be heard. The Central Government may confirm the resolution on such terms and conditions as it thinks fit.

It was made clear in *Zuari Agro Chemicals Ltd. v. F. S. Wadia and Others* (1974) 44 Comp. Cas. 465 that the Company Law Board (now Central government) will not substitute its own wisdom or judgement for the collective wisdom or judgement of the company expressed in special resolution. But the bonafides of the company's application for change can be screened.

Loss of revenues of state, whether relevant consideration. In *Orient Paper Mills Ltd. v. State*, AIR (1957) Ori. 232 it was observed that a State whose interests are affected by the change has a locus standi to oppose shift of registered office of a company. Accordingly, the Orissa High court declined to confirm change of registered office from Orissa to West Bengal, inter alia, on the ground that in a Federal constitution every State has the right to protect its revenue and, therefore, the interest of the State must be taken into account.

But in *Minerva Mills Ltd. v. Govt. of Maharashtra* (1975) 45 Comp. Cas 1(Bom.), Justice Ray of the Bombay High Court held that the Company Law Board (now Central government) cannot refuse confirmation on the ground that the change would cause loss of revenue to a State or would have adverse effects on the general economics of the State. The question of loss of revenue to one State would have to be considered in the prospectus of total revenues for the Republic of India and no parochial considerations should be allowed to turn the scale in regard to change of registered office from one State to another within India.

Similar view was expressed in *Rank Film Distributors of India Ltd. v. Registrar of Companies, West Bengal* [AIR (1969) Cal. 32]. i.e. that State has no statutory right under s. 17 to oppose the shifting of the registered office from one State to another.

A printed or a typewritten copy of the special resolution both under s. 146 and s. 17 should be sent to the Registrar within 30 days of its passing.

A certified copy of the Central Government order of the Central Government should be filed within three months thereof with the Registrar of each State – the old and the new State. If it is not filed within the prescribed time, then the alteration shall, at the expiry of such period, become void and inoperative.

A notice of the new location of the registered office must be given to the Registrar of the State to which the office has been shifted, within thirty days after the change of the office (s.146).

A company is in a position to shift its registered office from one State to another for certain purposes only. These are discussed in the following paragraph (under 'Alteration of objects' – the grounds being common).

Alteration of objects clause. Section 17 empowers a company by a special resolution to alter the objects or to change the place of its registered office from one State to another if the alteration is sought on any of the following grounds.

1. ***To carry on its business more economically and more efficiently.*** In *Dalmia Cement (Bharat) Ltd.***,** In re (1964) 34 Comp. Cas. 729 (Mad.), the Court observed that whether a company can carry on its business more economically or more efficiently is a matter for the judgement of the directors. If the directors consider that under the existing circumstances, it will be convenient and advantageous to combine the new objects with the existing objects and if it appears that such a conclusion may be fairly arrived at, the Court (now Central government) will not go behind it and hold an enquiry as to whether the opinion of the directors is well founded or is justified.

   The true legal position, observed the Delhi High Court, is that the business must remain substantially the same and the additions, alterations and changes should only be steps-in-aid to improve the efficiency of the company [*Delhi Bharat Grain Merchants Assn. Ltd., In re* (1974) 44 Comp. Cas. 214 (Delhi)].

   In Re, Scientific Poultry Breeders Association (1933) 3 Comp. Cas. 89 (CA), a company's memorandum prohibited payment of remuneration to the members of its governing body. It wanted for efficient management, amendment in the memorandum to enable it to pay remuneration to its governing body members which was allowed.

2. ***To attain its main purpose by new or improved means.*** For the companies registered after 10th October, 1965, there is no difficulty in ascertaining the main purpose because the Memorandum would state it. But for the companies registered earlier, one has to look not only to the memorandum but also to what has actually been done.

3. ***To enlarge or change the local area of its operation.*** In *India Mechanical Gold Extracting Company*, In Re (1891) 3 Ch. 538, the company's business was confined to the 'Empire of India'. It wanted to enlarge its operations by dropping these words. It was allowed to do so on the condition that the word 'Indian' was also dropped from its name.

4. ***To carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company.*** In fact, most of the amendments sought in objects clause are based on this ground. This clause enables a company to diversify. The working of the clause makes its scope very wide in as much as any activity which may either conveniently or advantageously be combined with the existing business may be allowed.

5. ***To restrict or abandon any of the objects specified in the memorandum.*** Even for deleting any portion of the object clause, the procedure laid down in s.17 has to be followed.

6. ***To sell or dispose of the whole or any part of the undertaking.*** Where a company wishes to adopt a cut-back or retrenchment strategy, i.e., where it feels that it has either grown too big or diversified in various directions that managing becomes difficult or uneconomical, it may alter its objects to sell or dispose of any of its undertakings.

7. ***To amalgamate with any other company or body of persons.***

A printed or a typewritten copy of the special resolution is required to be filed with the Registrar within thirty days of the passing thereof.

Also a petition is to be filed with the Central Government for confirmation of the special resolution. The Central Government, being satisfied that the notice of the resolution was given to all persons whose interests are likely to be affected by the alteration, including the Registrar and the State Government and having heard them, may confirm the alteration either wholly or in part.

A certified copy of the order of the Central Government together with a printed copy of the altered memorandum must be filed within three months of the date of the order, with the Registrar. The Registrar will register the documents and issue, within one month a certificate which will be conclusive evidence that everything required has been done (s.18). If the required documents are not filed within the prescribed time, the alteration and the order of the Central Government confirming the alteration, shall, at the expiry of such period, become void and inoperative (s.19).

Alteration of liability clause (s.38). The liability of a member of a company cannot be increased unless the member agrees in writing. The consent of the member may, however, be given either before or after the alteration. Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner.

In case where the company is a club or any other similar association and the alteration in the memorandum requires the member to pay recurring or periodical subscription or charges at a higher rate, although he does not agree in writing to be bound by the alteration, it shall be binding on him.

In case of unlimited liability company, the liability may be made limited. The alteration will, however, not affect any debts, liabilities, obligations or contracts entered into by or with the company before the conversion.

Alteration of capital clause. Section 94 provides that, if the articles authorise, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as:

1. to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;

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2. to consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
3. to convert all or any of its fully paid-up shares into stock and reconvert the stock into fully paid-up shares of any denomination;
4. to sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion paid and unpaid on each share must remain the same;
5. to cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person.

These five clauses are now explained.

Increase of authorised share capital. A company, limited by shares, if the article authorise, can increase its authorised share capital by passing an ordinary resolution.

Within 30 days of the passing of the resolution, a notice of increase in the share capital must be filed with the Registrar. On receipt of the notice, the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both.

If default is made in filing the notice, the company and every officer of the company who is in default shall be punishable with fine upto ₹ 50 per day during which the default continues (s.97).

Consolidation and sub-division of shares. Consolidation is the process of combining shares of smaller denomination. For instance, 10 shares of ₹ 10 each may be consolidated into one share of ₹ 100.

Sub-division of shares is just the opposite of consolidation, e.g., one share of ₹ 100 may be divided into 10 shares of ₹ 0 each.

Once a resolution has been passed, a copy of the resolution is required to be sent within thirty days to the Registrar of Companies.

Conversion of shares into stock and vice versa. Stock is simply a set of fully-paid up shares put together and is transferable in any denomination or fraction. On the other hand, a share is transferable as a whole; it cannot be split into parts.

Example: A share of ₹ 10 can be transferred as a whole; it cannot be transferred in parts. But if 10 shares of ₹ 10 each fully paid are converted into stock of ₹ 100, then the stockholder can transfer stock, say, worth ₹ 5 also.

Section 94 empowers a company to convert its fully paid-up shares into stock by passing a resolution in general meeting, if its articles authorise such conversion. A notice is to be filed with the Registrar within thirty days of the passing of the resolution specifying the shares so converted.

It is to be noted that stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also, stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.

When shares are converted into stock, the shareholders are issued stock certificates. In the Register of Members, the amount of stock is written against the name of a particular member in place of number of shares. The stockholder is as much a member of the company as a shareholder.

Diminution of share capital. Sometimes, it so happens that shares are issued, but are not taken up by the members of the public and, therefore, not allotted. Section 94 provides that a company may, if its articles authorise, by resolution in general meeting, cancel shares which, at the date

of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital which is discussed under unit on 'Share capital'.

8.4 Articles of Association

8.4.1 Meaning and Purpose

The articles of association of a company and its bye laws are regulations which govern the management of its internal affairs and the conduct of its business. They define the duties, rights, powers and authority of the shareholders and the directors in their respective capacities and of the company and the mode and form in which the business of the company is to be carried out. The Articles of association of a company have a contractual force between company and its members as also between the members inter se in relation to their rights as such members. They are subordinate to and are controlled by memorandum. Articles cannot supersede the objects as set out in the memorandum of association [*Birds Investments Ltd. v. C.I.T.* (1965) 35 Comp. Cas. 147 Cal.] The memorandum, as we have seen earlier, lays down the scope and powers of the company, whereas the articles govern the ways in which the objects of the company are to be carried out. Also the alteration of memorandum involves elaborate procedure, whereas the articles can be framed and altered by the members by passing special resolution. The memorandum is the area beyond which the actions of the company cannot go inside that area the shareholders may make such regulations for their own governance as they think fit. However, the articles must not be inconsistent with the memorandum. Also, as in the case of memorandum, the articles of the company must not contain anything which is against or repugnant to the provisions of the Companies Act (s.9).

8.4.2 Registration of Articles

Section 26 states that a public company limited by shares may register articles of association signed by the subscribers to the memorandum. If, however, it does not register its own articles, then the articles given in Table A of Schedule I automatically becomes applicable. Further, even if it does register articles of its own, Table A will still apply automatically unless it has been excluded or modified. There are actually three possible alternatives in which such company may adopt articles: (i) it may adopt Table A in full or, (ii) it may wholly exclude Table A and set out its own regulations in full, or (iii) it may set out is own articles and adopt part of Table A. The alternatives (ii) and (iii) are often employed; and partial adoption of Table A has particular advantage for small companies, because of economy in printing and also because any provision of Table A is legally beyond any doubt.

As regard a company limited by guarantee and unlimited liability company and, a private company limited by shares, s.26 provides for compulsory registration of articles prescribing regulations for the company. However, they may adopt any of the appropriate regulations of Table A.

In any case, the articles of a company must be: (i) printed, (ii) divided into paragraphs, numbered consecutively, (iii) signed by subscribers to the memorandum in the presence of at least one witness who shall attest the signatures. Also, articles are to be stamped with requisite stamp and filed along with the memorandum (s.3).

8.4.3 Subject Matter of Articles

The articles of a company usually deal with the following matters:

1. the business of the company;
2. the amount of capital issued and the classes of shares into which the capital is divided; the increase and reduction of share capital;
3. the rights of each class of shareholders and the procedure for variation of their rights;
4. the execution or adoption of a preliminary agreement, if any;
5. the allotment of shares; calls and forfeiture of shares for non-payment of calls;
6. transfer and transmission of shares;
7. company's lien on shares;
8. exercise of borrowing powers including issue of debentures;
9. general meetings, notices, quorum, proxy, poll, voting, resolution, minutes;
10. number, appointment and powers of directors;
11. dividends – interim and final – and general reserves;
12. accounts and audit;
13. keeping of books – both statutory and others.

8.4.4 Inspection and Copies of the Articles

A company shall, on being so required by a member, send to him within seven days of the requirement, on payment of one rupee, a copy of the articles. If a company makes default, the company and every officer of the company, who is in default, shall be punishable with fine up to ₹ 50 (s.39).

8.4.5 Alteration of Articles

Section 31 provides that subject to the provisions of the Act and to the conditions contained in its memorandum, a company may, by special resolution alter or add to its articles. A printed or type written copy of every special resolution altering the articles must be filed with the Registrar within 30 days of the passing of the special resolution.

The right to alter just by passing special resolution is so important that a company cannot in any manner deprive itself of the power to alter its articles. Also, the power to reduce or increase the number of members in the case of a company limited by guarantee without share capital, from time to time, as given in the articles can be done by a special resolution of the general body of members. However, in spite of the power to alter its articles, a company can exercise this power subject to certain limitations.

8.4.6 Limitations on Power to alter Articles

These are:

(i) The alteration must not exceed the powers given by the memorandum or conflict with the other provisions of the memorandum.

(ii) The alteration must not be inconsistent with any provision of the Companies Act or any other statute. For example, no company can purchase its own shares (s.77) and if the articles

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of a company are altered so as to have the power to purchase its own shares, then such power will be void.

(iii) The altered articles must not include anything which is illegal, or opposed to public policy or unlawful.

(iv) The alteration must be bona fide for the benefit of the company as a whole. The alteration will not, however, be bad merely because it inflicts hardship on an individual shareholder.

Example:

(i) A company had a lien on all shares "not fully paid" for calls due to the company. There was only one shareholder A, who owned fully paid-up shares. He also held partly-paid shares in the company. A died. The company altered its articles striking out the words "not fully paid up" and thus gave itself a lien on all shares – whether fully paid up or not. The legal representative of A challenged the alteration on the ground that the alteration had retrospective effect.

Held: The alteration was good, as it was done bona fide for the benefit of the company as a whole, even though the alteration had a retrospective effect [*Allen v. Gold Reefs of West Africa Ltd.* (1900) 1 Ch. 656].

(ii) By an alteration in the articles, a company was empowered to expropriate shares held by any member who was in business in competition with the company. At the time of alteration, there was only one member doing business in competition with the company. He challenged the alteration.

Held: The alteration was valid, although only one member was at that time within the ambit of alteration, as the alteration was bona fide and for the benefit of the company [*Sidebottom v. Kershaw Leese & Co.* (1920) Ch. 154 (C.A.)].

(v) The alteration must not constitute a fraud on the minority by the majority. If the alteration is not for the benefit of the company as a whole, but for majority of the shareholders, then the alteration would be bad. In other words, an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter have been deprived.

Example: In *Brown v. British Abrasive Wheel Co.* (1919) 1 Ch. 290, the majority which held 98 per cent of the shares passed a special resolution that upon the request of holders of 9/10th of the issues shares, a shareholder shall be bound to sell and transfer his shares to the nominee of such holders at a fair value. The alteration was held to be invalid since it amounted to an oppression of minority.

(vi) There cannot be alteration of the articles so as to compel the existing members to take or subscribe for more shares or in any way to contribute to the share capital, unless they given their consent in writing (s.38).

(vii) An alteration of articles to effect a conversion of a public company into a private company cannot be made without the approval of the Central Government (s.31).

(viii) A company cannot justify breach of contract with third parties or avoid a contractual liability by altering articles.

(ix) The amended regulation in the Articles of Association cannot operate retrospectively, but only from the date of amendment [*Pyare Lal Sharma v. Managing Director, J & K Industries Ltd.*].

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8.4.7 Effect of Memorandum and Articles/Binding Force of Memorandum and Articles

Section 36 provides that the memorandum and articles, when registered, bind the company and its members to the same extent as if they had been signed and sealed by each member and contained convenants on the part of each member to observe and be bound by all the provisions of the memorandum and articles. Thus, the company is bound to the members; the members are bound to the company; and the members are bound to the other members by whatever is contained in these documents. But neither a company nor its members are bound to outsiders. These relationships are discussed herein below:

Members bound to company. Each member must observe the provisions of the articles and memorandum. For instance, a company has a right of lien on members' shares, or to forfeit the shares on non-payment of calls. Every member is bound by whatever is contained in the memorandum and articles.

Example: The articles of a company contained a clause that on the bankruptcy of a member, his shares should be sold to other person and at a price fixed by the Directors. 'B', a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at the true value. Held, that the trustee was bound by the articles, as shares were purchased by 'B' in terms of the articles. [*Borland Trustees v. Steel Bros. Co. Ltd.* (1901) 1 Ch. 279].

Each member is not only bound by the covenants of memorandum and articles as originally framed but as altered form time to time in accordance with the provisions of the Companies Act. The articles of associations are the regulations of the company binding on the company and on its shareholders. Further, the shareholders cannot among themselves enter into an agreement which is contrary to or inconsistent with the articles of association of the company.

Company bound to members. Similarly, a company is bound to members by whatever is contained in its memorandum and articles of association. The company is bound not only to the "members as a body" but also to the individual members as to their individual rights. The members can restrain a company from spending money on ultra vires transactions. An individual member can make the company fulfil its obligations to him, such as to send the notice for the meetings, to allow him to cast his vote in the meetings.

Members bound to member. The articles bind the members inter se, i.e., one to another so far as rights and duties arising from the articles are concerned.

It is well settled that the articles of association will have a contractual force between the company and its members as also between the members inter se in relation to their rights as such members.

Example: The articles of a company provided that whenever any member wished to transfer his shares, he was under an obligation to inform the directors of his intention and the directors were under an obligation to take the said shares equally between them at a fair value. The directors refused to take the shares of a particular member on the ground that the Articles did not impose an enforceable liability upon them. Held: The directors were under an obligation to purchase the shares, as members of the company, in terms of the provisions of the Articles. There was a personal liability of members inter se [*Rayfield v. Hand* (1960) Ch.1].

Whether company or members bound to outsiders? No, the memorandum or articles do not confer any contractual rights to outsiders against the company or its members, even though the name of the outsiders is mentioned in the articles.

Example: The articles of a company provided that Eley should be solicitor for life to the company and should not be removed from office except for misconduct. Later on he also became a member of the company. But after employing him as a solicitor for a number of years, the company discontinued his services. He, being a member, sued the company for damages for breach of the contract contained in the articles of association. Held: His suit was dismissed on the ground that, he, as a solicitor, was no party to the articles. He must prove a contract independent of the articles. There was no infringement of his right as a member. The breach of contract was there but in his capacity as a non-member [*Eley v. Positive Government Security Life Assurance Co.*, (1876) 1 Ex. D. 88].

Whether directors are bound by whatever is contained in the articles? Yes, the directors of the company derive their powers from the articles and be subject to limitations, if any, placed on their powers by the articles. If they contravene any provisions of articles, two parties may be affected: (1) the company itself and (2) the outsiders.

In case of contravention of the provisions of the articles, the directors render themselves liable to an action at the instance of the members. However, members may ratify the act of the director, if they so desire. But if as a result of the breach of duty any loss has resulted to the company, the directors are liable to refund to the company any damage so suffered.

Further, where the directors contravene the provisions of the articles, it may affect outsiders' interest also. This is explained below with the help of a case, viz., *Royal British Bank v. Turquand*.

8.4.8 Constructive Notice of Articles and Memorandum

Section 610 provides that the memorandum and articles, when registered, become public documents and then they can be inspected by anyone on payment of a nominal fee. Therefore, any person who contemplates entering into a contract with the company has the means of ascertaining and is thus presumed to know the powers of the company and the extent to which they have been delegated to the directors. In other words, every person dealing with the company is presumed to have read these documents and understood them in their true perspective. This is known as 'Doctrine of Constructive Notice'. Even if the party dealing with the company does not have actual notice of the contents, it is presumed that he has "constructive notice" of them.

Example:

(i) One of the articles of a company provides that a bill of exchange to be effective must be signed by two directors. A bill of exchange is signed only by one of the directors. The payee cannot claim under the bill.

(ii) In *Kotla Venkataswamy v. Ram Murthy* AIR (1934) Mad. 579, the articles provided that all deeds and documents of the company shall be signed by the managing director, secretary and working director. A mortgage deed was accepted with secretary and working director's signature only. Held, the deed was invalid.

(iii) Similarly, if a person enters into a contract which is beyond the powers of the company, he cannot acquire any right under the contract against the company.

8.4.9 Doctrine of Indoor Management

The doctrine of constructive notice throws a burden on people entering into contracts with the company that they are presumed to have read the documents, though in fact, they might not have read them. On the other hand, the doctrine of indoor management allows all those who deal with the company to assume that the provisions of the articles have been observed by the

officers of the company. In other words, they are not bound to enquire into the regularity of internal proceedings. An outsider is not expected to see that the company carries out its internal regulations.

Example: The directors of a company were authorised by the articles to borrow on bond such sums of money as should from time to time, by a resolution of the company in general meeting, be authorised to be borrowed. The directors gave a bond to T without the authority of any such resolution. The question arose whether the company was liable on the bond. Held: The company was liable on the bond, as T was entitled to assume that the resolution of the company in general meeting had been passed [*The Royal British Bank v. Turquand* (1856) 6 E & B 327].

Exceptions. The doctrine of indoor management is subject to the following exceptions:

1. ***Knowledge of irregularity.*** The rule does not protect any person who has actual or constructive notice of the want of authority of the person acting on behalf of the company.

Example: The articles of a company empowered the directors to borrow up to £ 1,000. They could exceed the limit of £ 1,000 with the consent of the company in general meeting. Without such consent, they borrowed £3,500 from themselves and took debentures. The company refused to pay the amount. Held: Their debentures were good to the extent of £ 1,000 only as they had notice of the internal irregularity [*Howard v. Patent Ivory Co.,* (38 Ch. D. 156)].

2. ***No knowledge of articles.*** The rule cannot be invoked in favour of a person who did not consult the memorandum and articles and thus did not rely on them.

Example: T was a director in the investment company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the Directors could delegate their powers to one of them. But Rama Corporation never read the articles. Later, it was found that the directors of the company did not delegate their powers to T. Plaintiffs relied on the rule of Indoor Management. Held: They could not, because they did not know the existence of the power to delegate. [*Rama Corporation v. Proved Tin and General Investment Co.* (1952) 1 All ER 554].

3. ***Void or illegal transaction.*** The rule does not apply to transactions which are void or illegal ab initio, e.g., forgery.

Example: The secretary of a company forged signature of two of the directors required under the articles on a share certificate and issued the certificate without authority. The applicants claimed to be entitled to be registered as members of the company. Held: The certificate was a nullity and the holder of the share certificate could not take advantage of the doctrine of indoor management [*Ruben v. Great Fingal Consolidated* (1906) A.C 439].

4. ***Negligence.*** If an officer of a company does something which would not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make inquiry, he cannot rely on the rule.

Example: A person who was sole director and principal shareholder of a company paid into his own account cheques drawn in favour of the company. The bank should have made enquiries as to the power of the director. The bank was put upon inquiry and was accordingly not entitled to rely upon the ostensible authority of director [*A. L. Underwood v. Bank of Liverpool* (1924) 1 K. B. 775].

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8.5 Summary

- The whole process of formation of a company may be roughly divided, for convenience, into three parts. These are: (i) Promotion; (ii) Registration and (iii) Floatation.
- Section 12 states that, "any seven or more persons or where the company to be formed will be a private company, two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration form an incorporated company, with or without limited liability."
- Section 33 also requires a declaration to be filed with the Registrar along with the Memorandum and the Articles. This is known as "Statutory Declaration of Compliance."
- Section 20 states that a company cannot be registered by a name, which in the opinion of the Central Government is undesirable.
- On registration, the company comes into existence as a legal person distinct from its members who constitute it from the earliest moment of the day of incorporation stated in the certificated of incorporation, with rights and liabilities similar to a natural person, competent to enter into contracts (s.34).
- When the company has complied with these conditions, the Registrar will issue a certificate to commence business.
- The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated.
- The memorandum serves a two-fold purpose. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities.
- The articles of association of a company and its bye laws are regulations which govern the management of its internal affairs and the conduct of its business.
- Section 36 provides that the memorandum and articles, when registered, bind the company and its members to the same extent as if they had been signed and sealed by each member and of the memorandum and articles.

8.6 Keywords

Articles of association: The Articles of association of a company and its bye laws are regulations which govern the management of its internal affairs and the conduct of its business.

Association clause [s.13(4)(c)]: At the end of the memorandum of every company there is an association or subscription clause or a declaration of association.

Capital clause [s.13(4)(c)]: This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value.

Liability clause [s.13(2)]: This clause states the nature of liability of the members. In case of a company with limited liability, it must state that liability of members is limited, whether it be by shares or by guarantee.

Memorandum of Association: The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated.

Promotion: It is a term of wide important denoting the preliminary steps taken for the purpose of registration and flotation of the company.

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Provisional contract: Those contracts which are entered into by a public company after obtaining the certificate of incorporation but before getting the certificate to commence business are known as provisional contracts.

8.7 Self Assessment

Fill in the blanks:

1. Promoters have been described to be in .... (relationship of trust and confidence) with the company.
2. .... states that, on registration, memorandum and articles of the company bind the company.
3. In the case of .... also, the promoters may not invite public to subscribe to its share capital and may arrange the capital privately as in the case of a private company.
4. .... provides that a company can, in general, contract in the same form as an individual.
5. A .... which would be valid if made between private persons although made orally or by parol on behalf of the company by any person acting under express or implied authority.
6. The .... of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated.
7. .... provides that the company cannot alter the conditions contained in memorandum except in the cases and in the mode and to the extent express provision has been made in the act.
8. The .... of a company and its bye laws are regulations which govern the management of its internal affairs and the conduct of its business.

8.8 Review Questions

1. Discuss the formation of company?
2. What do you mean by winding up of a company? Discuss it in detail
3. Who is a promoter? Also explain the duties and liabilities of promoters.
4. What do you mean by memorandum of association? What does it contain?
5. Discuss liability clause, association clause, article association and what does it contain?
6. Describe Provisional Contract and how are alterations made in a memorandum of association?
7. State the relations of memorandum of association with article of association
8. Vikas has a company Graphics Zone. The liability clause is not given in memorandum. Discuss why vikas not mentioned liability clause in his memorandum. Under which type of company, the liability clause need not be given in the memorandum and discuss why it is not required?
9. Mr. Ankush singh wants to open a company. Discuss what procedure he has to follow for formation of company.
10. Arun the owner of XYZ Pvt. Ltd. Co. His company is solvent and able to pay its liability. But company winds up. Discuss which type of winding up is related to arun's company.

Answers: Self Assessment

Notes

1. fiduciary relationship
2. Section 36
3. public company
4. Section 46
5. contract
6. Memorandum of Association
7. Section 16
8. articles of association

8.9 Further Readings

Books

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Unit 9: Prospectus

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Objectives

After studying this unit, you will be able to:

- Discuss the meaning of Prospectus
- Explain SEBI guidelines reading to disclosure on prospectus

Introduction

In last unit you have studied about the formation of company. Promoters have been described to be in fiduciary relationship with the company. This relationship of trust and confidence requires the promoter to make a full disclosure of all material facts relating to the formation of the company. The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated. It tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. Thus, it defines as well as confines the powers of the company. In this unit will study about underwriting and prospectus in detail .

9.1 Steps which are Necessary before the Issue of Prospectus

We have mentioned earlier that a private company is prohibited from inviting public to subscribe to its share capital and it arranges its share capital privately. The shares are subscribed by a small number of persons who are known to the promoters or are related to them by family connections.

A public company may also decide not to invite public to subscribe to its share capital and arrange its capital privately as in the case of a private company. Under such circumstances, the public company is required to submit a statement in lieu of prospectus with the Registrar of Companies at least three days before the allotment of shares is made.

However, a public company limited by shares, generally issues shares to the public for which it has to issue a prospectus. In that case it has to follow the procedure below.

After the certificate of incorporation is obtained, the affairs of the company are taken over by the first directors appointed in accordance with the provisions of law. They will elect one of their members as the chairman of the Board of Directors, if none is named in the articles of association. The Board attends to the following matters:

(i) Appointment of various expert agencies such as bankers, auditors, secretary, etc.

(ii) Entering into underwriting contract, brokerage contracts.

(iii) Making arrangements for the listing of shares on stock exchanges.

(iv) Drafting a prospectus for the purpose of issue to the public.

The appointment of a banker is necessary as it has to receive the share application along with application moneys. The appointment of first auditor is in the hands of Board of directors and it becomes necessary, as we shall see later, to make the appointment before the issue of prospectus. The appointment of company secretary is obligatory in case of companies, having the prescribed paid-up share capital (presently, ₹ 50 lakhs or more). In other companies also, the appointment of a company secretary is desirable.

9.2 Underwriting

The Board of Directors enters into underwriting contracts with underwriters. Underwriting, in its simplest form, consists of an undertaking by some person or persons that if the public fails to

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take up the issue, he or they will do so. In return for this undertaking, the company agrees to pay the underwriter a commission on all shares or debentures, whether taken up by the public or by the underwriters.

Section 76 prescribes certain conditions subject to which underwriting commission may be paid. These are:

1. The authority to pay is given in the articles of the company. Authority in the Memorandum is not sufficient [*Republic of Bolivia Exploration Syndicate Ltd.* (1914) 1. Ch. 139].
2. The commission payable cannot be more than 5 per cent of the issued price of shares and per cent of the price of debentures.
3. The commission can be paid only on shares issued to the public.
4. The payment must be strictly by way of 'commission' and not merely a device to issue shares at a discount.
5. The rate of commission and the number of shares and debentures which the underwriters have agreed to subscribe for a 'commission' should be disclosed in the prospectus.
6. The names of the underwriters and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations must be disclosed in the prospectus.

When prospectus is issued to the public and the issue is a success, i.e., the issue has been subscribed fully, the underwriters are not required to take up the shares, but they receive their commission. On the other hand, if the issue is a failure, i.e., the issue has not been subscribed fully, the underwriters have to take up the shares not subscribed for by the public and pay for them. In this case also, they will get their commission.

Under s.69, as we shall see later, a company must receive applications equivalent to the minimum subscription as mentioned in the prospectus, otherwise money become refundable to the applicants. But when the issue is underwritten, the company is sure of getting the minimum subscription, as the underwriters act as insurers against under-subscription.

Sub-underwriting. Every underwriter has a certain limit up to which he would go in for taking risk by entering into an underwriting contract. The underwriters usually choose to spread their risk by using sub-underwriters who agree to take a certain number of shares for which they accept responsibility and for which they receive a commission out of the commission received by the underwriters. The difference between the commission paid by them to the sub-underwriters is known as overriding commission.

SEBI Guidelines relating to underwriting. SEBI guidelines for disclosure and investor protection provide rules as to underwriting.

9.3 Brokerage Contracts

In addition to underwriters, a company may also enter into brokerage contracts with brokers. A broker is a person who undertakes to 'place' shares, i.e., find persons who will buy shares, in consideration of an agreed brokerage and if he fails to place any of the shares, he is not personally liable to take them, nor is he entitled to any brokerage in respect of shares not placed. The underwriter, on the other hand, is bound to take up the shares, which the public has not taken and is entitled to the whole of the agreed commission.

It may be noted that there must be authority in the articles to pay brokerage and the brokerage must be disclosed in the prospectus, or statement in lieu of prospectus, as the case may be and it should pay a reasonable brokerage (s.76).

9.4 Listing of the Shares on a Stock Exchange

Shares of a public company may be sold or purchased on stock exchange. But for this purpose the company has to get permission from the stock exchange authorities. Section 73 provides that it is necessary for every public company, before issuing shares or debentures for public subscription by issue of a prospectus, to make an application for listing the security in one or more recognised stock exchanges. This is known as listing of the shares. The information that permission has been obtained from the stock exchange or that an application for getting permission has been made or will be made, may be mentioned in the prospectus.

The eligibility criteria for listing of securities of a company is: (i) minimum issued equity capital of a company should be ₹ 3 crores; and (ii) the minimum public offer of equity capital shall be not less than 25% [Rule 19(2)].

For listing of its shares, the company has to comply with all the requirements of the Securities Contracts (Regulation) Rules, 1957. Rule 19 (2) (b), requires that at least 25% of each class or kind of securities issued by the company shall be offered for public subscription through newspaper advertisement for a period not less than 3 days and that allotment to such applicants shall be made fairly and unconditionally.

9.5 Structure of Share Capital

The amount of authorised capital and its subdivision into equity and preference share capital is given in the Memorandum of Association which is prepared before the certificate of incorporation is obtained. After obtaining the certificate of incorporation and before the issue of prospectus, the Board of directors have to take a decision regarding the total amount of capital which is to be raised by issue of shares and the kinds of shares to be issued. A company cannot issue capital exceeding the authorised capital mentioned in the memorandum. How much capital should be raised at a particular time? It depends upon a number of factors, such as the purpose for which the capital is required (whether for acquiring fixed assets like plant and machinery, etc., or for providing additional working capital); the alternative sources of raising capital (e.g., debentures, public financial institutions and so on). The directors should also decide about the ratio of equity to preference share capital. For certain purposes the Central Government has fixed this ratio at 3:1. Also, the amount of capital in each category, i.e., equity and preference and the amount to be called up at the time of application, allotment, etc., are to be decided. Also, the Board of directors have to decide about the type of preference shares to be issued.

9.6 Time of Floatation

The Board of directors will then decide about the time of issue of prospectus. It is advisable to consider the condition of the capital market, the investors' mood, fiscal and monetary policies of the Government and the state of business conditions before issuing a prospectus.

9.7 Definition of a Prospectus

A prospectus, as per s.2 (36), means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate. Thus, a prospectus is not merely an advertisement; it may be a circular or even a notice. A document shall be called a prospectus if it satisfies two things: 1. It invites subscriptions to share or debentures or invites deposits. 2. The aforesaid invitation is made to the public.

What constitutes an offer to the public? Section 67 lays down two-way criteria as to what shall constitute an invitation to the public. These are:

1. An invitation to the public shall include an invitation to any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner. However, a document by way of invitation to existing members or debenture holders to subscribe to shares or debenture by way of right is not a prospectus [s.56 (5)].
2. An invitation shall not be an invitation to the public if it cannot be calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the invitation. Thus, it will not be an invitation to public where B, a friend of A who receives the invitation, also desires to subscribe, but his offer shall be refused because he was not invited to make the same. On the other hand, it will become an invitation to public where his (B's) offer shall also be accepted.

The offering of shares of kith and kin of a director is not an invitation to the public to buy shares [*Rattan Singh v. Moga Transport Co. Ltd.* (1959) 20 Comp. Cas. 165]. Further, the learned judge in this case held that in all cases the determination of the question of an offer being made to the public depends upon the facts and language of the notice and the particular circumstance of each case.

In *Nash v. Lynde* (1929, A.C. 1585). Justice Viscount Summer observed: "The 'public' is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve; perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceeding needless by himself subscribing the whole. The point is that the offer is such as to be open to any one who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not."

If a company (other than non-banking finance company and Public Financial Institution) makes an offer to 50 or more persons, it will be treated as a public issue. In other words, private placement by a company shall come under the purview of a 'public issue'.

9.8 Small Depositors (s. 58AA)

To protect small depositors, sections 58AA and 58AAA provide:

(i) A small depositor is one who has deposited, in a financial year a sum not exceeding ₹ 20000 in a company and includes his successors, nominees and legal representatives. However, the term does not include those small depositors (a) who renewed their deposits voluntarily; or (b) whose repayment is not made due to death or stay order of a competent court or authority.

(ii) Any company accepting deposits shall have to inform the Tribunal, on monthly basis, the names and addresses of each small depositor about its default in repayment of deposit or payment of interest thereon. A period of 60 days is prescribed for intimation of any default to the Central Government which shall, after giving the depositor an opportunity of being heard, pass an appropriate order within 30 days from the date of receipt of such intimation from the defaulting company.

 Such a defaulting company is prohibited to accept further deposits from small depositors at any time until the defaults are made good.

(iii) The total numbers of small depositors and the amount due to them in respect of which default is made the fact of wativer of interest accrued on deposits shall be stated in all future advertisements and application forms inviting deposits from the public. Further every application form for accepting deposits shall contain a statement that the applicant

has been apprised or every past default of the company in repayment of deposits and for payment of interest thereon to the small depositors.

(iv) Every director of such a defaulting company sall be prohibited to be appointed as a director of any public company for 5 years from the date of the default.

(v) No such defaulting company shall directly or indirectly make any loan to any body corporate, give guarantee or provide security or acquire security of any body corporate till such default continues.

(vi) Every non-compliance is punishable with imprisonment upto 3 years and also fine not less than ₹ 500 for everyday.

(vii) An aggrived depositor is also entitled to make an application to Tribunal for redressal of his grievance against the company.

Default in acceptance or refund of deposits to be cognizable (s. 58AAA). Every offence connected with or arising out of acceptance of deposits under s. 58A or s. 58AA is a cognizable offence under the Code of Criminal Procedure, 1973.

Dating of prospectus (s.55). Section 55 states that every prospectus must be dated and that date is deemed to be the date of publication of the prospectus.

Powers of SEBI. Section 55A provides that the provisions contained in sections 55 to 58, 59 to 81, 108-110, 112-113, 116-122, 206, 206A and 207, so far as they relate to issue and transfer of securities and non-payment of dividend shall be administered by SEBI in the following cases:

(a) in case of listed companies;

(b) in case of those public companies which intend to get their securities listed on any recognised stock exchange in India. In any other, case, the Central Government shall be the administering authority.

9.9 Contents of a Prospectus

Section 56 lays down that the matters and reports stated in Schedule II to the Act must be included in a prospectus. The format of a prospectus is divided into three parts. In the first part brief particulars are to be given about matters mentioned below:

1. ***General information.*** Under this head information is given about (i) Name and address of registered office of the company. (ii) Name/(s) of stock exchange/(s) where application for listing is made. (iii) Declaration about refund of the issue if minimum subscription of 90 per cent is not received within 90 days from closure of the issue. (iv) Declaration about the issue of allotment letters/refunds within a period of 10 weeks and interest in case of any delay in refund, at the prescribed rate, under s.73. (v) Date of opening of the issue. (vi) Date of closing of the issue. (vii) Name and address of auditors and lead managers. (viii) Whether rating from CRISIL or any rating agency has been obtained for the proposed debentures/ preference shares issue. If no rating has been obtained, this should be answered as 'No'. (ix) Names and address of the underwriters and the amount underwritten by them.

2. ***Capital structure of the company.*** (i) Authorised, issued, subscribed and paid-up capital. (ii) Size of the present issue, giving separately reservation for preferential allotment to promoters and others.

3. ***Terms of the present issue.*** (i) Terms of payment, (ii) How to apply, (iii) Any special tax benefits.

4. ***Particulars of the issue.*** (i) Objects, (ii) Project cost, (iii) Means of Financing (including contribution of promoters).

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5. ***Company management and project.*** (i) History and main objects and present business of the company. (ii) Promoters and their background. (iii) Location of the project. (iv) Collaborations, if any. (v) Nature of the product. (s) Export possibilities. (vi) Future prospects (vii) Stock market data for share/debentures of the company including high and low price in each of the last three years and monthly high and low during the last six months, if applicable.
6. ***Certain prescribed particulars*** in regard to the company and other listed companies under the same management which made any capital issue during the last 3 years.
7. ***Outstanding litigations*** relating to financial matters or criminal proceedings against the company or directors under Schedule XIII.
8. ***Management perception of risk factors*** (e.g., sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials or in marketing of products, cost/time over-run, etc.)

Part II of Schedule II requires the company to give detailed information. This part is further sub-divided into three parts viz., General Information, Financial Information and Statutory and Other Information.

General Information shall include information on matters like: (i) Consent of directors, auditors, solicitors, managers to the issue, Registrars to the issue, Bankers of the Company, Bankers to the issue and experts. (ii) Change, if any, in directors and auditors during the last 3 years and reasons therefor. (iii) Procedure and time schedule for allotment and issue of certificates. (iv) Names and address of Company Secretary, legal advisor, Lead Managers, Co-managers, Auditors, Bankers to the issue. (v) Authority for the issue and details of resolution passed therefor.

Financial information includes: (i) reports of the auditors of the company with respect to its profits and losses and assets and liabilities, and the dividends paid during the five financial years immediately preceding the issue of prospectus; (ii) report by the accountants (who should be named) on the profits or losses for the preceding 5 financial years and on the assets and liabilities on a date which must not be more than 120 days before the date of the issue of the prospectus.

Statutory and Other information includes information about: (i) Minimum subscription. (ii) Expenses of the issue. (iii) Underwriting commission and brokerage. (iv) Previous public or rights issue; if any, giving particulars about date of allotment, refunds, premium/discount, etc. (v) Issue of shares otherwise than for cash. (vi) Commission or brokerage on previous issue. (vii) Particulars about purchase of property, if any. (viii) Revaluation of assets, if any. (ix) Material contracts and time and place where such documents may be inspected. (x) Debentures and redeemable preference shares or other instruments issued but remaining outstanding on the date of the prospectus and terms of their issue.

Part III of the Schedule gives explanations of certain terms and expressions used under Part-I and Part – II of the Schedule.

9.10 SEBI Guidelines relating to Disclosure on Prospectus

Every prospectus submitted to Stock Exchange Board of India (SEBI) for vetting shall, in addition to the requirements of schedule II to the Act, contain/specify certain particulars as are announced from time to time.

9.11 Abridged Form of Prospectus

Section 56(3) requires that no one shall issue any form of application for shares in or debentures of a company unless the same is accompanied by a memorandum (Known as ‘Abridged Prospectus’) containing such salient features of prospectus as may be prescribed. Thus, instead of appending full prospectus, an ‘abridged prospectus’ need only be appended to the application form.

In order to provide for greater disclosure of information to prospective investors so as to enable them to take an informed decision regarding investment in shares and debentures, Form 2-A has been prescribed as a format of abridged prospectus. It is further required that the abridged prospectus and the share application form should bear the same printed number and the two should be separated by a perforated line. Accordingly, the investor may detach the application form before submitting the same to the company or the designated bankers.

When 'abridged prospectus' not necessary. In the following circumstances, an 'abridged prospectus' containing the prescribed particulars as per Form 2A need not accompany the application forms: (i) In the case of a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures. (ii) When shares or debentures are not offered to the public. (iii) Where offer is made only to existing members/debenture holders of the company by way of rights, whether with or without the right of renunciation. (iv) In the case of issue of shares or debentures which are in all respects similar to those previously issued and dealt in and quoted on a recognised stock exchange.

Penalty: Non-compliance of the aforesaid provisions by any person shall attract punishment in terms of fine which may extend to ₹ 5,000.

Besides, the omission from a prospectus of a matter required to be included by s.56 may give rise to an action for damage at the instance of a subscriber for share or debentures who has suffered loss thereby. It should be noted that the Act does not say that directors shall be liable, but this seems to be implied from s.56 (4).

9.12 Draft Prospectus to be made Public

SEBI requires making public the draft prospectus filed with it. The lead Merchant Bankers shall simultaneously file copies of the draft document with the stock exchanges where the issue is proposed to be listed. Lead Merchant Bankers shall also make copies available to the public. Lead Managers/stock exchanges can charge an appropriate sum from the person requesting such a copy(ies).

9.13 The Expert's Consent to the Issue of Prospectus

A prospectus may contain a statement purporting to be made by an expert. The term 'expert' includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him. The reports from an expert must not be included in a prospectus unless: (i) Such expert is unconnected with the formation or management of the company (s.57); (ii) he gave his consent (s.58); (iii) he is competent to make the report, valuation or statement; (iv) a statement that he has given and not withdrawn his consent thereto appears in the prospectus (s.58).

If the report of the expert is published in contravention of the above mentioned provisions, every person who is knowingly a party to the issue of the prospectus shall be punishable with fine up to ₹ 50,000 (s.59).

9.14 Registration of the Prospectus (S. 60)

A copy of the prospectus duly signed by every director or proposed director must be delivered to the Registrar before its publication. Further, every copy of the prospectus on its face must state that a copy has been delivered for registration. The copy must have attached to it the following documents namely:

(i) the consent of the expert to file the prospectus;

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(ii) a copy of every contract required to be specified in the prospectus or a memorandum giving full particulars of a contract not reduced to writing;

(iii) a copy of every contract appointing or fixing the remuneration of a managing director or manager;

(iv) the consent in writing of a person, if any, named in the prospectus as the auditor, legal adviser, attorney, solicitor, banker to the company to act in that capacity;

(v) consent of directors under s.266;

(vi) a copy of the underwriting agreement, if any; and

(vii) when the persons making the reports relating to profits and losses, assets and liabilities, etc., in respect of a business proposed to be acquired have made adjustments to them, a signed statement by them stating the adjustments and the reasons for the same.

9.15 Prospectus by Implication

Section 64 has been designed to check the by-passing of the provisions of s.56 as given above by making an offer of sale of shares or debentures through the medium of Issue Houses. The process involves allotment of shares to an Issue House who, in turn, will issue advertisement offering shares for sale. Since the advertisement is not issued by the company, it does not amount to a prospectus and thereby liability of non-compliance of s.56 provisions cannot be invoked. To check this malady, s.64 provides that all documents containing offer of shares or debentures for sale shall be included within the definition of the term 'prospectus' and shall be deemed as prospectus by implication of law. All enactments and rules of law as to the contents of prospectuses and as to the liability in respect of statements and omissions from prospectuses shall apply in respect of such documents.

Further, s.64 provides that unless the contrary is proved, an allotment of, or an agreement to allot, shares or debentures shall be deemed to have been made with a view to the shares or debentures being offered for sale to the public, if it is shown: (a) that the offer of the shares or debentures for sale to the public was made within 6 months after the allotment or agreement to allot; or (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been received by it.

In case a document is deemed as prospectus, then it must contain the following information in addition to the information required to be stated in prospectus under s.56: (a) the net amount of consideration received or to be received by the company in respect of the shares or debentures to which the offer relates; and (b) the place and time at which the contract under which the said shares or debentures have been or are to be allotted may be inspected.

For purposes of registration of a prospectus under s.60, the persons making the offer of sale to the public are to be deemed as directors of the company.

Where the person making the offer is a company or a firm, the documents (i.e., deemed prospectus) must be signed by at least two directors or one-half of the partners as the case may be.

Circumstances under which a document containing an offer for sale of shares or debentures be not deemed to be a prospectus. A document containing an offer for sale of shares or debentures is a prospectus or not depends upon whether it extends an invitation to the public to subscribe or not. The prima facie test of 'public offer' or 'public invitation' is whether the terms of the offer or invitation are such that, despite its limited circulation, it is open to any person who so chooses to bring his money and apply for shares in response to the invitation. If the offer or invitation is so open, then it constitutes a 'public offer'. If, on the other hand, an offer or invitation can be accepted only by the person to whom it is made and none other, then it will not be deemed to be an offer or invitation to the public.

The word 'public' includes any section of the public (s.67). It may, thus, include all registered medical practitioners in Delhi, all advocates of High Court of Delhi, all Englishmen living in India.

However, in the following cases, the document inviting subscription to shares or debentures of a company shall not be deemed as invitation to the public and hence shall not be a prospectus:

1. A circular inviting existing shareholders or debenture holders of the company. Although s.67(1) provides that such an offer shall be an offer to the public yet in view of the provisions of s. 67 (3) and (4) and that of s. 56 (5), considered view of the authors on the subject is that it does not amount to a public offer. The circular containing offer of rights shares is, therefore, not a prospectus.
2. The offering of shares to the kith and kin of a director is not an invitation to the public to buy shares [*Rattan Sigh v. Moga Transport Co. Ltd.* (1959)]. Such an offer, therefore, shall not be deemed as prospectus.
3. Where an invitation is made by the management of a company to selected persons for subscription or purchase by the persons receiving the offer or invitation, the shares or debentures and such invitation or offer is not calculated directly or indirectly to be availed of by other persons, such invitation or offer shall not be deemed as prospectus [s.67(3)]. However, this is in applicable in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more. In Nash v. Lyne (1929), a document marked 'strictly confidential' containing particulars of a proposed issue of shares was sent by the managing director to a co-director and through him passed on privately to a small circle of friends of the director. The House of Lords held that it was not a prospectus, as there had been no issue to the public.
4. Where a new company, by a circular, offered to buy all the shares of two existing companies and issued its own shares in exchange of those shares, it does not amount to an offer to the public as it neither involves an offer for the purchase of shares for money, nor an invitation for subscription of shares.

Is the issue of prospectus compulsory? When prospectus is not required to be issued? No, issue of prospectus by a company is not compulsory in the following cases:

(i) A private company is not required to issue a prospectus.

(ii) Even a public company need not issue a prospectus if the promoters or directors feel that they can mobilise resources through personal relationship and contacts. In such cases, the company is required to file a statement called 'statement in lieu of prospectus' with the Registrar of Companies.

(iii) A company may issue any forms of application for shares or debentures accompanied by a memorandum containing the prescribed salient features of prospectus (instead of prospectus). However, in such a case, a copy of the prospectus must be made available to any person on request [s.56 (3)].

(iv) Where the application form is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures (s.56 (3)].

(v) Where the application form is issued in relation to shares or debentures not offered to the public [s.56 (3)].

(vi) Where the shares or debentures are offered to existing holders of shares or debentures (i.e., rights issue) with or without the right of renunciation in favour of other persons [s.56 (5)].

(vii) Where invitation to the public for subscription to the shares or debentures of a company is made in the form of an advertisement, ordinarily called as "prospectus announcement" [s.66].

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9.16 Shelf-prospectus and Information Memorandum (S. 60A and 60B)

Section 60A makes provisions for a self-prospectus in certain situation. A ‘shelf-prospectus’ means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Any public financial institution, public sector bank or scheduled bank whose main object is financing shall file a shelf prospectus with the registrar. In such a situation such a company need not file a prospectus afresh at every stage of offer of securities by it within a period of validity not exceeding one year.

But a company filing a shelf prospectus is required to file an information memorandum (as given in s. 60B below) on all material facts relating to new charges created, changes in the financial position as have occured between the first offer of securities, previous offer of securities within such period as may be prescribed by the Central Government, prior to making of a second or subsequent offer of securities under the shelf prospectus.

An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities that prospectus.

Where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

9.17 Information Memorandum

Section 60B provides as follows as regards information memorandum:

(i) A public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.

(ii) A company inviting subscription by an information memorandum is bound to file a prospectus prior to the opening of the subscription lists and the offer as a redherring prospectus, at least three days before the opening of the offer.

The ‘red-herring’ prospectus means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.

(iii) The information memorandum and red-herring prospectus shall carry same obligations as are applicable in the case of a prospectus.

(iv) Any variation between the information memorandum and the red-herring prospectus shall be highlighted as variations by the issuing company.

(v) Every variation as made and highlighted under (iv) is to be individually intimated to the persons invited to subscribe to the issue of securities.

(vi) In the event of the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated cheques or stock invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.

(vii) The applicant or proposed subscriber can exercise his right to withdraw from the application on any intimation of variation within seven days from the date of such intimation and shall indicate such withdrawal in writing to the company and the underwriters.

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(viii) Any application for subscription which is acted upon by the company or underwriters or bankers to the issue without having given enough information of any variations, or the particulars of withdrawing the offer or opportunity for cancelling the post-dated cheques or stock-invest or stop payments for such payments shall be void. Further, the applicants shall be entitled to receive a refund or return of its post-dated cheques or stock-invest or subscription moneys on cancellation of its application, as if the said application had never been made and the applicants are entitled to receive back their original application and interest at 15% from the date of encashment till payment of realisation.

(ix) Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised, whether by way of debt or share capital and the closing price of the securities and any other details as were not complete in the red-herring prospectus shall be filed in a case of listed public company with SEBI and Registrar and in any other case with the Registrar only.

9.18 Statement in Lieu of Prospectus (S. 70)

If a public company makes a private arrangement for raising its capital then it must file a statement in lieu of prospectus with the Registrar at least three days before any allotment of shares or debentures can be made. Schedule III contains a model form of a Statement in Lieu of Prospectus in pursuance of s.70; Schedule IV contains a model form of a Statement in Lieu of Prospectus when a private company is converted into a public company in pursuance of s.44. If allotment of shares or debenture is made without filing the Statement in lieu of prospectus, the allottee may avoid it within two months after the statutory meeting, or where no such meeting is to be held, within two months of the allotment. Contravention also renders the company and every director liable to a fine upto ₹ 10,000.

9.19 Liability for Untrue Statements in the Prospectus (Ss.62-63)

The prospective shareholders are entitled to all true disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not omit material facts.

What is an untrue statement? According to s.65 (1): (a) A statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included; and (b) where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed in respect of such omission, to be a prospectus in which an untrue statement is included. The expression 'included' with reference to a prospectus means, included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

Example: A company issued a prospectus. All the statements included therein were literally true. One of the statements disclosed the rates of dividends paid for a number of years. But dividends had been paid not out of trading profits but out of realised capital profits. This material fact was not disclosed. Held, that the prospectus was false in material particulars and Lord Kylsant, the managing director and chairman, who knew that it was false, was held guilty of fraud [*Rex v. Kylsant*, (1932) 1 K. B. 442].

A person who has applied for shares in the company and who has been allotted shares has certain remedies against the company and the persons issuing the prospectus. But a buyer of shares in the open market or a subscriber to the memorandum has no such right. If, however, a prospectus is issued with the object of including persons to buy shares in the open market, any person who buys shares even in the open market on the basis of the statements made in it has a right of action if the statements are untrue or there is material omission from the prospectus.

A false statement or omission of material facts gives rise to civil as well as criminal liability.

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9.20 Civil Liability (S. 62)

Where a prospectus is issued inviting persons to subscribe for shares in, or debentures of a company, the following persons shall be liable to pay compensation to every subscriber for loss or damage he may have sustained by reason of any untrue statement included in the prospectus on the faith of which he had applied for the shares or debentures:

1. every person who is a director of the company at the time of the issue of the prospectus;
2. every person who has authorised himself to be named and is named in the prospectus as a director, or as one having agreed to become a director, either immediately, or after an interval of time;
3. every promoter of the company; and
4. every person (including an expert) who has authorised the issue of the prospectus. But an expert is liable only in respect of his own untrue statements.

Thus, an allottee of shares, who had applied for shares on the faith of prospectus containing untrue statements has remedies available against the different persons, i.e., the company, directors, promoters and experts.

Remedies against the company. Any person who, relying on mis-statements in or omission of material facts from a prospectus, takes shares from the company may: (1) rescind the contract to take the shares; (2) claim damages. The effect of the rescission of the contract would be that the shareholder would give up the shares and get back his money with interest. He must, however, take action to rescind to contract: (a) within a reasonable time, (b) before proceedings to wind up the company have commenced; and (c) before he does anything (after he comes to know of the mis-statements in the prospectus), which is inconsistent with the right to repudiate, e.g., to accept dividends. The allottee can claim relief only if he can show that the mis-statement or omission was: (i) one of fact and not of law, nor an expression of opinion, (ii) material; and (iii) acted upon by him.

The second right of the allotte against the company is to sue for damages for deceit. In order to succeed, the allottee must, in addition to the three facts mentioned above (in connection with the rescission of contract), prove: (i) that those acting on behalf of the company acted fraudulently; (ii) that those purporting to act on behalf of the company were authorised to act in its behalf; and (iii) that he suffered a loss or damages.

It is important to remember that the allottee cannot both retain the shares and get damages from the company. In actual practice, suit for damages against the company is rarely filed. The usual claim against the company is for rescission of the contract of allotment. Damages are generally claimed from the directors, promoters and other persons who had authorised the issue of the prospectus personally, or from experts who had signed reports referred to in the prospectus.

Remedies against directors or promoters. A shareholder who had been induced to take shares may claim from the directors or promoters or from any one else responsible for untrue statement occurring in the prospectus: (i) damages for fraudulent misrepresentation; (ii) compensation under s.62; (iii) damages for non-compliance with the requirements of s.56 regarding contents of the prospectus.

Damages for fraudulent misrepresentation. An allottee of shares may bring an action for deceit, i.e., fraudulent misrepresentation. There must be an intention to defraud and that is to be proved by him. The directors, etc., will not be liable for the tort of deceit if they honestly believed the statements to be true. The facts in *Derry v. Peek* were as follows: The directors of a Tramway Company issued a prospectus stating that they had the right to run tram-cars with steam power instead of with horses as before. In fact, the Act incorporating the company provided that such power might be used with the sanction of the Board of Trade. But the Board of Trade refused to

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give permission and the company had to be wound up. P, a shareholder sued the directors for damages for fraud. The House of Lords held that the directors were not liable in fraud because they honestly believed what they said in the prospectus to be true.

Compensation for untrue statement (s.62). Another remedy available to an allottee of shares for misstatements in a prospectus is to file a suit for compensation under s.62. A claim can be made, whether the statements are fraudulent or innocent. Section 65 provides that a statement is deemed to be untrue if it is misleading in the form and context in which it is issued. It is not necessary for the allottee to prove any fraud or knowledge on the part of the directors that the statement was untrue.

If a director pays damages under s.62, he is entitled to recover contributions from his co-directors, if they, too, are guilty of misstatement, misrepresentation, untrue statement; and on the death of the co-directors, from their estates.

Defences available to avoid civil liability [s.62(2)]. Section 62 names persons who are liable to pay compensation but certain defences are available to them. In a claim for compensation, the director may prove in defence that:

(i) he withdrew his consent to act as director before the issue of the prospectus and it was issued without his authority or consent; or

(ii) the issue was made without his knowledge or consent and on becoming aware of the issue he gave reasonable public notice of that fact; or

(iii) he withdrew his consent after the issue of the prospectus but before allotment and public notice was given; or

(iv) he had reasonable ground to believe that the statements were true and believed them to be true; or

(v) the statement was correct and fair summary or copy of an expert's report; or

(vi) the statement was made by an official document.

Another remedy available to an allottee of shares is to file a suit for damage in case the prospectus does not include the matters required to be included in accordance with the provisions of the Act.

Remedies against expert. The allottee to the shares who has been induced to take shares on the faith of an untrue statement of an expert in the prospectus is entitled to claim from the expert: (i) damages, (ii) compensation under s.62.

An expert is liable in damages in respect of his own untrue statement, wrong report or valuation made by him and contained in the prospectus and the same principles apply as in the case of a fraudulent or an innocent statement made by the directors. An expert is also liable to pay compensation under s.62. However, he shall not be liable if he proves: (i) that having given his consent, he withdrew it in writing before delivery of a copy of the prospectus for registration; or (ii) that after delivery of prospectus for registration and before allotment, he became aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and his reasons; or (iii) that he was competent to make the statement and believed on reasonable grounds that it was true.

Liability under s.56. An omission from a prospectus of a matter required to be stated under s.56 (i.e., as per Sch. II) may give rise to an action for damages at the instance of a subscriber for shares, who has suffered loss thereby, even if the omission does not make the prospectus false or misleading. But, the plaintiff must prove that he has sustained damage by reason of the omission of a matter required to be stated in the prospectus. A director or other person sued under s.56 may escape liability if he proves: (a) that he had no knowledge of the matter not disclosed; or (b) that the contravention arose out of an honest mistake of fact; or (c) in the opinion of the court,

non compliance or contravention was not material or that the person sued ought reasonably to be excused, having regard to all the circumstances of the case.

9.21 Criminal Liability for Misstatement in Prospectus (S. 63)

Where a prospectus contains an untrue statement, every person authorising its issue is punishable: (i) with imprisonment for a term upto two years or (ii) with fine upto ₹ 50,000, or (iii) with both imprisonment and fine. However, an expert is not criminally liable in respect of misstatements in the prospectus.

Liability under s.68. Section 68 provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into or to offer to enter into any agreement for, or with a view to acquiring, disposing of, subscribing for, underwriting shares or debentures shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to ₹ one lakh or with both.

9.22 Golden Rule for Framing of Prospectus

The 'Golden Rule' for framing of a prospectus was laid down by Justice Kindersley in *New Brunswick & Canada Rly. & Land Co. v. Muggeridge* (1860). Briefly, the rule is:

Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take shares on the faith of the representation contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as fact which is not so and no fact should be omitted the existence of which might in any degree affect the nature or quality of the principles and advantages which the prospectus holds out as inducement to take shares. In a word, the true nature of the company's venture should be disclosed.

In *Rex v. Kylsant* (1932), the prospectus stated that dividends of 5 to 8 per cent had been regularly paid over a long period. The truth was that the company had been incurring substantial losses during the seven years preceding the date of the prospectus and dividends had been paid out of the realised capital profit. Held, the prospectus was false and misleading. The statement though true in itself was rendered false in the context in which it was stated.

A half truth, for instance, represented as a whole truth may tantamount to a false statement (Lord Halsbury in *Aarons Reefs v. Twisa*).

Thus, the persons issuing the prospectus must not include in the prospectus all the relevant particulars specified in Parts I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge with might in any way affect the decision of the prospective investor to invest in the company.

9.23 Allotment of Shares in Fictitious Names Prohibited (S. 68A)

Following acts are punishable with imprisonment for a term extending to five years:

(i) making an application to a company for acquiring or subscribing for, any shares therein under a fictitious name; or

(ii) making a company to allot or register any transfer of shares therein to any other person in a fictitious name.

Also this Section should be prominently reproduced both in the prospectus as well as in application forms for shares.

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Intitial offer of securities to be in dematerialised form i certain cases (s. 68B). Every listed company, making initial public offer of any security for a sum of spaces ten crores or more, shall issue the same only in dematerialised form by complying with the requisite provisions of the Depositories Act, 1996 and regulations made thereunder.

9.24 Announcement regarding Proposed Issue of Capital

It is very common for companies to get an announcement regarding proposed issue of shares/ debentures inserted in the leading newspapers. It is not required by company law to do so. But it is done in order to invite the attention of the public to the proposed issue. On the top of the insertion it is given that. "It is only an announcement and not a prospectus", in order to avoid provisions under s.56 for publishing an incomplete prospectus.

9.25 Public Deposits

The invitation and acceptance of public deposits by companies were brought within the jurisdiction of Companies Act in 1974. Rules have been framed prescribing the limits upto which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members. Section 58-A and Companies (Acceptance of Deposits) Rules made thereunder contains the restrictions and limitations subject to which deposits may be invited and accepted by companies. The provisions of the Section and the summary of the important rules made thereunder are as follows:

1. ***Meaning of deposit.*** Explanation to s.58-A defines the expression 'deposit' to mean any deposit of money with and includes any amount borrowed by a company but shall not include such categories or amount as may be prescribed in consultation with the Reserve Bank of India.

   Further rule 2 (b) provides that 'deposit' means any deposit of money with and includes any amount borrowed by a company. However, the expression 'deposit' does not include:

   (i) any amount received from the Central Government or a State Government or any amount received from any other source and whose repayment is guaranteed by the Central Government or State Government or any amount received from a local authority or a foreign Government or any other foreign citizen, authority or person;

   (ii) any amount received as a loan from any banking company including a co-operative bank;

   (iii) any amount received from any of the notified financial institutions;

   (iv) any amount received by a company from any other company;

   (v) any amount received from an employee of a company by way of security deposit;

   (vi) any amount received by way of security or as an advance from any purchasing agent, selling agent or other agents in course of or for the purposes of the business of the company or any advance received against orders for the supply of goods or properties or for the rendering of any services;

   (vii) any amount received by way of subscriptions to any shares, stock, bonds or debentures and any amount received by way of calls in advance on shares, in accordance with the Articles of the company so long as such amount is not repayable to the members under the Articles;

   (viii) any amount received in trust or any amount in transit;

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(ix) any amount received from a director of the company or any amount received from a relative of a director or member of a private company.

(x) any amount raised by issue of the bonds or debentures secured by the mortgage of any immovable property of the company or with an option to convert them into shares in the company. (However, in the case of such bonds or debentures secured by the mortgage of any immovable property, the amount of such bonds or debentures must not exceed the market value of such immovable property);

(xi) any amount brought in by the promoters by way of unsecured loans in pursuance of stipulations of financial institutions subject to the fulfillment of the following conditions; namely:

(a) the loans are brought in pursuance of the stipulation imposed by the financial institutions in fulfillment of the obligation of the promoters to contribute such finance;

(b) the loans are provided by the promoters themselves and/or by their relatives and not from their friends and business associates; and

(c) the exemption shall be available only till the loans of financial institutions are repaid and not thereafter.

2. No company shall invite or accept any deposit except after the publication of an advertisement specifying therein the financial condition, management structure and other specified particulars of the company. The "renewal of deposits" are included in the "acceptance of deposits" [*Jagjivan Hiralal Doshi and Others v. Registrar of Companies* (1989) 65 Comp. Cas. 553].

3. Every deposit by a company, unless renewed in accordance with the rules made under s.58A, shall be repaid in accordance with the terms and conditions of such deposit.

4. The form of application shall contain a declaration by the depositor that the money is not being deposited out of funds acquired by him by borrowing or accepting deposits from any other person.

5. A company cannot accept or renew deposits payable on demand.

6. Also, a company cannot accept deposits repayable before 6 months. However, deposits for less than 6 months may be accepted provided such deposits do not exceed 10% of the paid-up capital and free reserves.

   However, in no case shall a company accept deposits repayable before 3 months.

7. ***Ceiling on deposits.*** A company shall not accept deposits over and above the following limits:

   (a) 10 per cent of the paid up capital and free reserves, in case of deposits in the form of any deposit against an unsecured debenture, deposit from a shareholder (not being a deposit accepted by a private company from its shareholders) or any deposit guaranteed by the Directors of the company;

   (b) any other deposit exceeding 25 per cent of the aggregate of the paid-up share capital and free reserves of the company.

8. No Government company shall accept any deposits in excess of 35 per cent of its paid-up capital and free reserves.

9. ***Interest on deposits.*** A Company cannot pay rate of interest exceeding the maximum rate of interest prescribed by the Reserve Bank of India, which is, at present, 11 percent compounded on monthly basis.

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10. ***Penalties for contravention.*** Any deposit received in contravention of the provisions of the Act/Rules must be paid back within 30 days from the date of acceptance of such deposit. The period of 30 days may be extended by the Central Government by another period but not exceeding 30 days.

    In case of default, the company shall be subjected to fine which shall not be less than twice the amount not repaid and ½ of the fine shall be paid to the depositor. In addition, every officer of the company, who is in default, shall be punishable with imprisonment for a term which may extend upto 5 years [s.58A (5)].

    Penalty for acceptance of deposit. Where the contravention relates to acceptance of deposit, the company may be subjected to fine which shall not be less than the amount of deposit so accepted.

    Penalty for invitation of any deposit. Where contravention relates to the invitation of any deposit, the company shall be punishable with fine which may extend to ₹ 10 lakh but shall not be less than ₹ 50,000.

    In both these cases of acceptance or invitation of deposit in contravention, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend upto 5 years and shall also be liable to fine [*H.H. Marthanda Varma & H.H. Bhupendra Narain Singh v. Registrar of Companies* (1988) Comp. Cas. 125].

11. ***Register of deposits.*** According to Rule 7 every company accepting deposits shall keep at its registered office one or more registers in which there shall be entered separately in the case of each depositor the following particulars, namely:

    (a) name and address of the depositor;

    (b) date and amount of each deposit;

    (c) duration of the deposit and the date on which each deposit is repayable;

    (d) rate of interest;

    (e) date or dates on which repayment of interest will be made;

    (f) any other particulars relating to the deposit.

    The register of deposit shall be kept for a minimum period of 8 years from the financial year in which the latest entry is made in the register.

12. Where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board may, if it is satisfied, either on its own motion or on the application of the depositor, that it is necessary to do so to safeguard the interests of the company, the depositors or the public, by order direct the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the Order – sub-s.(9).

    However in the following circumstances, application under s.58A(9) of the Act will NOT lie: (vide Dept. of Company Affairs Notificated dt. 8.3.1990).

    (i) Deposit made for booking/purchase of scooter, car, etc.

    (ii) Deposits accepted by financial companies like hire-purchase, finance company, a housing finance company, an investment company, a loan/mutual benefit financial company, an equipment leasing company, a chit fund company or a company, which receives deposits under any scheme or arrangement by way of contribution/subscription or by sale of units/certificates.

    (iii) Deposits accepted by a sick industrial company covered by the Sick Industrial Companies (Special Provisions) Act, 1985, in respect of which Board for Industrial &

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Financial Reconstruction, has specifically, by order, suspended the operation of any contract, agreement, settlement, etc. under s.22(3) of the said Act.

(iv) Deposits accepted by relief undertakings which are notified as such under the State Laws.

Further, it may be clarified that the depositors can, besides the relief under the Companies Act, take action against the defaulting companies under the normal civil law of the country.

13. ***Penal interest on overdue Deposits.*** Rule 8A provides that a penal rate of interest of 18 percent shall be paid for the overdue period in case of public deposits matured and claimed but remaining unpaid.

    In the case of deposits made by a small investor, the penal rate of interest shall be 24 percent compoundable on annual basis.

14. ***Maintenance of liquid assets.*** Every company shall before the 30th day of April of each year, deposit or invest, as the case may be, a sum which shall not be less than 15 per cent (w.e.f. 1st April 1992) of the amount of its deposits maturing during the year ending on the 31st of March next following in any one or more of the securities prescribed in this regard. The amount so invested or deposited shall only be used in repayment of the deposits outstanding and repayable within next 31st March. At no time such investment or deposit shall fall below 10% of the deposits repayable within next 31st March.

    It may be noted that all deposits of non-banking and non-financial companies are regulated under s.58A and the Rules made thereunder.

15. ***Register of deposits.*** According to Rule 7, every company accepting deposits shall keep at its registered office one or more registers in which there shall be entered separately in the case of each depositor the following particulars, namely:

    (a) name and address of the depositor;

    (b) date and amount of each deposit;

    (c) duration of the deposit and the date on which each deposit is repayable;

    (d) rate of interest;

    (e) date or dates on which repayment of interest will be made;

    (f) any other particulars relating to the deposit.

    The register of deposit shall be kept for a minimum period of 8 years from the financial year in which the latest entry is made in the register.

16. ***Facility of nomination etc.*** A depositor under s.58A is allowed to make a nomination. The provisions of Ss. 109 A and 109 B shall apply to such a nomination also.

17. ***Small Depositors - Special Provisions (Sections 58AA and 58AAA).*** The Companies (Amendment) Act, 2000 added two new Sections, viz., Sections 58AA and 58AAA, for the protection of small depositors. 'A small depositor' means a depositor who has invested in a financial year a sum not exceeding Rupees twenty thousand in a company and includes his successors, nominees and legal representatives.

    1. If any default is made by a company in repayment of any public deposit accepted from small depositor or part thereof or any interest thereupon, s. 58AA makes it obligatory on the part of a company to give an intimation on monthly basis to the Company Law Board within 60 days from date of default. Such intimation shall include particulars in respect of the names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereupon.

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The Company Law Board shall, on receipt of the intimation, exercise on its own motion, powers conferred upon it by sub-section (9) of s. 58A and pass an appropriate order within a period of 30 days from the date of receipt of intimation from the company.

The Company Law Board may pass the above order after giving the small depositors an opportunity of being heard. However, it shall not be necessary for a small depositor to be present at the hearing of the proceedings.

2. *Prohibition on companies to accept further deposits.* A company shall not at any time, accept further deposits from 'small depositors' unless each small depositor, whose deposit has matured, had been paid the amount of the deposit and the interest accrued thereupon. This prohibition will, however, not apply in the following cases:

   (i) where such deposit has been renewed voluntarily by the small depositor; or

   (ii) where repayment of the deposit has become impracticable due to the death of the small investor or a competent court or authority has stayed its repayment.

3. *Advertisement and application form.* Where a company has defaulted in repayment of deposit or part thereof or any interest thereon to a small depositor, it shall state in every future advertisement and application form for inviting deposits from the public, the total number of small depositors and amount due to them in respect of which such default has been made.

4. *Waiver of interest due to depositors.* Where any interest accrued on deposits of the small depositors has been waived, the fact of such waiver shall be mentioned by the company in every advertisement and application form inviting deposits issued after such waiver.

5. *Loan for working capital to be used for repayment of deposits.* If a company has accepted deposits from small depositors and subsequent to this obtains funds by way of loan for working capital from any bank, it shall first utilize such funds for the repayment of any deposit or any part thereof or any interest thereupon to the small depositor before applying such funds for any other purpose.

6. *Application form to contain statement.* Every application form issued by a company to a small depositor for accepting deposits from him shall contain a statement to the effect that the applicant has been apprised of-

   (a) every past default by the company in repayment of deposit or interest thereon; and

   (b) the waiver of interest as above and the reasons therefor.

   It may be noted that the prohibition to accept new deposit from small depositors under sub-section (4) applies where there is a subsisting default. As against this, sub-section (8) dealing with issue of application form to small depositors relates to past default(s) which presumably are no longer subsisting.

   Default in acceptance or refund of deposit shall be cognizable. Section 58AAA makes the default in acceptance or refund of deposit to a small investor to be a cognizable offence under the Code of Criminal Procedure, 1973. However, no court shall take cognizance of the offence, in this regard, unless the complaint is made by the Central Government or any officer authorized by it in this behalf.

18. ***Exemptions.*** The provisions of s.58A do not apply to: 1. A banking company [s.58A (7)]. 2. Companies other than banking companies as the Central Government may after consultation with the Reserve Bank of India, specify in this behalf.

Exemption of small scale units: In pursuance of its powers, the Central Government has, after consultation with the Reserve Bank of India, granted exemption from the applicability of the provisions of s.58A to the companies which are small scale units as per the parameters notified from time to time.

According to the notification GSR No. 73 (E), dated 2-2-1996, the exemption from the provisions of s.58A of the Act shall be available to small scale industrial units only if they fulfil all the following conditions, namely: (a) the paid-up capital of the company does not exceed rupees 25 lakhs; (b) the company accepts deposits from not more than 100 persons; (c) there is no invitation to public deposits; and (d) the amount of deposits accepted by the company does not exceed rupees 20 lakhs or the amount of its paid-up capital, whichever is less.

3. Financial companies as the central government may, after consultation with the Reserve Bank of India, specify in this behalf.

However, the central government cannot exempt the financial companies from the provisions relating to advertisement contained in s.58A(2)(b). The Central Government, in exercise of its aforesaid powers, exempted all classes of financial companies from all the provisions of s.58A except the provisions relating to advertisement – vide Notification No. SD 523 (E), dated 18-9-1975.

Power of the Central Government to grant total or partial exemption [s.58A (8)]: The Central Government has been empowered to grant partial or total exemption from the provisions of s.58A for a specified period to a company (or a class of companies) after consultation with the Reserve Bank of India. The Central Government is also empowered to grant extension of time to any company (or a class of companies) after consultation with the Reserve Bank in complying with these provisions.

Issue of commercial paper exempted. The Department of Company Affairs has vide notification dated 29-12-1989 exempted the class of companies which fulfil the criteria under the Non-Banking Companies (Acceptance of Deposits through Commercial Paper) Directions, 1989 from the provisions of s.58A with respect to deposits received by non-banking companies by the issue of commercial paper as per the aforementioned Directions. The following conditions are required to be satisfied:

(i) the companies comply with the terms and conditions stipulated from time to time by the Reserve Bank of India relating to the issue of such commercial paper; and

(ii) the companies in their annual account disclose the maximum amount raised at any time during the financial year and the amount outstanding as at the end of the financial year.

19. ***Advertisement for inviting deposits (Rule 4).*** Every company intending to invite deposits or allowing or causing any person to invite deposits on its behalf is required to issue an advertisement for the purpose in a leading English newspaper and in one vernacular newspaper circulating in the State in which the registered office of the company is situated. Each advertisement should contain the particulars as prescribed in Rule 4. The advertisement must be issued on the authority and in the name of the Board of Directors of the company. It must also state the date on which the text was approved by the Board of Directors. It must contain reference to the conditions subject to which the deposits shall be accepted by the company.

According to s.58B, an advertisement inviting a prospectus and consequently all the provisions of the Act, applicable to the prospectus, are applicable to the advertisement inviting deposits.

Signing of advertisement. The advertisement should be signed by a majority of the directors in the Board of the company, as constituted at the time the Board approved the advertisement, or their duly authorised agents, in writing and a copy of the same should be delivered to the Registrar of companies for registration. Even a letter of authority is sufficient for this purpose and power of attorney is not necessary. [Circular No. 23/75 (1)/14/75-CL (IV)] dated 25-9-1975 issued by the Department of Company Affairs].

Period of validity of advertisement and delivery of the text to the registrar. The advertisement shall remain valid for a period of 6 months from the date of the closure of the financial year in which it is issued or until the date the balance sheet is laid before the company in general meeting or where the Annual General Meeting is not held, the latest date on which the meeting should have held, whichever is earlier. A fresh advertisement has to be made in each succeeding financial year for inviting deposits thereafter.

Statement in lieu of advertisement (Rule 4A). Where a company intends to accept deposits without inviting or allowing or causing any other person on its behalf, to invite such deposits, it need not issue the advertisement. It is, however, required to file with the Registrar a statement in lieu thereof containing all the particulars required to be included in the advertisement under the Rules and signed (in the same manner as the advertisement for deposits is to be signed) before accepting any deposit.

The statement in lieu of advertisement shall be valid until the expiry of 6 months from the date of closure of the financial year in which it is so delivered or until the date on which the balance sheet is laid before the company in the annual general meeting, or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier.

20. ***Acceptance of deposits in joint names [Rule 8(2)].*** Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without any one of the clause namely "either or survivor".

21. ***Return of deposits (Rule 10).*** Every company is required to file with the Registrar on or before 30th June every year, a return of deposits in the prescribed form furnishing information contained therein as on 31st of March of that year duly certified by the auditors of the company. A copy of the return is required to be simultaneously furnished to the Reserve Bank of India.

9.26 Summary

- A public company may also decide not to invite public to subscribe to its share capital and arrange its capital privately as in the case of private company. Under such circumstances, the public company is required to submit a statement in lieu of prospectus with the Registrar of Companies at least three days before the allotment of shares is made.
- The payment must be strictly by way of 'commission' and not merely a device to issue shares at a discount.
- The rate of commission and the number of shares and debentures which the underwriters have agreed to subscribe for a 'commission' should be disclosed in the prospectus.
- The names of the underwriters and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations must be disclosed in the prospectus.
- The amount of authorised capital and its subdivision into equity and preference share capital is given in the Memorandum of Association which is prepared before the certificate of incorporation is obtained.

- A prospectus, as per s.2(36), means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate.
- Every prospectus submitted to Stock Exchange Board of India (SEBI) for vetting shall, in addition to the requirements of schedule II to the Act, contain/specify certain particulars as are announced from time to time.
- Any variation between the information memorandum and the red-herring prospectus shall be highlighted as variations by the issuing company.
- Every variation as made and highlighted under (iv) is to be individually intimated to the persons invited to subscribe to the issue of securities.
- In the event of the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated cheques or stock invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.
- The prospective shareholders are entitled to all true disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not omit material facts.

9.27 Keywords

Certain prescribed particulars: In regard to the company and other listed companies under the same management which made any capital issue during the last 3 years.

Financial Information: reports of the auditors of the company with respect to its profits and losses and assets and liabilities, and the dividends paid during the five financial years immediately preceding the issue of prospectus.

Outstanding litigations: relating to financial matters or criminal proceedings against the company or directors under Schedule XIII.

Prospectus: A document shall be called a prospectus if it satisfies two things: 1. It invites subscription to share or debentures or invites deposits. 2. The aforesaid invitation is made to the public.

Shelf-prospectus: A shelf-prospectus means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Small depositor: A small depositor is one who has deposited, in a financial year a sum not exceeding ₹ 20000 in a company and includes his successors, nominees and legal representatives.

Sub-underwriting: Every underwriter has a certain limit up to which he would go in for taking risk by entering into an underwritting contract.

Underwriting: consists of an undertaking by some person or persons that if the public fails to take up the issue, he or they will do so.

Notes

9.28 Self Assessment

Fill in the blanks:

1. A .... limited by shares, generally issues shares to the pubic for which it has to issue a prospectus.
2. .... lays down that the matters and reports stated in Schedule II to the Act must be included in a prospectus.
3. .... requires that no one shall issue any form of application for shares in or debentures of a company unless the same is accompanied by a memorandum (Known as 'Abridged Prospectus') containing such salient features of prospectus as may be prescribed.
4. .... requires making public the draft prospectus filed with it.
5. A .... may contain a statement purporting to be made by an expert.
6. .... has been designed to check the by-passing of the provision of s.56 as given above by making an offer of sale of shares or debentures through the medium of issue houses.
7. .... makes provisions for a self-prospectus in certain situation.
8. A company inviting subscription by an .... is bound to file a prospectus prior to the opening of the subscription lists and the offer as a redherring prospectus, at least three days before the opening of the offer.
9. The invitation and acceptance of public deposits by companies were brought within the jurisdiction of Companies Act in ....
10. .... provides that a penal rate of interest of 18 percent shall be paid for the overdue period in case of public deposits matured and claimed but remaining unpaid.

9.29 Review Questions

1. What is a prospectus? Who are liable for misstatements in a prospectus?
2. Explain the extent of civil and criminal liability for such misstatements.
3. Write a short note on statement in lieu of prospectus.
4. State the restrictions and limitations on inviting and accepting deposits by companies.
5. What is a misstatement in a prospectus?
6. What are the defences available to a director for any misstatement in a prospectus
7. Discuss the remedies available to an allottee who had applied for shares on the faith of a false prospectus.

Answers: Self Assessment

1. public company
2. Section 56
3. Section 56(3)
4. SEBI
5. prospectus
6. Section 64
7. Section 60A
8. information memorandum
9. 1974.
10. Rule 8A

Notes

9.30 Further Readings

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, India, 2007

S.S Gulshan, *Business Law,* Third Edition, Excel Books, New Delhi, 2006

S.S Gulshan, *Mercantile Law,* Third Edition, Excel Books, New Delhi, 2006

Online links

http://www.caclubindia.com/articles/ca-and-cs-final-company-law-cases-compilation-2009--4099.asp

http://www.commonlii.org/in/legis/num_act/ca1956107/

http://www.mca.gov.in/Ministry/acts_bills.html

http://www.netlawman.co.in/acts/companies-act-1956.php

Unit 10: Share Capital

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Objectives

After studying this unit, you will be able to:

- Discuss the meaning of share capital
- Explain the allotment of shares
- Describe the inspection and investigation
- Discuss management of company

Introduction

In earlier unit you have studied about the formation of company and prospectus. As you all know that Promoters have been described to be in fiduciary relationship with the company. A prospectus, as per s.2 (36), means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate. In this unit you will study about sharte, share capital and allotment of share .

10.1 Meaning of Share Capital

It means the capital of a company, or the figure in terms of so may rupees divided into shares of a fixed amount, or the money raised by the issue of shares by a company.

As mentioned above, a public company and its subsidiary can issue only two kinds of shares, viz., preference and equity. Therefore, such a company can have only two kinds of share capital by issue of preference shares and equity shares, viz., preference share capital and equity share capital. The expression "Preference Share Capital" and "Equity Share Capital" are used in the following different senses:

Nominal, authorised or registered capital. This is the sum stated in the memorandum as the share capital of a company with which it is proposed to be registered. This is the maximum amount of capital which it is authorised to raise by issuing shares and upon which it pays stamp duty. As we shall see later, when the original amount of the authorised capital is exhausted by issue of shares, it can be increased by passing an ordinary resolution.

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Issued capital. It is that part of the authorised capital which the company has issued for subscription. The amount of issued capital is either equal to or less than the authorised capital.

Subscribed capital. It is that portion of the issued capital which has been subscribed for by the purchasers of the company's shares. The amount of subscribed capital is either equal to or less than the issued capital.

Called-up capital. The company may not call up full amount of the face value of the shares. Thus, the called-up capital represents the total amount called-up on the shares subscribed. The total amount of called-up capital can be either equal to or less than the subscribed capital.

Thus, uncalled capital represents the total amount not called up on shares subscribed and the shareholders continue to be liable to pay the amounts as and when called. However, the company may reserve all or part of the uncalled capital, which can then be called in the event of the company being wound up. For this purpose, a special resolution is required to be passed and then it is known as Reserve Capital or Reserve Liability (s.99).

Paid-up capital. Paid-up capital is the amount of money paid-up on the shares subscribed.

10.1.1 Alteration of Share Capital

Section 94 provides that, if the articles authorise, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as:

1. to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;
2. to consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
3. to covert all or any of its fully paid-up shares into stock and reconvert the stock into fully paid-up shares of any denomination;
4. to sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion paid and unpaid on each share must remain the same;
5. to cancel shares which, at the date of the passing of the resolution in this behalf, have not been taken or agreed to be taken by any person.

These five clauses are now explained.

1. ***Increase of authorised share capital.*** A company, limited by shares, if the articles authorise, can increase its authorised share capital by passing an ordinary resolution.

   Within 30 days of the passing of the resolution, a notice of increase in the share capital must be filed with the Registrar. On receipt of the notice, the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both. If default is made in filing the notice, the company and every officer of the company who is in default shall be punishable with fine upto ₹ 50 per day during which the default continues (s.97).

2. ***Consolidation and sub-division of shares.*** Consolidation is the process of combining shares of smaller denomination. For instance, 10 shares of ₹ 10 each are consolidated into one share of ₹ 100. Sub-division of shares is just the opposite of consolidation, i.e., one share of ₹ 100 is divided into 10 shares of ₹ 10 each. Once a resolution has been passed, a copy of the resolution is required to be sent within thirty days to the Registrar.

3. ***Conversion of shares into stock and vice versa.*** Stock is simply a set of fully paid-up shares put together and is transferable in any denomination or fraction. On the other hand, a share

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is transferable as a whole; it cannot be split into parts. For example, a share of ₹ 10 can be transferred as a whole; it cannot be transferred in parts. But if 10 shares of ₹ 10 each fully paid are converted into stock, of ₹ 100, then the stockholder can transfer stock, say, worth ₹ 17 also.

Section 94 empowers a company to convert its fully paid-up shares into stock by passing a resolution in general meeting, if its articles authorise such conversion. A notice is to be filed with the Registrar within thirty days of the passing of the resolution specifying the shares so converted.

It is to be noted that stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also, stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.

When shares are converted into stock, the shareholders are issued stock certificates. In the Register of Members, the amount of stock is written against the name of a particular member in place of number of shares. The stockholder is as much a member of the company as a shareholder.

4. ***Diminution of share capital.*** Sometimes, it so happens that shares are issued, but are not taken up by the members of the public and, therefore, not allotted. Section 94 provides that a company may, if its articles authorise, by resolution in general meeting, cancel shares which at the date of the passing of the resolution in that behalf have not been taken or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital which is discussed herein below.

10.1.2 Reduction of Capital

Sections 100-105 provide for the reduction of share capital. A company limited by shares, if so authorised by its articles, may, by special resolution, which is to be confirmed by the Court reduce its share capital:

(i) by reducing or extinguishing the liability of members for uncalled capital, e.g., where a share of ₹ 10 on which ₹ 5 are paid, is treated as a share of ₹ 5 fully paid-up. In this way the shareholder is relieved from liability on the uncalled capital;

(ii) by paying off or returning capital which is in excess of the wants of the company, e.g., where there is a share of ₹ 10 fully paid-up, reduce it to ₹ 5 and pay back ₹ 5 to the shareholder;

(iii) pay off paid-up capital on the understanding that it may be called up again, e.g., a share of ₹ 10 is fully paid-up, on which ₹ 2.50 may be returned to the shareholder on the condition that when necessary, the company may call it up again. Thus, the difference between method (i) and this method is that the uncalled liability is not extinguished in the latter;

(iv) a combination of the preceding methods;

(v) write off or cancel capital which has been lost or is not represented by available assets, e.g., a share of ₹ 10 fully paid-up is represented by ₹ 7.50 worth of assets. In such a situation, reality can be re-introduced into the balance sheet position of the company by writing off ₹ 2.50 per share. This is the most common method of reduction of capital. The assets side of the balance sheet may include useless assets, fictitious goodwill, preliminary expenses, discount on issue of shares and debentures, etc. These assets are either cancelled or their values are reduced to the extent they are useless. Correspondingly, share capital on the liability side is reduced.

Procedure for reduction of capital. After passing the special resolution for the reduction of capital, the company has to apply to the Court by way of petition to confirm the resolution under s.101. The creditors are entitled to object where the proposed reduction of share capital involves either: (1) the diminution of liability in respect of unpaid capital; or (2) the payment to any shareholder of any paid-up share capital, or in any other case, if the Tribunal so directs.

To enable the creditors to object, the Court settles a list of such people. If any creditor objects, either his consent to the proposed reduction should be obtained or he should be paid off or his payment secured. However, the Court may dispense with the consent of a creditor on the company securing payment of the debt or claim by appropriating the full amount or that fixed by the Court.

Section 102 states that if the Court is satisfied that either the creditors entitled to object have consented to the reduction, or that their debts have been paid or secured, it may confirm the reduction. It may also direct that, the words "and reduced" be added to the company's name for a specified period and that the company must publish the reasons for the reduction and the causes which led to it.

Section 103 provides for registration of the Court's order with the Registrar. The company has also to send the minutes giving details of the share capital as altered. The reduction of share capital takes effect only on registration of the Tribunal's order with the Registrar and not before. The Registrar will issue a certificate of registration which will be a conclusive evidence that both the requirements of the Act have been complied with and that the share capital is now as set out in the minutes. The registered minutes are deemed to be substituted for the corresponding capital clause in the memorandum, thereby altering the memorandum within the meaning of s. 40. The copies of the memorandum which will be issued subsequently must, therefore, be in accordance with the articles.

Section 104 provides that after the reduction of capital, the members cease to be liable for calls as regards the amount by which the nominal amount of their shares has been reduced. If, however, any creditor entitled to object to the reduction of share capital is not entered on the list of creditors, then every member at the time of the registration of the Tribunal order and minutes is liable to contribute for the payment of that debt.

Section 105 provides for punishment with imprisonment extending to one year or with fine or both, if any officer of the company knowingly conceals the name of any creditor entitled to object to the reduction or misrepresents the nature or amount of claim or debt or abets such concealment or misrepresentation.

10.1.3 Reduction of Share Capital without the Sanction of the Court

There are some cases in which there is reduction of share capital and no confirmation by the Court is necessary. These are:

(i) ***Forfeiture of shares.*** A company may, in pursuance of its articles, forfeit shares for non-payment of calls.

(ii) ***Surrender of shares.*** It is a shortcut to forfeiture. It may be accepted by the company under circumstances where its forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from liability on shares.

(iii) ***Diminution of capital.*** This has already been explained. Section 94 clearly states that diminution of capital does not amount to reduction of capital.

(iv) ***Redemption of redeemable preference shares.*** This has already been explained as provided by s.80.

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(v) ***Purchase of shares of a member by the company under s. 402.*** The Company Law Board may order the purchase of shares of any member of the company by the company, under certain circumstances.

Reduction of capital vs. diminution of capital. Reduction of capital involves working off past losses against capital cancellation of the uncalled capital or repayment of surplus capital. It may involve reduction of issued capital, subscribed or paid up share capital. Diminution of capital denotes cancellation of the authorised or issued capital (but not subscribed). Diminution of capital does not constitute a reduction of capital within the meaning of the Companies Act. The distinction between reduction and diminution of capital is as follows:

1. Diminution of capital is the reduction of the issued capital. Reduction of capital involves reduction of subscribed or paid up capital; there is no reduction of issued capital.
2. Both require authorisation by Articles but whereas 'diminution' can be effected by an ordinary resolution (if so authorised by Articles), reduction of capital cannot be effected without passing a special resolution.
3. 'Reduction' requires confirmation by Court (s.100) but 'diminution' needs no confirmation by the Court (s.94).
4. In case of 'reduction', Court may order the company to add the words 'and reduced' after its name [s.102 (3) but no such order can be passed in case of 'diminution' s.94].
5. In case of 'diminution', notice is to be given to Registrar within 30 days from the date of cancellation whereupon the Registrar shall record the notice and make the necessary alteration in the Memorandum of Association and Articles of Association. In case of 'reduction' more detailed procedure has been prescribed though there is no time limit as in case of 'diminution'.

10.1.4 Purchase of its own Shares by a Company (S. 77)

No company limited by shares and no company limited by guarantee and having a share capital, shall have power to buy its own shares, unless the consequent reduction of share capital is effected and sanctioned by the court in pursuance of s.100 to 104 or of s.402. Further, no public company and no private company which is a subsidiary of a public company can directly or indirectly (through loans or guarantee) provide financial assistance to any person to buy shares in the company or in its holding company.

If default is made in compliance of s.77, then the company and every officer of the company in default shall be punishable with a fine upto ₹ 1 lakh.

There are, however, certain exceptions to s. 77. They are: (1) A company may redeem its redeemable preference shares issued under s.80; or (2) A banking company may lend money for the purpose in the ordinary course of its business; or (3) A company in pursuance of scheme for the purchase of fully paid-up shares in the company to be held by trustees for the benefit of its employees including salaried directors, may advance loan for the purchase; or (4) A company may advance loans to its bona fide employees (excluding directors or managers) to enable them to purchase fully paid shares for amount not exceeding six months' salary or wages of each employee; or (5) An unlimited company can purchase its own shares; or (6) A private company which is not a subsidiary of a public company may advance loan or offer guarantee for purchase of its shares. However, even such a company cannot purchase its own shares.

The Companies (Amendment) Act, 1999 inserted three new sections – 77A, 77AA and 77B. The companies have been allowed to buy-back their shares subject to certain safeguards. SEBI (Buy Back of Securities) Regulations, 1998 have also been issued. These are:

1. Section 77A provides that a company may purchase its own shares or other specified securities (also known as "buy-back") out of (i) its free reserves; or (ii) the securities

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premium account; or (iii) the proceeds of any shares or other specified securities. However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

2. This buy-back is allowed only if the following conditions are satisfied;
   (a) the buy-back is authorised by the articles,
   (b) a special resolution has been passed in general meeting of the company authorising the buy-back;
   (c) the buy-back does not exceed 25% of the total paid-up capital and free reserves of the company; also, the buy-back of equity shares in any financial year shall not exceed 25% of the total paid-up equity capital in the financial year;
   (d) the ratio of the debt owed by the company must not be more than twice the capital and its free reserves after such buy-back. However, the Central Government may prescribe a higher ratio of the debt for a class or classes of companies. The term 'debt' here includes all amounts of unsecured and secured debts;
   (e) all the shares or other specified securities, for buyback must be fully paid-up;
   (f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI;
   (g) the buy-back in respect of unlisted shares or other specified securities is in accordance with the guidelines prescribed.
3. The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating (a) a full and complete disclosure of all material facts; (b) the necessity for the buy-back; (c) the class of security intended to be purchased under the buy-back, (d) the amount to be invested under the buy-back; (e) the time-limit for completion of buy-back. In any case every buy-back shall be completed within 12 months from the date of passing the special resolution.
4. The buy-back may be (a) from the existing security-holders on a proportionate basis; or (b) from the open-market; or (c) from odd lots, (i.e., where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or (d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.
5. Where a company has passed a special resolution to buy-back its own shares or other securities, it shall, before making such buy-back file with the Registrar of Companies and the SEBI a declaration of solvency in the prescribed form. This declaration is to be verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board and signed by at least two directors of the company, one of whom shall be the managing director, if any.

   However, in case if a company whose shares are not listed on a recognised stock exchange, no such declaration need be filed with SEBI.

   Where a company buys back its own securities, it shall extinguish and physically destroy the securities so bought back within seven days of the last day of completion of buy-back.
6. Where a company completes a buy-back of its shares or other specified securities, it shall not make further issue of the same kind of shares [including allotment of further shares

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under s.81 (1)] or other specified securities within a period of 24 months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

7. Where a company buys-back the securities, it shall maintain a register of the securities so bought, the consideration paid for the securities bought back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

8. A company shall, after the completion of the buy-back, file with the Registrar and SEBI, a return containing such particulars relating to the buy-back within 30 days of such completion as may be prescribed. However, no such return need be filed with SEBI, in the case of a company whose shares are not listed on any recognised stock exchange.

9. If a company makes a default in complying with the above provisions, the company or any officer of the company who is in default shall be punishable with imprisonment for a term which may extend upto 2 years, or with fine which may extend upto ₹ 50,000 or with both.

10. For the purposes of this Section – (i) 'specified securities' includes employees' stock option or other securities as may be notified by the Central Government from time to time, (ii)" free reserves" shall have the meaning assigned to it in s.372A

11. Transfer of certain sums to capital redemption reserve account (s.77AA). Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet.

12. Prohibition for buy-back in certain circumstances (s.77B). This section provides that no company shall directly or indirectly purchase its own shares or other specified securities (a) through any subsidiary company including its own subsidiary companies, or (b) through any investment company or group of investment companies; or (c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures, or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institution or bank, is subsisting.

13. Further no company shall directly or indirectly purchase its own shares or other specified securities in case it has not complied with provisions of Ss. 159, 207 and 211.

10.2 Raising of Capital/Issue of Shares

Companies limited by shares have to issue shares to raise the necessary capital for their operations. Issue of shares may be made in three ways. (i) By private placement of shares; (ii) By allotting entire shares to an issue-house, which in turn, offers the shares for sale to the public; and (iii) By inviting the public to subscribe for shares in the company through a prospectus.

Private placement of shares. A private company limited by shares is prohibited by the Act and the Articles from inviting the public for subscription of shares or debentures. It also need not file statement in lieu of prospectus. Its shares are issued privately to a small number of persons known to the promoters or related to them by family connections.

A public company can also raise its capital by placing the shares privately and without inviting the public for subscription of its shares or debentures. In this kind of arrangement, an underwriter or broker finds persons, normally his clients who wish to buy the shares. He acts merely as an agent and his function is simply to procure buyer for the shares, i.e., to place them. Since no public offer is made for shares, there is no need to issue any prospectus. However, under s.70,

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such a company is required to file with the Registrar a statement in lieu of prospectus at least 3 days before making allotment of any shares or debentures.

As per the guidelines issued by SEBI in June, 1992, private placement of shares should not be made by subscription of shares from unrelated investors through any kind of market intermediaries. This means promoters share should not be contributed by subscription of those shares by unrelated investors through brokers, merchant bankers, etc. However, subscription of such shares by friends, relatives and associates is allowed.

By an offer for sale. Under this arrangement, the company allots or agrees to allot shares or debentures at a price to a financial institution or an Issue-house for sale to the public. The Issue-house publishes a document called an offer for sale, with an application form attached, offering to the public shares or debentures for sale at a price higher than what is paid by it or at par. This document is deemed to be a prospectus [s.64(1)]. On receipt of applications from the public, the Issue-house renounces the allotment of the number of shares mentioned in the application in favour of the applicant purchaser who becomes a direct allottee of the shares.

By inviting public through prospectus. This is the most common method by which a company seeks to raise capital from the public. The company invites offers from members of the public to subscribe for the shares or debentures through prospectus. An investor is expected to study the prospectus and if convinced about the prospects of the company, apply for shares.

Issue of shares to existing shareholders. The capital is also raised by issue of rights shares to the existing shareholders (s.81). In this case the shares are allotted to the existing equity shareholders in proportion to their original shareholding, e.g., one share against every two shares held by a member.

Public issue of shares. Public issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares or debentures, a public company has to comply with the provisions of the Companies Act, the Securities Contracts (Regulations) Act including the Rules made thereunder and the Guidelines and instructions issued by the concerned Government authorities, the Stock Exchange and SEBI, etc. Management of public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrars to the issue, solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, stock exchange, SEBI, etc.

It is advisable to keep in mind the guidelines issued by SEBI with regard to issue of shares termed as "Guidelines for Disclosure and Investor Protection" before issuing shares to the public.

Share application form to seek permanent account number. In respect of applications for value of ₹ 50,000 or more, the applicant or in case of applications in joint names, each of the applicant, shall mention his/her permanent account number/GIR number and income-tax circle, ward, district or the fact of non-allotment of PAN/GIR number, as the case may be and applications not complying with the provisions are liable to be rejected.

10.3 Allotment of Shares

Introduction

In response to the issue of the prospectus, the company receives the applications for shares along with application money either at the register office or the company or by its bankers. Now, the Board of Directors would like to make the allotment of shares. But before this can be done, certain statutory restrictions are to be complied with. In this part, we shall discuss the meaning of allotment and the restrictions which are imposed by law before allotment of shares can be made.

Meaning of Allotment

Offer for shares are made on application forms supplied by the company. When an application is accepted, it amounts to an allotment. The expression allotment is not defined under the Companies Act. It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons. The supreme Court in *Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd.* AIR 1964 SC 250 defined allotment as "the appropriation but out of the previously unappropriated capital of the company of a certain number of shares to a person".

Since re-issue of forfeited shares does not constitute appropriation out of unappropirated capital, it does not constitute allotment.

What is termed 'allotment' is generally neither more nor less than the acceptance by the company of the offer to take shares.

General principles regarding allotment

With regard to the allotment of shares the following general principles should be observed in addition to the provisions of the Companies Act.

Allotted by Proper authority – The allotment should be made proper authority i.e., the Board of Directors of the company or a Committee authorized to allot shares on behalf of the Board. An allotment made without proper authority will be invalid.

In *P.V. Damodara Redy v. Indian National Agencies Ltd.* [1945] 15 Comp. Cas. 148 (Mad.), R & N applied to the company for allotment of shares. Their application was considered by the Board and accepted and their names entered in the register of members. The Articles of the company however provided that the shares could not be allotted to outsiders without the consent of the company in general meeting. Eight months later, on the objection of the Auditor, the allotment was cancelled and the names of R & N removed from the register. The contention of the company was that acceptance of the applicants' offers by the directors alone was entirely inoperative and accordingly there were no allotments and that the applicants must be deemed to have contracted on the footing of the Articles of Association.

Held that, applying the rule laid down in *Royal British Bank v. Turquand* [1856] 6 E & B 37, applicants were entitled to assume that the directors were acting regularly and that the sanction of the company in general meeting had in fact been obtained. That being so, the allotments could not be avoided by the company.

However, allotment of shares in a company made by an irregularly constituted Board of directors shall prima facie be invalid.

Allotment against application only – No valid allotment can be made on an oral request. Section 41 provides that for becoming a member, a person should agree in writing. Thus, no allotment can be made without a written application for allotment [*H.H. Manabendra Shah v. Official Liquidator* [1977] 47 Comp. Cas. 356. In practice, application is to be made on the form supplied by the company in this regard.

Where there was no application in writing for allotment of shares and allotment was made in blank, a company was rightly directed by the Special court of return money paid for the shares. *Rahul Subodh Windoors Ltd. v. A.K. Menon* [1999] 96 Comp. Cas. 579 [SC].

Allotment not to be in contravention of any other law – If shares are issued in a manner prohibited by foreign exchange regulations, the issue would be invalid and void and confer on the allottee no title whatsoever to the shares.

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Reasonable time – Allotment must be made within a reasonable period of time; otherwise, the application lapses. What is reasonable time must remain a question of fact in each case. The interval of about 6 months between application and allotment has been held to be not reasonable *Ramsgate Victoria Hotel Company v. Montefiore* [1866] LRI Ex. 109. On the expiry of reasonable time, s. 6 of the Indian Contract Act becomes applicable and the application must be deemed to have been revoked. In *Karachi Oil Products Ltd. v. Kumar Shree Narendrasinghji* [1948] 18 Comp. 215 (Bom.), it was held that an allotment of shares made almost a year after the date of application was ineffective. In this case, an application for shares was made on 11-7-1941 and allotment was made on 15-6-1942. The court observed that an allotment to be valid should be made within a reasonable time and the applicant is not bound to accept the allotment if made after the lapse of reasonable time.

However, if there is unreasonable delay in allotment of shares but shares are accepted by applicant and are not repudiated he cannot plead that his offer had lapsed because of delay. Thus, where the applications for shares were made on 2-9-1947 posted letters of acceptance allotting the shares to the defendants and the shares certificates were sent to the defendants on 20-10-1947 which were received by them but when the company made demands on 31-8-1948 for the share amounts, the defendants repudiated and denied liability for the amount of the shares allotted to them, it was held that there was an offer and acceptance sufficient to constitute a concluded contract.

Communication – The allotment of shares must be communicated to the applicant. A contract of allotment of shares is like any other contract. There is no fallacy in likening the contract, between a company and a person who makes an application to become a member, to an ordinary contract; the circumstances are different but the principles are identical. There must be consent of the two parties. There must be acceptance of the offer by words or conduct to the knowledge of person who made the offer. That is required in the case of an application of shares, just as in the case of any other contract.

In *Universal Banking Corporation*, In re [1867] LR 3 CH APP 40 (CA), one gentleman applied for shares and remitted application money; but he never received a certificate or a notice of allotment nor any information that shares had been allotted to him, nor was any demand made on him for remittance of the applications on allotment, as was stipulated in the prospectus letter. When he enquired about the allotment, he was told that it would be looked into. However, it was recorded in the Minute Book that it had been resolved to allot shares to G; his name had already been entered in the register of shareholders. But as the company had been ordered to be wound up, the question was whether G's name had been properly put on the list of contributories. Held, that, in the circumstances, it was impossible to hold that any contract had been entered into or that any knowledge of allotment was given to G. It was not his duty to search the register of members; his name was, therefore, to be deleted from the list of contributories.

Similarly, a person cannot be treated as a shareholder unless a notice of allotment has been sent to him. However, once allotment is made and communicated, the directors shall have no power to release the shareholder by cancelling the allotment; even if the shares had been taken under a mistake.

Posting of a properly addressed and stamped letter of allotment is a sufficient communication even if the letter is delayed or lost in the course of post. *Household Fire and Carriage Accident Insurance Co. v. Grant* [1874-80] All ER 919 (CA) is the leading authority. The defendant 'Grant' applied for some shares in the plaintiff company. His application was sent by post and letter of allotment was dispatched by the company soon after. But the letter never reached the applicant. He was nevertheless held liable as a shareholder.

Absolute and unconditional – The allotment must be absolute and unconditional, i.e., must be made on the same terms as stated in the application. Thus, where a person applied for 500 shares, he is not bound to accept an allotment of, say, 100 shares.

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Similarly, the applicant applied for shares in a company on the condition that he should be appointed a branch manager of the company. Shares were allotted to him but he was not appointed the branch manager. Held, he was not bound by the allotment – *Ramanbhai v. Ghasi Ram* [1918] Bom. LR 595.

Likewise, no condition should be attached to the acceptance of an offer to purchase shares. If the acceptance introduced a new term, it will be a new offer by a company and it shall not be effective unless it is accepted by the appllicant.

Revocation – Although application to purchase shares amounts to an offer, and allotment to acceptance but the general rules of revocation of an offer are not applicable to revocation of an offer to purchase shares of a company. An offer, in general, may be revoked till accepted. However, section 72(5) of the Companies Act makes an exception to this rule. It provides that an application made in pursuance of a prospectus issued generally, i.e., issued to persons who are not existing members or debenture holders of the company is not revocable until after the expiration of the 5th day from the date of the opening of the subscription list. But, if before the expiry of the said 5th day a public notice has been given by some person responsible under s. 62 (for mis-statement in a prospectus) which shall have the effect of excluding, limiting or diminishing the responsibility of the person giving it, the application shall not be revocable until the giving of such notice. In other words, an application for shares or debentures may be revoked only after the expiry of the 5th day after the opening of the subscription list or a after the public notice as aforesaid but before the allotment.

An allotment of shares is an appropriation by the Board of directors of a certain number of shares to a person in response to his application for shares. In other words, it is an assignment of shares of particular value, of different classes, singly or jointly to different persons. But, it should be remembered that allotment is an appropriation of a certain number of shares, e.g., 10 shares, 50 shares or 100 shares, and not of specific shares with any distinctive numbers.

10.3.1 Statutory Restrictions on Allotment (Sections 69, 70, 72 and 73)

Certain conditions are to be fulfilled before the Board of directors, or its Committee, if one is appointed by the Board, can proceed to allot shares. These conditions are:

Registration of prospectus [Sec. 60(1)] –A copy of the prospectus signed by every person who is named therein as a director or proposed director of the company or by his agent authorized in writing shall be duly filed with Registrar for registration on or before the date of its publication.

Application money [Sec. 69(3)] – An amount payable on application on each share shall not be less than 5% of the nominal amount of the share. As per SEBI Guidelines, 2000, application money shall not be less than 25 per cent of the nominal value of the share.

Monies to be kept deposited in a separate bank account [Sec. 69(4)] – All monies received from applicants for shares shall be deposited and kept deposited in a scheduled bank: (a) until the certificate to commence business has been obtained under section 149; or (b) where such certificate has already been obtained, until the entire amount payable on application for shares in respect of the minimum subscription has been received by the company.

Minimum subscription [Sec. 69 (1)] – A public limited company cannot make any allotment of shares unless: (a) the amount stated in the prospectus as the minimum amount has been subscribed; and (b) the sum payable on application for such amount has been paid to and received by the company.

As per SEBI Guidelines, 2000, a company making any public issue of shares must receive a minimum of 90% subscription against the entire issue as on the date of the closure of the issue [within 60 days of the closure of the issue, if the issue is underwritten] before making an allotment of shares to the public. If minimum amount of 90% is not received within the aforesaid period, all

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monies received from applicants for shares must be forthwith repaid to them without interest. In case any such money is not repaid within next 8 days [10 days as per Sec. 69], the company shall be liable to repay the same with interest which is, presently, 15 per cent per annum [6 per cent per annum as per s. 69].

Statement in lieu of Prospectus (Section 70). Where a public company invites public subscription, it must file a prospectus with the Registrar, before making the allotment. In case, the public company arranges capital privately, it must file a statement in lieu of prospectus with the Registrar at least three days before the first allotment is made. The Statement should be in the prescribed form and must contain the particulars and reports set out in Schedule III.

The aforesaid provisions of s. 70 do not apply to a private company.

Opening of the Subscription List (Section 72). No allotment shall be made of shares applied for in pursuance of the prospectus until the beginning of the fifth day after that on which the prospectus is issued (or such later time as specified in the prospectus itself). This is called the opening of the subscription list. As mentioned above, an applicant cannot withdraw his application until after the expiration of the fifth day of the opening of the subscription list.

Closing of the Subscription List. Although Companies Act is silent as to the time for which the subscription list must be kept open, SEBI's Guidelines, 2000 provide that the subscription list for public issue must be kept open for at least 3 working days and for not more than 10 working days. However, public issues of infrastructure companies may be kept open for 21 working days.

Listing of Shares (Section 73). No allotment of share can be made unless the provisions of s. 73 are complied with. Every company, intending to offer shares or debentures to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more recognized stock exchanges for permission for the shares or debentures intending to be so offered to be dealt in on the stock exchange or each such stock exchange. Further where a prospectus states that an application has been made for permission for the shares or debentures offered thereby to be dealt in one or more recognized stock exchange, then the allotment shall be void if the permission has not been granted by the stock exchange or each such stock exchange, as the case may be, before the expiry of ten weeks from the date of closing of the subscription list.

If permission has not been granted by any one of the several stock exchanges named in the prospectus for listing of shares, the consequence is to render the entire allotment void and the grant of permission by one or more of them is inconsequential. If, however, an appeal against the decision of any stock exchange refusing permission for the shares or debentures to be dealt-in thereat, has been preferred, such allotment shall not be void until the dismissal of the appeal.

If the prospectus mentions the names of more than one stock exchanges, then permission must come from all of them. Each stock exchange must decide about the enlistment of shares of the company within ten weeks from the date of closing of the subscription list. Where a stock exchange fails to dispose of the application within ten weeks, then the same will be deemed to have been rejected. The company may, under s.22 of Securities Contracts (Regulation) Act, 1956 appeal to the Central Government against the refusal: (i) within fifteen days from the date of refusal; (ii) within fifteen days from the date of the expiry of ten weeks; whichever is earlier.

Where the allotment is void under s.73, the company has to repay the application money at once to the applicants, and if it is not repaid within eight days after the company becomes liable to repay, the company and every director of the company who is an officer in default shall be jointly and severally liable to repay it with interest at the rate of 15% p.a.

Refund of Excess Money (Oversubscription). SEBI's Guidelines, 2000 disallow retention of over-subscription under any circumstances. Accordingly, where the permission has been granted by the stock exchange(s), all moneys in excess of the application money on shares allotted must be repaid forthwith without interest [s. 73(2A)]. If such money is not repaid within eight days, then the company and every director who is an officer in default shall, on and from expiry of the 8th

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day, be jointly and severally liable to repay with interest at the rate of 15% p.a. If default is made in complying with this provision, then the company and every officer who is in default shall be liable to be fined up to ₹ 50,000 and where repayment is not made within six months from the expiry of the eighth day, also with imprisonment upto one year.

10.3.2 Effect of Irregular Allotment (Section 71)

If a company, without complying with the provisions of Sections 69 and 70 (i.e., minimum subscription, the application money, or a statement lieu of prospectus), makes an allotment, then such an allotment is known as irregular allotment and is voidable at the instance of the allottee. An allottee may avoid the allotment, if he so desires: (i) within two months of the statutory meeting, or (ii) within two months of allotment, if the allotment was made after the statutory meeting.

Furthermore, the directors are liable to compensate the company or the allottee for any loss or damage suffered through such irregular allotment, provided that the proceedings to recover such loss or damage are commenced before the expiration of two years from the date of the allotment.

In this connection, provisions of s. 69 regarding the effect of not receiving minimum subscription should also be noted. If the company is unable to receive minimum subscription within 120 days after the first issue of the prospectus [According to SEBI Guidelines, 2000, on closure of issue within 60 days from the closure of the issue, (if the issue is underwritten)], it must refund within next 10 days [8 days, as per SEBI Guidelines, 2000] all moneys received from the applicants. If the money is not refunded within the said period of 10 days [8 days, as per SEBI Guidelines, 2000], then the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of six per cent per annum [According to SEBI Guidelines @15% p.a.] from the expiry of the 10th day [8th day as per SEBI Guidelines].

10.3.3 Effect of Allotment of Shares in Contravention of S. 72

The validity of an allotment is not affected by non-compliance of the provisions of s.72. In other words, the allotment is valid. However, the company and every officer who is in default is liable to be fined upto ₹ 50,000.

10.3.4 Effect of Contravention of Section 73

The allotment, if made, shall be void, and money becomes refundable to the allottee, as explained earlier.

Table 10.1 summarises the various provisions relating to allotment of shares and the consequences of their non-compliance.

Notes

Table 10.1 : Irregular Allotment - Its Effects

S. No.	Nature of Irregularity	Legal effects on Allotment	Liability of company/directors, etc.
1.	Copy of a prospectus not delivered to the Registrar (Sec. 60)	Allotment is valid	Company and every person knowingly a party to the issue of such prospectus, punishable with fine which may extend to ₹ 50,000 [Sec. 60(5).
2.	Application money being less than 5%* of the nominal value of share [Sec. 69(3)]	Allotment is voidable [Sec. 71(1)]	(a) Director, willfully authorizing contravention, liable for damages to the company as well as to allottee [Sec. 71 (3)]. (b) Company and every officer of the company punishable with fine which may extend to 5,000 rupees [Sec. 629A-residue clause].
3.	Minimum Subscription not subscribed for [Sec. 69(1)]	Allotment is voidable [Sec. 71(1)]	One closure of the issue [after 60 days from the closure of the issue if the issue is under written], all moneys to be refunded to applicants without interest; and after 8 days directors liable to pay money with 15% p.a. interest [Sec. 69(5) and SEBI Guidelines]
4.	Application money not kept deposited with a scheduled bank [Sec. 69(4)]	Allotment is voidable [Sec. 71(1)]	Director willfully authorizing the contravention liable for damages to the company as well as the allottee [Sec. 71(3)]
5.	Application money not kept deposited with a scheduled bank [Sec.69(4)]	Allotment is voidable [Sec.71(1)]	Director willfully authorizing the contravention liable for damages to the company as well as the allottee [Sec. 71(3)]
6.	A statement is lieu of prospectus not delivered to the Registrar [Sec.70]	Allotment is voidable [Sec. 71(1)]	(a) Company and every director, responsible for contravention punishable with fine upto ₹ 10,000 [Sec. 70(4)] (b) Director who wilfully authorizes the contravention liable for damages to the company as well as the allottee [Sec. 71(3)]
7.	Time limit as to opening of the subscription list not observed [Sec. 72]	Allotment is valid [Sec. 72(3)]	Company and every officer who is in default liable for fine upto ₹ 50,000 [Sec. 72(3)]
8.	Condition as to listing of shares on a recognized stock exchange not observed [Sec. 73(1)]	Allotment is void [Sec. 73(1)]	If permission is not granted within 10 weeks from the date of closing of the subscription list, application money to be refunded. If not refunded within 8 days, directors to repay with interest @ 15% p.a. [Sec. 73(2)].

* According to SEBI Guidelines, application money cannot be less than 25% except where the issue size is above ₹ 500 crores in which case it cannot be more than 25%.

10.3.5 Matters Connected with Allotment of Shares

Once the statutory conditions for allotment are satisfied, the Board of directors can proceed with the allotment of shares. If the issue has been just fully subscribed or is short of full subscription (but not less than the minimum subscription) there is no difficulty in making the allotment of

shares. A resolution sanctioning the allotment to each applicant the actual number of shares applied for may be passed by the Board.

Allotment in case of Oversubscription. In case, the issue is over-subscribed, the applicants will have to be allotted lesser number of shares than applied for. The Board of directors may adopt either the lottery method (i.e., by drawing lots for the purpose of allotment), or pro rata method (i.e., by allotting shares to each applicant in proportion to the number of shares applied for). In case, shares have been listed on a stock exchange, then the allotment will be made in consultation with the stock exchange authorities.

Resolution for Allotment. The Board of directors then passes a resolution making the allotment of shares and authorising the company secretary to issue letters of allotment and letters of regret, as the case may be, to the applicants.

Renunciation of Allotment. The Articles of association of a company may give the allottee the right to renounce his right to be allotted shares in favour of another person. This is known as renunciation of allotment. The letter of allotment is accompanied by a blank letter of renunciation and a letter of request for allotment to be filled in by the person in whose favour the allotment has been renounced. In such a situation the original allottee is simply selling the right to be allotted the shares. He is not to follow the elaborate procedure of transfer of shares as his name has not been put on the register of members. As soon as the letter of renunciation duly filled in by the original allottee and the Letter of Request for allotment duly filled in by the person in whose favour the allotment is renounced, together with the allotment money, are sent to the company, the name of the person making the request for allotment is entered in the Register of members.

Request for split. Sometimes, the original allottee may not be interested in selling the right to be allotted the shares to one person. He may, instead, be interested in selling the right of allotment to many persons. In that case, he will make a request to the company to “SPLIT” (divide) his original allotment letter into a number of such letters.

10.3.6 Return as to Allotment

Section 75 provides that after allotment of shares by any company a Return of Allotment in the prescribed Form No. 2 must be filed with the Registrar within 30 days of the allotment.

(a) ***Where shares are allotted for cash***, the return must state: (i) the number and nominal amount of the shares allotted; (ii) the names, addresses and occupation of the allottees; (iii) the amount paid or payable on each share.

The company shall in no case show in such return any shares as having been allotted for cash if cash has not actually been received in respect of such allotment.

(b) ***Where shares (other than bonus shares) are allotted fully or partly paid-up otherwise than in cash*** for example, where consideration for allotment of shares is paid by way of property, goods or services, the return of allotment should contain: (i) a written contract constituting the title of the allottee to the shares, (ii) the contract of sale or for services or other consideration for which the allotment was made; and (iii) a return stating the number and nominal amount of the shares so allotted, to the extent to which they are paid up, and the consideration for which they are allotted.

Where shares are issued as fully or partly paid up in consideration of a property thereafter to be sold to the company or services to be rendered to the company or in consideration of the release of a claim or by way of compromise, the issue is for consideration other than cash.

Where requisite formalities have been complied with, the Tribunal will not interfere merely on the ground of inadequacy of consideration unless the contract is fraudulent or shows on the face of it that the consideration given to the company is illusory or clearly not equal to the nominal value of the shares.

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With regard to shares allotted for consideration other than cash, the Department of Company Affairs has instructed that the original contract together with a copy thereof duly verified by an affidavit should be sent along with the Return of Allotment to the Registrar. The affidavit has to be made on a stamp paper by a responsible officer of the company stating that the copy is a true copy of the contract. Where, in terms of a contract, shares are allotted to the nominees of the parties to the contract, a letter or letters from each such party should be obtained, addressed to the company to allot such shares to the nominees. Copies of such letter should be duly verified by an affidavit by a responsible officer of the company.

(c) ***Where bonus shares have been issued, a return must be field with the Registrar stating:*** (i) the number and nominal amount of such shares comprised in the allotment; (ii) the names, addresses and occupation of the allottees; and (iii) a copy of the resolution authorising the issue of such shares.

(d) ***Where the shares have been issued at a discount,*** a copy of the resolution passed by the company authorising such issue and a copy of the order sanctioning the issue must be filed with the Registrar. If rate of discount exceeds 10%, the relevant order of the Tribunal must also be filed with the Registrar.

Other requirements:

(i) ***Return to be signed and dated:*** The Return of the Allotments must be duly dated and signed by a director or the secretary.

(ii) ***Penalty:*** If default is made in complying with the provisions of s. 75, every officer of the company who is in default shall be punishable with fine which may extend to ₹ 5,000 for every day during which the default continues. However, where the default relates to contravention of showing in the return that shares have been allotted for cash, when such is not the case, every promoter and the company who is guilty of contravention shall be punishable with fine which may extend to ₹ 50,000.

(iii) ***Re-issue of forfeited shares:*** No return of allotment is required to be filed with regard to the re-issue of forfeited shares [s.75(5)]. Re-issue of forfeited shares does not amount to allotment within the meaning of s.75(1). It is only an issue of existing shares.

10.4 General Meetings and Proceedings

Need for Meetings

A company is an artificial person and therefore, cannot act itself. It must act through some human intermediary. The various provisions of law empower shareholders to do certain things. They are specifically reserved for them to be done in company's general meetings. Section 291 empowers the Board of Directors to manage the affairs of the company. In this context meetings of shareholders and of directors becomes necessary. In this Part meetings of shareholders are taken up and later in Part 14, meetings of directors are discussed. The Act has made provisions for following different types of meetings of shareholders:

(i) Statutory Meeting;

(ii) Annual General Meeting;

(iii) Extraordinary General Meeting; and

(iv) Class Meetings.

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Statutory Meeting (S. 165)

Some of the most important legal provisions regarding the statutory meeting are:

(i) It is required to be held only by a public company having a share capital. A private company or a public company registered without share capital is under no obligation to hold such a meeting.

(ii) It must be held within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business.

(iii) At least 21 days before the day of meeting, a notice of the meeting is to be sent to every member stating it to be a Statutory Meeting.

(iv) The Board of Directors should also get a report, called the Statutory Report, sent to each member along with the notice of the meeting. If the statutory report is forwarded later, it shall be deemed to have been duly forwarded if it is so agreed to by all the members entitled to attend and vote at the meeting. A copy of the Statutory Report should also be sent to the Registrar after the same is sent to the members.

The Statutory Report contains (a) the total number of shares allotted – fully paid-up and partly paid-up; allotted for cash and for consideration other than cash; (b) the total cash received by the company in respect of all allotments; (c) an abstract of receipts and payments up to a date within seven days of the date of the Report and the balance of cash in hand; (d) any commission or discount paid on the issue of shares or debentures; (e) the names, addresses and occupations of directors, auditors, managers and the secretary of the company; (f) the extent to which any underwriting contract has not been carried out; (g) the arrears due on calls from every director; (h) the particulars of any commission or brokerage paid to any director or manager on the issue of shares and debentures.

The Statutory Report is required to be certified as correct by at least two directors, one of whom shall be the managing director, where there is one. Also, the auditors of the company shall certify that part of the Statutory Report which relates to the shares allotted, each received thereon and the receipts and payments and the balance of cash in hand.

(v) The members present at the meeting may discuss any matter relating to the formation of the company or arising out of the statutory report without previous notice having been given.

(vi) The meeting may adjourn and the adjourned meeting has the same powers as the original meeting. The adjourned meeting, therefore, may do anything which could have been done by the original meeting.

(vii) If default is made in complying with the provisions of s.165, the following consequences may follow:

(a) Every director or other officer of the company who is in default shall be punishable with fine upto ₹ 5,000;

(b) The Registrar or a contributory may apply to the Court for the winding up of the company [s.439]. However, the Court may, instead of passing an order for winding up, give directions for the holding of the meeting or filing of the Statutory Report.

(viii) It should be remembered that this meeting is required to be held only once in the life time of a public company, having a share capital.

Annual General Meeting (AGM) (Ss.166-168)

As the name signifies, this is an annual meeting of a company. The provisions relating to this meeting are:

(1) Every company, whether public or private, having a share capital or not, limited or unlimited must hold this meeting.

(2) The meeting must be held in each calendar year and not more than fifteen months shall elapse between two meetings. However, the first AGM may be held within eighteen months from the date of its incorporation and if such general meeting is held within that period, it need not hold any such meeting in the year of its incorporation or in the following year. The maximum gap between two such meetings may be extended by three months by taking permission of the Registrar, who may so allow for any special reason.

The Company Law Department has expressed the view that the Registrar can grant extension of time, for special reasons, upto a maximum period of 3 months, even if such extension allows the company to hold its AGM beyond the calendar year. However, the said extension shall be granted only if the application therefor is made to the Registrar before the expiry of the period as per s.166 (1).

(3) The meeting must be held (i) on a day which is not a public holiday, (ii) during business hours, (iii) at the registered office of the company or at some other place within the city, town or village in which the registered office is situated. [s.166(2)].

(4) The business to be transacted (s.173) at such a meeting may comprise of:

(i) Ordinary business which relates to the following matters: (a) consideration of accounts, balance sheet and the reports of the Board of Directors and Auditors; (b) declaration of dividend; (c) appointment of directors in the place of those retiring; and (d) appointment of auditors and fixation of their remuneration. (ii) Any business other than ordinary business transacted at the meeting will be deemed to be special business. With regard to all special business, an Explanatory Statement is required to be annexed to the notice.

(5) What about a situation where annual accounts are not ready for being placed before the AGM? In case annual accounts are not ready for laying at the appropriate AGM, it is open to the company concerned to adjourn the said AGM to a subsequent date when the annual accounts are expected to be ready for laying. Since consideration of annual accounts is only one of the matters to be dealt with at an AGM, directors are under a statutory obligation to hold the meeting. The proper course shall be to hold the meeting and then adjourn it to a suitable date for considering the accounts. The adjourned meeting must, however, be held within the maximum time limit allowed under s.166.

(6) The combined reading of Ss.166 and 210 requires compliance with the following:

(a) There must be one meeting held in each calendar year.

(b) Not more than 15 months must elapse between one general meeting and another.

(c) The period of 15 months may be extended to 18 months by the Registrar.

(d) Except in the case of the first AGM, the accounts must relate to a period beginning with the day immediately after the period for which they were submitted and ending with a day which must not precede the day of the meeting by more than 6 months; or 6 months and the extension granted by the Registrar, i.e., a maximum period of 9 months.

(7) The company must give twenty-one days notice to all the members of the company and the auditor. A shorter notice may be held valid if consent is accorded to by all the members entitled to vote at the meeting (s.171). Such a consent may be given before the meeting

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is held or after the resolutions are passed. A copy of directors' report on the company's position for the year together with copy of the audited accounts and auditors' report must accompany the notice. Also a proxy form must be attached with the notice, on which it shall be specifically mentioned that a member entitled to vote is entitled to appoint Proxy, and Proxy need not be a member of the company.

The notice must specify the place and the day and hour of the meeting and shall contain a statement of the business to be transacted thereat [s.172(1)].

If the time of holding the meeting and other essential particulars required by the section are not specified in the notice, the meeting will be invalid and all resolutions passed thereat will be of no effect.

The notice must be given to every member, legal representative of a deceased member or assignee of an insolvent member and to auditor or auditors [s.172(2)].

(8) If default is made in holding the meeting, the Central Government may, on the application of any member of the company, call or direct the calling of the meeting. If the company fails to hold the meeting either originally or when directed to do so by the Central Government, then the company and every officer of the company who is default shall be punishable with fine upto ₹ 50,000; and in the case of a continuing default, with a further fine of ₹ 2500 per day during the continuance of default (s.168).

Certain Typical Issues in Respect of AGM

1. Whether AGM can be called on a public holiday. Section 166(2), inter alia, provides that every AGM shall be called on a day that is not a public holiday. The Department of Company Affairs has opined that it is a mandatory provision.

   However, Bank holidays (for purposes of closing) though declared as public holidays under the Negotiable Instruments Act, 1881 shall not be treated as public holidays for the aforesaid purpose. Thus, 31st March and 30th Sept. shall not be considered as public holidays.

   In the following cases, however, AGM may be held on a public holiday: (i) Section 2(38) provides that if any day is declared by the Central Government to be a public holiday after the issue of the notice convening such a meeting, it shall not be deemed to be a public holiday in relation to the meeting. (ii) Where a public company or its subsidiary has by its articles fixed the time of its AGM and the day turns out to be a public holiday [Proviso (a) to s.166(2)]. (iii) Where a public company or its subsidiary has, by a resolution passed in one AGM fixed the time for its subsequent AGM and the day turns out to be a public holiday [Proviso (a) to s.166(2)]. (iv) A private company which is not a subsidiary of a public company may also [like a public company or its subsidiary under (ii) and (iii) above] by a resolution agreed to all the members thereof fix the time as well as the place of its AGM and the same shall be valid if the day happens to be a public holiday [Proviso (b) to s.166(2)]. (v) A company to whom a licence is granted under s.25 is exempted from the provisions of s.166(2). (vi) Where the AGM is adjourned because of lack of quorum, it is to be held on the same day in the next week at the same time and place (s.174). In case the day comes to be accidentally a public holiday, it shall not amount to contravention of s.166(2).

2. It is not obligatory to advertise notice of meetings in the newspapers. However, as an abundant precaution, the company may advertise in the newspapers to avoid objection from such of the shareholders as reside outside India and who incidentally may not receive the notices served through post.

3. Voting rights of members shall be determined as at the date of the meeting and not as they would/have been if the meeting had been held within the prescribed time.

4. A meeting beyond statutory time cannot be said to be void or illegal. If the Tribunal does not extend the date of holding the AGM u/s 167, the Directors shall be subjected to increasing penalty but the meeting shall be a valid meeting. Otherwise, the position in law would become impossible.

5. The Board of Directors has the power to cancel or postpone a meeting convened, though it cannot be exercised except for bona fide and proper reasons.

10.4.1 Extraordinary Meeting (EGM) – S. 169

Clause 47 of Table A (Schedule – I) provides that all general meetings other than AGMs shall be called the EGMs. The legal provisions as regards such meetings are:

1. EGM is convened for transacting some special or urgent business that may arise in between two AGMs, for instance, change in the objects or shift of registered office or alteration of capital. All business transacted at such meetings is called special business. Therefore, every item on the agenda must be accompanied by an 'Explanatory Statement'.

2. An EGM may be called: (i) by the Directors of their own accord; (ii) by the Directors on requisition; (iii) by the requisitionists themselves; (iv) by the Tribunal. The Board of Directors may call a general meeting of the members at any time by giving not less than 21 days notice. A shorter notice may, however, be held valid if consent is accorded thereto by members of the company holding 95% or more of the voting rights (s.171).

The Board of Directors must convene a general meeting upon request or requisition if the following conditions are satisfied (s.169):

The requisitionists must be such number of members who, at the date of the deposit of the requisition, are the holders of 1/10th of total voting power. Thus, in case of a company having share-capital they should hold at least 1/10th of such of the paid-up capital that carries right to vote in regard to that matter. Preference shareholders have voting power only as regards matters relating to the preference shareholders. They have no voting right and therefore, no right to requisition in respect of other matters. If the company does not have a share capital, they should at least hold 1/10th of the total voting power of the company in regard to that matter. The requisition must state the objects of the meeting, i.e., it must set out the matters for the consideration of which the meeting is to be called. Further, requisition must have been deposited at the registered office of the company. The requisition must be signed by the requisitionists. In case all the aforesaid conditions are satisfied, the Board of Directors must within 21 days of the receipt of the requisition call the meeting giving at least 21 days notice fixing the meeting within 45 days of the receipt of the requisition.

Where the resolution proposed is a special resolution then the requirements of s.189(2) must be complied with, viz., it should be so described and explanatory statement be annexed.

If the Board of Directors does not or fails to call the meeting as aforesaid (i.e., within 21 days fixing the date of the meeting within 45 days of the deposit of a valid requisition), the meeting may be called: by the requisitionists themselves: (a) In case of a company having share capital, by one or more requisitionists as represent: (i) a majority in value of the paid-up share capital held all the requisitionists; or (ii) at least 1/10th of the paid-up share capital carrying voting rights in respect of that matter, whichever is less; or (b) in case of a company not having share capital, by one or more requisitionists who represent at least 1/10th of the total voting power of the company in regard to the matter of the requisition.

Where the Articles, in accordance with the provisions of s.180, provide that members who have not paid calls on their shares would not be entitled to vote, them they can not requisition a meeting, nor vote it and if they do so the proceedings would be invalid.

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The requisitioned meeting must be held within 3 months of the date of the deposit of the requisition. Further, where two or more persons hold any shares or interest in an company jointly, a requisition, or a notice calling a meeting, signed by one or some only of them shall, for the purposes of this section, have the same force and effect as if it had been signed by all of them.

Any reasonable expenses incurred by the requisitionists, as aforesaid, shall be repaid to them by the company and the same shall be recouped from directors at fault.

Meeting by the requisitionists must be held in the same manner as nearly as possible, in which the meetings are to be called by the Board. However, where the registered office is not made available to them for holding the meeting, they may hold the meeting elsewhere [*R. Chettair v. M. Chettair* (1951) 21 Comp. Cas. 93].

Powers of the Company Law Board (s.186). If for any reason it is impracticable to call a meeting of the company, other than an AGM, the Company Law Board may direct the calling of the meeting: (a) on its own motion; (b) on an application of any director; (c) on an application of any member entitled to vote at that meeting.

For the aforesaid meeting, the Company Law Board may give directions in respect of the place, date and the manner in which the meeting be held and conducted. It may also give such ancilliary or consequential directions as it thinks expedient, including a direction that one member present in person or proxy shall be deemed to constitute a meeting.

10.4.2 Class Meetings (S. 107)

When it is proposed to alter, vary or affect the rights of particular class of shareholders (e.g., where accumulated dividends on cumulative preference shares is to be cancelled) and it is not possible to obtain the consent in writing, of the holders of 3/4th of the issued shares of that class, a meeting of the holders of those shares may be called. Such a meeting is commonly known as a 'class meeting'. It should be noted that all resolutions in a class meeting must be passed as special resolutions.

The holders of at least 10 percent of the issued shares of that class who did not consent in favour of the resolution may apply to the Court within 21 days to have the resolution cancelled and where such application is made, the resolution shall not have effect unless and until it is confirmed by the Court.

10.4.3 Point of Order

A point of order deals with the conduct or procedure of the meeting. The chairman has to give his ruling or decision on a point of order at once. His ruling on any matter of procedure is final.

10.4.4 Minutes of Proceedings of Meeting

Minutes are a record of business transacted at meetings. Every organisation must keep minutes containing a fair and correct summary of all proceedings of general meetings of members and of Management Committee. It is the duty of the secretary to make this record.

After the meeting is over or as soon thereafter as possible, whilst the proceedings are still fresh in mind, the secretary should proceed to draft the minutes of the meeting. Each minute entered on the minute book should be consecutively numbered, abbreviated in the margin and indexed. They must be written in the order in which the business was transacted at the meeting. Minutes may be recorded either in the form of narration or conclusions. In the latter case, only conclusions in the form of resolutions passed are recorded. The practice is to have conclusions only. Details of the actual discussion and irrelevant talks should be omitted. The minutes should be clear,

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compact, unambiguous and definite. Minutes of each meeting must begin on a fresh page and should be headed with the number, date and nature of the meeting. The wording of resolutions and amendments must be recorded in full and the name of the proposer and seconder given, whether they are eventually carried or not.

Section 193 provides that every company must keep minutes containing a fair and correct summary of all proceedings of general meetings in books kept for that purpose. The minutes book must have their pages consecutively numbered and minutes must be recorded within 30 days of the meeting.

10.5 Accounts, Audit and Dividends

10.5.1 Maintenance of Accounts by Companies

Every company must keep at its registered office proper books of accounts which shall give a true and fair view of the financial affairs of the company. Section 209 lays down the Books of Accounts to be maintained by a company. These books are open to inspection by any director during business hours, as also by the Registrar of companies or an officer authorised by the Central Government. Also the books of accounts should be retained for a period of eight years. It is obligatory on companies to maintain accounts on accrual basis.

It is the responsibility of the Managing Director or manager of the company to comply with legal requirements relating to accounts, but they may engage a competent person and make him responsible for the accounts. On the default of compliance, every person charged with the maintenance of accounts would be liable to be punished for imprisonment up to six months, or fine up to ₹ 10,000 or with both.

Section 210 requires that at every AGM, the Board of Directors must lay before the company a Balance Sheet and Profit Loss account; and in the case of non-profit companies, an Income and Expenditure Account should be submitted.

Section 211 talks about form and contents of the Balance Sheet and Profit and Loss Account. The form of the Balance Sheet and the details to be given in the Profit and Loss Account are set out in Schedule VI of the Act. The Balance Sheet and Profit and Loss Account must be signed on behalf of the Board by two directors and countersigned by manager or secretary. If the company has a managing director, he should be one of the signing directors. The Balance Sheet and Profit and Loss Account must be approved by the Board before they are submitted to the auditors who must in turn attach their own report thereto. The report of the Board shall describe the company's state of affairs, the amount proposed to be carried to reserves, the amount recommended for dividend and also any change which occurred during the financial year in regard to the nature of the business of the company (s.217). The report should also explain adverse remarks of the auditor, if any. The report must also include a list showing the names of all employees of the company who are in receipt of remuneration of ₹ 24 lakhs per annum or ₹ 2 lakhs per month or more (inclusive of the value of perquisites). The report must also state whether any such employee is a relative of any director or manager of the company and if so, the name of such director.

Directors' Responsibility Statement: Section 217 (2AA) provides that every company shall include in its directors report a statement of its director's resonsibility which shall indicate that (i) in preparation of the annual accounts, the applicable accounting standas had been followed alongwith proper explanation relating to material departure therefrom; (ii) the directors had followed such policies consistently so as to give a true and fair view of the state of affairs of the company; (iii) the directors had taken proper and sufficient care for the maintenance of adequate accounting records so as to safeguard the company's assets and to detect frauds and irregularities; and (iv) the directors had prepared the annual accounts on a going concern basis.

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Section 212 provides that the Balance Sheet of a holding company should have annexed to it certain documents relating to its subsidiary. Some of them are: (i) a copy of the Balance Sheet of the subsidiary; (ii) a copy of its Directors' report; (iii) a copy of its Profit and Loss Account.

Section 219 provides that not less than 21 days before the date of the meeting a copy of the Balance Sheet together with Profit and Loss Account, Auditor's and Board's reports, must be sent to every member, debentureholder, trustee for the debentureholder, legal representative of deceased member, official Receiver or Assignee of an insolvent member, and auditor of the company. However the Act, gives a choice to the listed companies either to send detailed accounts to its shareholders or a statement containing the salient features only. Where a company has sent only the salient features of accounts to its shareholders, it must send a copy of the detailed accounts free of cost to a shareholder, who demands the same. Further, accounts and documents need not be sent to debentureholders. However, these shall be required to be sent to the trustee of the debentureholders.

Section 220 requires every company to file with the Registrar three copies of the Balance Sheet and the Profit and Loss Account within thirty days from the date of the AGM, and where it is not held, then within 30 days from the last day on or before which that should have been held. If the accounts are not adopted in the A.G.M, or the meeting is adjourned without adopting the accounts, it is obligatory on the part of the company to report to the Registrar the reason for the same. The penalty for failure to file in time the annual accounts would be a continuing offence within meaning of s.472 of Code of Criminal Procedure, 1973.

10.5.2 Appointment of Auditors

It is compulsory for every company to appoint qualified auditors to do the audit of the accounts maintained by the company. The first auditors(s) can be appointed by the Board of Directors within one month of the date of the incorporation of the company. The first auditors hold office until the conclusion of the first AGM of the company. However, they can be removed by members at their meeting held before the first AGM by giving a special notice of an intention to remove them. Also, if the Board of Directors do not appoint the first auditors, then the company in general meeting may do so.

The Board of Directors is also authorised to fill casual vacancies arising for reasons other than by the resignation of an auditor, which can only be filled up by the company in general meeting. The duration of the auditor, so appointed in casual vacancy shall be upto the conclusion of the next AGM.

Every company must appoint at each AGM to hold office from the conclusion of the AGM until the conclusion of the next AGM. The company has to inform, within seven days of the appointment, the auditor so appointed, unless he is a retiring auditor (s.224). The company, however must obtain a certificate from the auditor to the effect that the appointment or re-appointment is within the limits of the number of audits which can be undertaken by an auditor. No company or its Board of Directors shall appoint or reappoint any person who is in full time employment elsewhere; or firm as its auditor, if such person or firm is, at the date of such appointment or re-appointment, holding appointment as auditor of the specified number of companies or more than the specified number of companies. However, in the case of a firm of auditors, "specified number of companies" shall be construed as the number of companies specified for every partner of the firm who is not in full-time employment elsewhere. The specified number means (a) in the case of a person or firm holding appointment as auditor of number of companies each of which has a paid up share capital of less than 25 lakhs, 20 such companies; (b) in any other case, 20 companies, out of which not more than 10 shall be companies each of which has a paid-up share capital of ₹ 25 lakhs or more. Where a firm is appointed as auditors, the ceiling of twenty will be per partner. However, when any partner of a firm or auditors is also a partner in any other firm or firms of auditors, the overall ceiling in relation to such partner will also be twenty.

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The private companies are not to be taken into account for calculating the number of companies which an auditor can audit.

A person will not be eligible for appointment as an auditor of a company if be, after a period of one year from the commencement of the Amendment Act is holding any security in that company.

Every auditor so appointed, must within thirty days of the receipt from the company of the intimation of his appointment, inform the registrar in writing that he has accepted the appointment or has refused the same.

Appointment of auditor by special resolution only (s.224-A)

(1) In the case of a company in which not less than 25 per cent of the subscribed share capital is held, whether singly or in any combination, by: (a) a public financial institution or a Government Company or Central Government or any State Government, or (b) any financial or other institution established by any Provincial or State Act, in which a State Government holds not less than 51 per cent of the subscribed share capital, or (c) a nationalised bank or an Insurance Company carrying on general insurance business, the appointment or re-appointment at each AGM of an auditor or auditors shall be made by a special resolution.

(2) In case any company referred to in (1) above omits or fails to appoint an auditor or auditors in the manner as aforesaid, it shall be deemed that no auditors or auditors had been appointed by the company at its AGM and thereupon the Central Government shall be empowered to fill the vacancy.

Re-appointment of auditors. Section 224(2) provides for automatic reappointment of auditors. At every AGM, retiring auditor, by whatever authority appointed, is automatically reappointed, unless (i) he is not qualified for reappointment, or (ii) he has given a written notice to the company of his unwillingness to be re-appointed, or (iii) a resolution has been passed at that meeting appointing somebody instead of him, or providing expressly that he shall not be re-appointed, or (iv) where notice has been given of any intended resolution to appoint some person in his place, but owing to that person's death, incapacity or disqualification, the resolution had to be dropped.

Section 224(3) empowers the Central Government to appoint an auditor, where no auditors are appointed at the AGM of a company. The company is under an obligation to inform the Central Government within one week of the holding of the AGM, where no auditors are appointed.

10.5.3 Remuneration of Auditors

It is fixed by the Board of Directors as regards appointments made by it. As regards other appointments, the company in general meeting fixes the remuneration.

Section 225 makes provision for a resolution relating to appointment or removal of auditor. A special notice must be given of a resolution at the AGM (i) to appoint a person other than a retiring auditor; or (ii) to provide that a retiring auditor shall not be re-appointed. When the company receives this notice, it must forthwith send a copy of it to the retiring auditor. The retiring auditors may make a written representation to the company and ask that the same should be sent to all the members. The company must, unless it receives the representation too late (i) state the fact of the representation having been made, in any notice of the resolution given to the members; and (ii) send a copy of the representation to every member to whom notice of the meeting is sent. If a copy is not sent out in this way because the representation was received too late or because of the company's default, then the auditor may demand that his statement shall be read out at the meeting. He shall, of course, have the right to be heard orally at the meeting. However, the copies of the representation need not be sent out, nor need the representation be read out, if the company or any aggrieved person applies to the Central Government and the thinks that the auditor is abusing his rights to secure needless publicity for defamatory matter.

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10.5.4 Qualification of Auditors

Section 226 provides for qualifications of auditors. A person who is a Chartered Accountant in practice is qualified to become an auditor. In other words, he must be a member of the Institute of Chartered Accountants of India and in practice. However, none of the following persons, even though qualified as above, can be appointed as auditor of a company: (i) a body corporate; (ii) an officer or employee of the company (officer includes a director, manager or secretary); (iii) a person who is a partner or who is in the employment of an officer or employee of the company; (iv) a person who owes the company more than ₹ 1,000 or who has guaranteed the repayment of any debt of more than ₹ 1,000 due to the company by a third person; (v) a person holding any security of that company after a period of one year from the date of commencement of the companies (Amendment) Act, 2000. The term 'security' here means an instrument which carries voting rights; (vi) a person who is disqualified for appointment as auditor of the company's subsidiary or holding company, or a subsidiary of its holding company. If an auditor becomes disqualified in any of the above ways after his appointment as auditor, then he shall be deemed to have vacated his office as such.

10.5.5 Powers and Duties or Obligations of Auditors

Section 227 enumerates some of the powers of auditors:

(i) Every auditor of a company has right of free and complete access at all times to the books, accounts and vouchers of the company whether kept at the head office or elsewhere.

(ii) He has also the right to require from the officers of the company such information and explanation as may be necessary for the performance of his duties as auditor.

(iii) He is entitled to receive notice of and to attend general meetings of the company and be heard on any part of the business which concerns him as auditor.

Section 227 also imposes some obligations on the auditor. He is to make a report to the members of the company on the accounts examined by him and on every Balance Sheet and every Profit and Loss Account laid before the company in general meeting during his tenure of office. The report, besides other things necessary in any particular case, must expressly state:

(i) Whether, in his opinion and to the best of his information and according to explanations given to him, the accounts give the information required by the Act and in the manner so required.

(ii) Whether the Balance Sheet gives a true and fair view of the company's affairs as at the end of the financial year and the Profit and Loss Account gives a true and fair view of the profit and loss for its financial year;

(iii) Whether he has obtained all the information and explanations required by him for the purposes of his audit;

(iv) Whether in his opinion, proper books of accounts as required by law have been kept by the company and proper returns for the purpose of his audit have been received from the branches not visited by him.

(v) Whether the company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of account and returns.

(vi) Whether, in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to under s. 211 (3c).

(vii) In thick type or in italics the observations or comments of the auditors which have any adverse effect on the functioning of the company.

(viii) Whether any director is disqualified from being appointment as director under s. 274(1) (g).

Where any of these matters enumerated from (i) to (v) is answered in the negative or with a qualification, the Auditor's Report must state the reason for the answer. Such a report is called the 'qualified report'.

Branch Audit

Section 228 states that the audit of a branch office of a company, if any, must be conducted by the company's auditors. However, in case the branch is situated outside India then the accounts of the branch can be audited either by the company's auditors or by a person qualified to act as auditor according to the laws of that country.

Where the accounts of any branch office are audited by a person other than the company's auditor, the company's auditor: (a) shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor; and (b) shall have a right of access at all times to the books and accounts and vouchers of the company maintained at the branch office.

The branch auditor shall prepare a report on the accounts of the branch office examined by him and forward the same to the company's auditors who shall, in preparing the auditor's report, deal with the same in such manner as he considers necessary.

The branch auditor shall receive such remuneration and shall hold his appointment subject to such terms and conditions as may be fixed either by the company in general meeting or by the Board of Directors if so authorised by the company in general meeting.

Special Audit

Section 233A empowers the Central Government to appoint auditors for conducting a Special Audit. Where the Central Government is of opinion: (i) that the affairs of a company are not being managed in accordance with sound business principles or prudent commercial practices; or (ii) that the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or (iii) that the financial position of any company is such as to endanger its solvency; then the Central Government may at any time, by order direct that a special audit of the company's accounts for such period or periods as may be specified in the order, shall be conducted by a chartered accountant specifically appointed by the Government for the occasion, or it may be conducted by the company's auditor.

The special auditor shall have the same powers and duties in relation to the special audit as an auditor of a company has under s.227. However, he shall, instead of making his report to the members of the company, make the same to the Central Government. The report of the special auditor shall, as far as may be, include all the matters required to be included in an auditor's report under s.227 and if the Central Government so directs, shall also include a statement on any other matter which may be referred to him by that Government.

The special auditor has to report to the Central Government and on receipt of the report, the Government shall take such action as it may consider necessary. But if the Government does not take any action on the report within four months from the date of its receipt, it shall send to the company a copy of the report with its comments for circulating among the members of the company.

The expenses of the special audit, as determined by the Government, shall be paid by the company. Also the Central Government is empowered to direct any person specified in the order to furnish to the special auditor within such time as may be specified in the order such information as may be required by the special auditor. Default in compliance of the order is punishable with fine upto ₹ 500.

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Cost Audit

Section 233B empowers the Central Government to issue necessary directions for conducting Cost Audit of companies engaged in production, processing, manufacturing or mining activities. The manner of conducting cost audit of a particular company may be specified in the order of the Government.

The cost audit can be conducted by a Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959. However, a chartered accountant can also conduct cost audit if sufficient number of cost auditors are not available and the Central Government issues a notification to this effect.

The cost auditor can be appointed by the Board of Directors in accordance with the provisions of s.224(B) and with the previous approval of the Central Government. The appointment of any person as cost auditor of a company who is in full-time employment elsewhere is also prohibited. The ceilings on number of audits are also applicable to a cost auditor as in the case of financial auditor under s.224. An auditor of the company cannot be appointed cost auditor. Also a person who is disqualified as an auditor is also disqualified for appointment as cost auditor. Further, if the cost auditor, after his appointment as such suffers from any of the disqualifications, he must cease to act as cost auditor. The provisions of s.224 shall also apply in relation to a cost auditor. The cost auditor shall make a report in relation to the audit conducted by him to the Central Government and send a copy of the report to the company.

Dividends

All the profits of a company are not available for distribution amongst the shareholders. Only the divisible profits which are determined in accordance with legal provisions are available for distribution. Some of the more important provisions regarding dividends are:

(1) No dividend shall be declared or paid for any financial year except out of profit of the current year or of the previous years.

(2) The company must provide for depreciation (including arrears of depreciation – as per Department of Company Affairs clarification) before declaring dividends.

(3) Dividends can be paid in cash only. (Payment of dividend by cheque or dividend warrant amounts to payment of dividend in cash). However, capitalisation of profits or reserves for the purpose of issuing fully paid-up bonus shares is allowed.

(4) Capital profits can also be distributed by way of dividend but only if (i) the capital profits are realised; (ii) the capital profits remain after the revaluation of all the assets; and (iii) the distribution of a dividend of such profits is permitted by the company's articles.

(5) The company must transfer from the profits to its reserves the following minimum amount; before declaring dividends, at the rates mentioned below:

Per cent Rate of Dividend Proposed.	Minimum percentage of profits to be transferred to Reserves.
10 per cent to 12.5 per cent.	2.5 per cent.
12.5 per cent to 15 per cent.	5 per cent.
15 per cent to 20 per cent.	7.5 per cent.
20 per cent and above.	10 per cent.

A company may transfer a higher percentage of profits (i.e., more than 10 per cent) voluntarily to the reserves in accordance with the Rules framed by the Central Government (s.205). However, no transfer to reserves shall be required if the dividend proposed is less than 10 per cent (as per clarification).

(6) In case of inadequacy or absence of profits in any year, the company may declare dividends out of previous year's accumulated profits and reserves in accordance with Rules framed by the Central Government.

The Rules framed by the Central Government in this regard, called Companies (Declaration of Dividends out of Reserves) Rules, 1975, inter alia, provide as follows:

(i) The rate of the dividend declared shall not exceed the average of the rates at which dividend was declared by the company in the five years immediately preceding that year or 10 per cent of its paid-up capital, whichever is less.

(ii) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to 1/10th of the sum of its paid-up capital and free reserves.

(iii) The amount so drawn from general reserves shall first be utilised to set-off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared.

(iv) The balance of reserves after such drawal shall not below 15 per cent of its paid-up share capital.

(7) The rate of dividend is recommended by the Board of Directors and is declared by the shareholders in the AGM. The shareholders cannot insist on either declaration of dividend or on increasing the rate recommended by the Board of Directors.

(8) The dividends must be paid or the warrants in respect thereof posted to the shareholders, within 30 days from the date of declaration (s.207).

The total amount of dividends unpaid or unclaimed should, within seven days from the date of the expiry of the said period of 42 days, be kept in a separate special account with any scheduled bank which would be called the Unpaid Dividend Account of company Limited/Private Limited. The payment of dividends should then be made out of this Account [s.205 A(1)].

All the unclaimed dividends lying to the credit of the said Dividend Account for a period of more than three years will have to be transferred to a "General Revenue Account of the Central Government". The shareholders will have to prefer their claims for arrears of dividends for more than three years to the Central Government [s.205-A(5)].

(9) Section 206A provides for payment of dividend and allotment of bonus and right shares to the transferee on a mandate in this regard from the transferor. But in the absence of such a mandate, it is obligatory on the part of the company to transfer the dividends accruing on such shares to the Unpaid Dividend Account and to keep in abeyance offer to rights or bonus shares till the title to the shares is decided.

(10) The articles may also empower the directors to declare interim dividends. An interim dividend is that dividend which is declared by the Board of Directors at any time in between two AGMs. The directors should seek the opinion of auditors before declaring any interim dividend, as it must be paid out of the profits of the company, otherwise it may amount to payment of dividend out of capital which is not allowed.

(11) Section 205 lays down the general rule that dividends can be paid out of profits only and not out of capital. An exception to this rule is, however, constituted by s.208. It provides that where shares are issued to raise money to defray the cost of works of building or plant which cannot be made profitable for a long period, the company may (i) pay interest @ 4 per cent on the amount of capital paid-up in respect of such shares, if the articles of the company allow and previous sanction of the Central Government is obtained; and (ii) charge such interest to capital as part of the cost of works, building, or plant.

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(12) Section 205 delinks the depreciation from that under the Income-tax Act. The companies must provide for depreciation at rates as given in Schedule XIV to the Companies Act. Depreciation at rates higher than Schedule XIV may, however, be provided. Department of Company Affairs has clarified that Schedule XIV rates represent the minimum rates at which the companies should provide depreciation.

(13) The Companies (Amendment) Act, 2000 introduced certain changes in s. 205, 205A and 207. Also for the first time Companies (Amendment) Act, 2000 defined the term 'dividend'. It includes any interm dividend. [s.2 (14)]

The board of directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend (s. 205). The dividend is required to be paid (within 30 days from the date of declaration) in cash, by cheque or warrant or bank draft (s. 205A). For such non-payment within the prescribed period, every director of the company shall, if he is knowingly a party to the default, be punishable with simple imprisonment upto 3 years and also five of ₹ 1000 for every day during which the default continues. Also the company shall be liable to pay simple interest at the rate of 18 per cent per annum during the period the default continues (s. 207).

All the provisions of sections 205, 205A, 20, 206a and 207 shall be applicable to interim dividend as well (s. 205).

10.6 Inspection and Investigation

Inspection of Books of Account etc., of Companies

Section 209A provides that the books of account and other books and papers of every company shall be open to inspection during business hours (i) by the Registrar, or (ii) by such officer of government as may be authorised by the Central Government in this behalf.

The books of account include ledger, cash book, journal and vouchers, deeds, writings and documents.

The place at which inspection may be carried out need not be registered office of the company. The books of account are required to be kept either at the registered office of the company or at some other place, after intimation to Registrar. Thus the books of account can be inspected at such other place also.

Section 209A(2) requires every director, other officer or employee of the company to assist in inspection. He is required to produce to the inspecting authority such books of account and other books and papers of the company in his custody or control and to furnish him with any statement, information or explanations relating to the affairs of the company as the said authority may require him within such time and at such place as may be specified.

Section 209 gives certain powers to the inspectors. These are: (i) to make copies; (ii) to place identification marks; (iii) to exercise powers of civil courts with regard to (a) the discovery and production of books of account and other documents, at such place and such time as may be specified by him; (b) summarising and enforcing the attendance of persons and examining them on oath; (c) inspection of any books, registers and other documents of the company at any place.

Investigation

The Act, affords some protection to shareholders and creditors of a company by giving powers to the Central Government in certain circumstances to investigate either (i) the affairs; or (ii) the ownership of a company.

The following chart shows the powers of the Central Government to appoint one or more competent inspectors to conduct investigation of the affairs of a company (Ss.235 and 237).

Table 10.2: Power of Investigation of Central Government

Discretionary		Mandatory	
(i)	if required by the Members, or	(i)	If required by the company by special resolution; or
(ii)	on the Report by the Registrar; or	(ii)	If required by the Court.
(iii)	on its own motion.		

10.6.1 Discretionary Powers of the Central Government

The Central Government may appoint one or more competent persons as inspectors to investigate into the affairs of any company and to report in such manner as the Central Government may direct in the circumstances as under.

(i) ***On the application of members of a company.*** Where (a) in the case of a company having a share capital, the number of members making application is not less than 200, or the members are holding not less than one-tenth of the total voting power, or (b) in the case of a company not having a share capital, an application has been received from not less than one-fifth of the members, the Company Law Board may, after giving the parties an opportunity of being heard, by order, declare that the affairs of the company should be investigated by an inspector or inspectors and on such declaration being made, the Tribuna shall appoint one or more competent persons as inspectors to investigate the affairs of the company and to report thereon in such manner as the Central Government may direct (s.235).

(ii) ***On the report of the registrar.*** The Central Government may, where a report has been made by the Registrar in pursuance of s.243, appoint one or more inspectors to investigate the affairs of a company and to report thereon in such manner as the Central Government may direct. The Registrar's report is made where a document filed by any company (whether having a share capital or not) with him discloses an unsatisfactory state of affairs, or it does not disclose full and fair statement of the matter to which it purports to relate [s.235 (1)].

(iii) ***On suggestion of the Tribunal.*** Section 237 provides that the Central Government may appoint if, in opinion of the Tribunal, there are circumstances suggesting: (a) that the company's business is being conducted with intent to defraud its creditors, members or any other persons, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive of any of its members, or that the company was formed for any fraudulent or unlawful purpose; or (b) that persons concerned in the formation or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or any of its members; or (c) that the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director or the manager of the company.

(iv) Where the company, by special resolution, resolves that the affairs of the company be investigated by an inspector appointed by the Central Government (s.237).

(v) Where the court by order declares that the affairs be investigated by an inspector appointed by the Central Government (s.237).

10.6.2 Mandatory Powers

Section 237 provides that the Central Government must appoint (independently of its powers under s.235) one or more competent inspectors to investigate the affairs of a company, and to report thereon as the Central Government directs, if either the company by special resolution or the Court by order, declares that its affairs ought to be so investigated.

10.6.3 Powers of the Inspectors

1. Under s.239, the inspector, appointed under s.235 or 237, is empowered to investigate the affairs of any other body corporate which is, or has at any relevant time been: (a) the company's subsidiary or holding company or a subsidiary of its holding company, or a holding company of its subsidiary; (b) managed by any person as managing director or manager or who is, or was at the relevant time either the managing director or manager of the company; (c) managed by the company or whose Board of Directors comprises of nominees of the company or is accustomed to act in accordance with the directions or instructions of: (i) the company, or (ii) any of the directors of the company, or (iii) any company, any of whose directorships is held by the employees or nominees of those having the control and management of the first mentioned company; (d) the company's managing director or manager.
2. The inspector may require any officer and other employees to preserve and produce to him or any person authorised by him all books and papers of, or relating to the company, which are in their custody or power.
3. The inspector may, with the prior approval of the Central Government, require anybody corporate to furnish or produce such books and papers as he may consider necessary if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation. The inspector is further empowered to keep such books in his custody for 6 months.
4. An inspector is also empowered to examine on oath: (a) any officers or employees of the company; (b) any other person provided prior approval of the Central Government has been obtained.

10.6.4 Inspector's Report (S. 241)

The inspector may and if so directed by the Central Government shall make interim reports to that Government and on the conclusion of the investigation shall make a final report to the Central Government. The report may be written or printed, as the Central Government direct.

The Central Government – (a) shall forward a copy of any report (other than the interim report) made by the inspectors to the company at its registered office and also to any body corporate dealt within the report by virtue of s.239; (b) may, if it thinks fit, furnish a copy thereof, on request and on payment of the prescribed fee, to any person – (i) who is a member of the company or other body corporate dealt within the report; (ii) whose interests as a creditor of the company, or other body corporate aforesaid appear to the Central Government to be affected; (c) shall, on request, furnish a copy to the applicants for investigation; (d); shall, where appointed at the instance of the Company Law Board, furnish a copy to it; (e); may also cause the report to be published.

10.6.5 Investigation of Ownership of a Company (Ss. 247-248)

The Central Government, if satisfied that there is a good reason, may appoint one or more inspectors to investigate and report on the membership of any companies, for the purpose of determining who are the persons financially interested in its success or failure or are able to

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control its policy. The inspector may also investigate (with the prior approval of the Central Government) the ownership of other connected companies such as subsidiary companies, holding companies. On completion of his investigation, the inspector is required to submit his report to the Central government, but the latter is under no obligation to supply copies of the inspector's report to the company or any other person, if it is of the opinion that there is no good reason for not divulging the contents of the report or parts thereof (s.247). Similarly, wherever it appears to the Central Government or the Company Law Board that there is good reason so to do, it may appoint on or more inspectors to investigate the ownership of shares and debentures of a company (s.248). Further, s.250 provides that in a case where, owing to a change in the ownership of shares, a change in the directors of a company is likely to take place, which, if permitted would, in the opinion of the Central Government, be prejudicial to the public interest, then the government may direct that for a specified period voting rights shall not be exercised by the transferees of those shares.

10.7 Management of a Company

10.7.1 Managerial Personnel

A company, being an artificial person, acts through human agency. Accordingly, under the Act, it is necessary for every company to have a Board of Directors. In addition to this, the following categories of managerial personnel may be appointed (s.197-A): (i) Managing Director; or (ii) Manager. But s.197A does not prohibit the employment of other managerial personnel, such as executives or wholetime directors, which do not come within the term "managing director" or "manager".

10.7.2 Directors and their Legal Position

In this Part following matters are discussed: (a) Legal Position of Directors (b) Legal Provisions as regards directors and (c) Director's Powers, Duties and liabilities. Section 2 (13) defines a director as including "any person occupying the position of director, by whatever name called." This is a definition based purely on function; a person is a director if he does whatever a director normally does. But the Act gives no further guidance on the function, duties and position of a director. In reality, directors are the persons who direct, conduct, manage or superintend a company's affairs. Section 291 has entrusted the management of the affairs of the company in their hands. They chalk-out the general policy of the company within the framework of the Memorandum of the company. They appoint the company's officers and recommend the rate of dividend. The directors of company are collectively referred to as the 'Board of Directors'.

The exact position of 'director' is hard to define, as no formal definition, either statutory or judicial, of the term has been given. However, judicial pronouncements have described them as (i) agents, (ii) trustees, or (iii) managing partners.

The directors act as agents of the company and the ordinary rules of agency apply. They exercise the powers and are subject to duties within the framework of the company's Articles, and the Act. For instance, they may make contracts on behalf of the company and they will not be personally liable as long as they act within the scope of their authority. But if they contract in their own name, or fail to exclude personal liability, they also will be liable. If the directors exceed their authority, the same act may be ratified by the company. But if they do something beyond the objects clause of the company, then the act is ultra vires and the company cannot ratify the same. But directors are not agents for the individual shareholders, they are the agents of the company– the artificial person.

The directors have also been described as trustees. But they are not trustees in the full sense of the term in as much as no proprietary rights of the company's property are transferred to them and,

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therefore, they enter into contracts on behalf of the company and in the name of the company. On the other hand, in the case of a trust, the legal ownership of the trust property is transferred to the trustee and therefore, he can enter into contract in his own name, but whatever he does, he does for the benefit of the beneficiaries.

Although directors are not trustees in the real sense of the term, they occupy an office of the trust and are in certain respects in the position of trustees for the company. Such cases are:

(i) They are trustees of money which comes to their hands or which is actually under their control. If they misapply company's money, they have to make good the same as if they were trustees.

(ii) They are trustees for exercising powers conferred on them for the benefit of the company. For instance, powers to allot shares, to make calls, forfeit shares should be exercised bona fide in the interests of the company.

(iii) They stand in a fiduciary relationship to the company and, therefore, whenever there is clash of his personal interests with that of the company, he should keep in mind the company's interests.

A director is in no way a trustee for individual shareholders except when the former induces the latter by misrepresentation to sell the shares to him.

The directors are also sometimes described as managing partners. They manage the affairs of the company on their own behalf and on behalf of other shareholders who elect them.

Are the directors employees of the company? They are not employees of the company or employed by the company, nor are they servants of the company, or members of "Company's staff". A director can, however, hold a salaried employment or an office in addition to that of his directorship which may, for these purposes, make him an employee or servant and in such a case he would enjoy rights given to employees as such; but his directorship and his rights through that directorship are quite separate from his rights as employee.

10.7.3 Legal Provisions as Regards Directors

Some of the important legal provisions as regards directors are summarised as follows:

(1) ***Number of directors.*** Every public company must have at least three directors. Every private company must have at least two directors (s.252). However, a public company having: (a) a paid-up capital of ₹ 5 crore or more; (b) 1000 or more small shareholders may have a director elected by such small shareholders in the manner as may be prescribed. The phrase 'small shareholders' means a shareholder holding shares of nominal value of ₹ 20,000 or less in a public company to which this section applies. This is the minimum legal requirement of the number of directors. The Articles of a company may and usually do, fix the minimum and maximum number of directors of its Board. For instance, the articles may fix 5 as the minimum and 9 as the maximum number of directors of the Board. Also, the articles may fix, within these limits, the number which will constitute the Board for the time being. For instance, in the above example, the number of directors constituting a Board may be fixed at 7.

(2) ***Increase in number of directors.*** A company in general meetings may, by ordinary resolution, increase or reduce the number of its directors within the limits fixed in that behalf by its articles (s.258).

In certain cases, the increase in number of directors also requires the approval of the Central Government. Section 259 provides that if a public company, or a private company which is subsidiary a public company wishes to increase the number of its directors beyond the maximum fixed by its articles, the increase even though decided upon by

resolution of the company in general meeting will not have any effect unless approved by the Central Government and shall become void if and in so far as it is disapproved by the Central Government. But if the increase in the number will not make the total number of directors more than twelve, no approval of the Central Government is necessary. However, independent private companies and Government companies are exempted from the provisions of s.259.

(3) ***Individuals to be directors.*** No body corporate, association or firm shall be appointed director of any company. Only an individual can be a director (s.253).

10.7.4 Managing Director

Section 2(26) defines 'managing director' as a 'director' who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him. The expression includes a director occupying the position of a managing director, by whatever name called.

However, the power to do administrative acts of routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within substantial powers of management. Further, a managing director of a company shall exercise his powers subject to the superintendence, control and direction of its Board of Directors.

Some of the more important legal provisions about managing directors are summarised as follows:

(i) He, being a director, must be an individual.

(ii) He is appointed, usually to perform such functions and carry out such duties as may be assigned to him by the Board of directors to whom he is responsible or subject. The Board can revoke the authority of the managing director.

(iii) He must be entrusted with substantial powers of management.

(iv) There can be two or more than two managing directors in a company.

(v) A person cannot be appointed as managing director of more than two companies unless so permitted by the Central Government.

His appointment is subject to the approval by the Central Government. The Central Government upon application for permission to appoint a person as managing director of the company has power to impose conditions. Ss. 268, 269, 316 and 317 are applicable to a public company or a private company which is subsidiary of a public company.

Section 268 states that an amendment of any provision relating to appointment or reappointment of a managing director (or a wholetime director) shall not be effective unless approved by the Central Government and shall be become void if and in so far as, it is disapproved by the Central Government.

Appointment of managing or whole-time director or manager to require government approval only in certain cases (s.269). Every public company and/or private company which is subsidiary of a public company having a paid-up share capital of not less than ₹ 5 crore must appoint either a managing or a whole-time director or Manager. Also no approval of the Central Government to the appointment of managerial personnel is required on fulfillment of certain conditions laid down in Schedule XIII [including the minimum remuneration under s.198(4) as also increase in the remuneration under Ss. 310 and 311].

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For appointment of a managing, wholetime director or a manager, approval of the Central Government would not be required if the following conditions were satisfied:

(i) he had not been sentenced to imprisonment for any period or to fine exceeding ₹ 1,000 for conviction of an offence under any of the fourteen acts mentioned in Schedule XIII;

(ii) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act 1974;

(iii) he has completed the age of 25 years but has not attained the age of 70 years;

(iv) he is not a managing or wholetime director or manager or in any way in wholetime employment elsewhere;

(v) he is citizen of India and is resident in India;

(vi) the company had neither suffered loss nor had inadequate profits: (a) during the preceding financial year immediate to the financial year in which appointment is made, or (b) in any of the three financial years out of the four financial years immediately preceding.

In case any of the above conditions are not complied with, an application must be made to the Central Government within 90 days of the appointment. If the appointment is not approved by the Central Government the appointee shall vacate the office immediately on communication of the decision by the Central Government.

Section 316 states that a person, who is either the managing director or the manager of any other company (including a pure private company), cannot be appointed a managing director of a public company or a private company which is a subsidiary of a public company. But such an appointment can be made if the board of such company approves of the appointment by a unanimous resolution passed at the Board meeting specific notice of which had been given to all the directors then in India. Also the Central Government is empowered to permit, by order, the same person to be managing director of more than one companies, if it is satisfied and it is necessary for their proper working that the companies should function as a single unit and have a common managing director.

Section 317 states that the term of office of a managing director cannot exceed five years at a time. Also re-appointments or extension can be made on the basis of 5 years tenure on each occasion, provided each time the re-appointment or extension is made by the company during two years of the existing term.

It may be emphasised that Ss.268, 269 and 317 relating to restrictions on appointment of managing directors (as noted above) do not apply to pure private companies.

Disqualification of a Managing Director

Section 267 prohibits the appointment or employment or the continuance of the appointment or employment of any person by a company as its managing director or wholetime director, if the said person: (i) is an undischarged insolvent or has at any time been adjudged an insolvent; (ii) suspends, or has at any time suspended payment to his creditors, or makes or has at any time made a composition with them; or (iii) is or has at any time, been convicted by a court of an offence involving moral turpitude.

It may be noted that these disqualifications are in addition to the ones mentioned in s.272 (i.e., disqualifications of a director).

Whole Time Director

In many sections of the Companies Act, the term 'Whole time director' has been used side by side with that of the 'managing director'. Confusion is, therefore, likely to arise in respect of their respective position and role.

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While the term 'managing director' has been specifically defined under Section 2(26), no such definition of a whole time director is available. Explanation to Section 269, however, states that the expression 'whole time director' includes a director in the whole time employment of the company.

Regarding appointment/re-appointment and remuneration of whole time director, same provisions as are applicable to a managing director, are applicable. Under section 269, every public company and a private company which is a subsidiary of a public company must have a managing director a whole-time director if its paid-up share capital is ₹ 5 crores or more. Similarly Sections 267 and 268 providing for disqualifications of managing directors and approval of Central Government for their appointment/re-appointment also make the provisions applicable to whole time directors. Also, the provisions of Sections 309, 310 and 311 dealing with remuneration of directors and other managerial personnel are applicable to whole time directors.

Distinction between Managing Director and Whole Time Director

However, the following points of distinction between a managing director and a whole time director may be noted:

1. A managing director may be appointed in that capacity in two or more companies at the same time but a whole-time director, by virtue of his whole time employee cannot act as such in more than one company.
2. The tenure of a managing director of a public company or a private company which is the subsidiary of a public company cannot be more than five years at a time. There is no such restriction in the case of a whole-time director.

10.7.5 Manager

Section 2(24) states that "manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole of the affairs of the company and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not".

Thus, an individual must be incharge of the whole or substantially the whole of the business of the company, in order to be called a manager in accordance with the Act. A person who is one of the departmental managers or a branch manager is not deemed to be a manager in this sense. Some of the more important legal provisions about managers are summarised as follows:

(1) Only an individual can be appointed a manager of a company (s.384)

(2) Section 385 lays down the disqualifications of a Manager. No company shall appoint or continue the appointment or employment of any person as its manager, who (a) is an undischarged insolvent; or (b) has at any time within the preceding five years been adjudged an insolvent; or (c) suspends, or has suspended payment to his creditors; or (d) make, or has at any time, within the preceding five years made a composition with his creditors; or (c) is, or has at any time within preceding five years been convicted of an offence involving moral turpitude.

(3) A person may not be appointed manager of more than 2 companies.

(4) The provision of the following sections relating to managing directors have been made applicable to Manager also (s.388);

   (a) *S.269:* Appointment or re-appointment requires Government approval except in cases specified under Schedule XIII;

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(b) *Ss. 310-311:* Provisions for increase in remuneration requires Government approval;

(c) *S.312:* Prohibition of assignment of office by a director;

(d) *S. 317:* Term of appointment to be not more than five years at a time.

Distinction between a Managing Director and a Manager

The following points of distinction between the two are worth noting:

1. A managing director is entrusted with substantial powers of management. A 'manager', on the other hand, has the management of the whole or substantially the whole of the affairs of a company.
2. A company may have more than one managing director but it cannot have more than one manager.
3. A managing director is appointed either under an agreement or by a resolution of the Board or general meeting or under the provisions of the Memorandum or Articles. A manager, on the other hand, is usually appointed either under a contract of service of by the Board of directors though the Articles may also provide for his appointment.
4. A managing director must be a director whereas a manager may or may not be a director.
5. A managing director, on his ceasing to be a director, shall automatically cease to be the managing director as well. A manager-director, however, can continue as a manager even though he ceases to be a director.
6. The grounds of disqualifications of a managing director as given in Section 267 remain effective for whole life and cannot be waived by the Central Government. Most of the grounds of disqualification of a manager as given in section 385 are only for five years and can also be waived by the Central Government.

10.8 Compensation to Directors for Loss of Office

Section 318 provides that no compensation for loss of office may be paid by a company to any director other than the managing director, or wholetime director, or a director holding the office of manager. Even in their cases, no such payment must be made: (i) when he resigns his office on reconstruction or amalgamation of the company; (ii) where the office is vacated under s.203 or s.283; (iii) where he has to give up directorship beyond 20 directorships; (iv) where the winding up of the company takes place due to his negligence and mismanagement; (v) where he has been guilty of fraud or breach of trust in relation to, or of gross negligence in or gross mismanagement of the conduct of the affairs of the company or any subsidiary or holding company thereof; (vi) where he has instigated or has taken part directly or indirectly in bringing about the termination of his office.

Where, however, the compensation is payable, it must not exceed the remuneration which would have been earned by the director for the unexpired residue of the term or for three years whichever is shorter. The calculation of this amount should be based on the average remuneration actually earned by him during a period of three years immediately prior to the date on which he ceased to hold the office, or where he held the office for a shorter period than three years, during such period. No such payment can be made to him if the winding up has commenced either before or at any time within 12 months after the date of his ceasing to hold office, if the assets of the company are not sufficient to repay to the shareholders the share capital including the premium, if any, contributed by them.

10.9 Summary

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- Nominal, authorised or registered capital. This is the maximum amount of capital which it is authorised to raise by issuing shares and upon which it pays stamp duty. As we shall see later, when the original amount of the authorised capital is exhausted by issue of shares, it can be increased by passing an ordinary resolution. (1) Issued capital, (2) Subscribed capital, (3) Called-up capital and (4) Paid-up capital.
- No company limited by shares and no company limited by guarantee and having a share capital, shall have power to buy its own shares, unless the consequent reduction of share capital is effected and sanctioned by the court in pursuance of s.100 to 104 or of s.402. Further, no public company and no private company which is a subsidiary of a public company can directly or indirectly (through loans or guarantee) provide financial assistance to any person to buy shares in the company or in its holding company.
- Companies limited by shares have to issue shares to raise the necessary capital for their operations. Issue of shares may be made in 3 ways. (i) By private placement of shares; (ii) By allotting entire shares to an issue-house, which in turn, offers the shares for sale to the public; and (iii) By inviting the public to subscribe for shares in the company through a prospectus.
- Offer for shares are made on application forms supplied by the company. When an application is accepted, it amounts to an allotment. The expression allotment is not defined under the Companies Act. It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons. The supreme Court in Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd. AIR 1964 SC 250 defined allotment as "the appropriation but out of the previously unappropriated capital of the company of a certain number of shares to a person".
- A company is an artificial person and therefore, cannot act itself. It must act through some human intermediary. The various provisions of law empower shareholders to do certain things. They are specifically reserved for them to be done in company's general meetings.
- Minutes are a record of business transacted at meetings. Every organisation must keep minutes containing a fair and correct summary of all proceedings of general meetings of members and of Management Committee. It is the duty of the secretary to make this record.
- Every company must keep at its registered office proper books of accounts which shall give a true and fair view of the financial affairs of the company. Section 209 lays down the Books of Accounts to be maintained by a company. These books are open to inspection by any director during business hours, as also by the Registrar of companies or an officer authorised by the Central Government. Also the books of accounts should be retained for a period of eight years. It is obligatory on companies to maintain accounts on accrual basis.
- It is compulsory for every company to appoint qualified auditors to do the audit of the accounts maintained by the company. The first auditors(s) can be appointed by the Board of Directors within one month of the date of the incorporation of the company.
- Section 225 makes provision for a resolution relating to appointment or removal of auditor. A person who is a Chartered Accountant in practice is qualified to become an auditor. In other words, he must be a member of the Institute of Chartered Accountants of India and in practice.
- The Central Government may appoint one or more competent persons as inspectors to investigate into the affairs of any company

Notes

- 'managing director' as a 'director' who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him.
- "manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole of the affairs of the company and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not".
- Section 318 provides that no compensation for loss of office may be paid by a company to any director other than the managing director, or wholetime director.

10.10 Keywords

Auditor: The first auditors(s) can be appointed by the Board of Directors within one month of the date of the incorporation of the company.

Called-up capital: The company may not call up full amount of the face value of the shares. Thus, the called-up capital represents the total amount called-up on the shares subscribed. The total amount of called-up capital can be either equal to or less than the subscribed capital.

Issued capital: It is that part of the authorised capital which the company has issued for subscription. The amount of issued capital is either equal to or less than the authorised capital.

Manager: "manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole of the affairs of the company and includes a director or any other person occupying the position of a manager.

Managing director: managing director' as a 'director' who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him

Meaning of Allotment: Offer for shares are made on application forms supplied by the company. When an application is accepted, it amounts to an allotment. The expression allotment is not defined under the Companies Act. It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons. The supreme Court in Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd. AIR 1964 SC 250 defined allotment as "the appropriation but out of the previously unappropriated capital of the company of a certain number of shares to a person".

Paid-up capital: Paid-up capital is the amount of money paid-up on the shares subscribed.

Subscribed capital: It is that portion of the issued capital which has been subscribed for by the purchasers of the company's shares. The amount of subscribed capital is either equal to or less than the issued capital.

10.11 Self Assessment

Fill in the blanks:

1. .... This is the maximum amount of capital which it is authorised to raise by issuing shares and upon which it pays stamp duty.
2. Shares are made .... supplied by the company.

3. A company is an .... and therefore, cannot act itself. It must act through some human intermediary.
4. The various provisions of law empower .... to do certain things. They are specifically reserved for them to be done in company's general meetings.
5. Every company must keep at its .... of accounts which shall give a true and fair view of the financial affairs of the company.
6. It is .... for every company to appoint qualified auditors to do the audit of the accounts maintained by the company.
7. .... makes provision for a resolution relating to appointment or removal of auditor.
8. The .... may appoint one or more competent persons as inspectors to investigate into the affairs of any company
9. .... who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him.
10. ....an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole of the affairs of the company and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not"
11. ....provides that no compensation for loss of office may be paid by a company to any director other than the managing director, or wholetime director.
12. .... are a record of business transacted at meetings.

10.12 Review Questions

1. Write a short notes on the following: (i) Issue of shares at premium (ii) Issue of shares at discount.
2. Describe the procedure for alteration of share capital.
3. Describe the procedure for reduction of share capital.
4. What is meant by allotment of shares? State the statutory requirements in this respect.
5. Write short note on: (i) Listing of shares, (ii) Opening and closing the subscription list, (iii) Return of allotment, (iv) Duplicate share certificate.
6. Distinguish between transfer and transmission of shares.
7. What charges are registered under the Companies Act, 1956?
8. What is the effect of non-registration of a registrable charge?
9. What are the different kinds of general meetings of a company?
10. Define statutory meeting of a public company.
11. What books of account is a company bound to maintain?
12. Write notes on (i) special audit and (ii) cost audit. Discuss the powers and duties of auditors with reference to leading cases.

Notes

13. Discuss the powers of the Central Government for Investigation and Inspection.
14. Define Managing Director and state the statutory provisions regarding his appointment and remuneration.
15. Distinguish between a managing director and a wholetime director.

Answers: Self Assessment

1. Nominal, authorised or registered capital
2. on application forms
3. Artificial person
4. shareholders
5. registered office proper books
6. compulsory
7. Section 225
8. Central Government
9. 'managing director' as a 'director'
10. "manager means
11. Section 318
12. Minutes

10.13 Further Readings

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Unit 11: Trade Union Act, 1926

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Objectives

After studying this unit, you will be able to:

- Explain background and forces responsible for birth of trade unions
- Discuss various conceptual and theoretical aspects of trade unions
- Understand Trade Union Act 1926

Notes

- Describe the challenges before trade unions management in changing business environment

Introduction

Trade Union had to pass through a very difficult and hostile period in the initial years. The employers wanted to crush them with iron hands. Then came the period of agitation and occasional acceptance. When the union gained strength they started confronting the employer. This is the period of struggle which continued for long. Employers were forced to accommodate, tolerate and hesitatingly accept them. Then came the period of understanding in the industry in collective bargaining. This was followed by a fraternal stage where union became matured and employers started consulting them. The desired state is the "Fusion Stage" in which joint efforts were required to be made for union-management cooperation and partnership.

11.1 Trade Unions: Meaning and Justification

According to Webbs, a trade union is a continuous association of wage-earners for the purpose of maintaining and improving the conditions of their working lives. Under the Trade Union, Act of 1926, the term is defined as any combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workers and employers or for imposing restrictive conditions on the condition of any trade or business and includes any federation of two or more unions. Let us examine the definition in parts:

1. Trade union is an association either of employees or employers or of independent workers.
2. It is a relatively permanent formation of workers. It is not a temporary or casual combination of workers.
3. It is formed for securing certain economic (like better wages, better working and living conditions), and social (such as educational, recreational, medical, respect for individual) benefits to members. Collective strength offers a sort of insurance cover to members to fight against irrational, arbitrary and illegal actions of employers. Members can share their feelings, exchange notes and fight the employer quite effectively whenever he goes off the track.

A more recent and non-legislative definition of a union is:

"An organisation of workers acting collectively who seek to protect and promote their mutual interests through collective bargaining".

-De Cenzo & Robbins (1993)

11.2 Theories of Trade Unionism

There is no one theory of Trade Unionism, but many contributors to these theories are revolutionaries like Marx and Engels, Civil servants like Sydney Webb, academics like Common and Hoxie and labour leaders like Mitchall. Important theories of trade unionism are as follows:

1. ***Political Revolutionary Theory of Labour Movement of Marx and Engels:*** The Theory is based on Adam Smith's theory of labour value. Its short-run purpose is to eliminate competition among labour, and the ultimate purpose is to overthrow capitalist-businessman. Trade union is a pure and simple class struggle, and the proletarians have nothing to lose but their chains and there is a world to win.

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Note Marx and Engels lived as revolutionary exiles in England during the period of the rise of trade unionism. Even before they had arrived in England, they had recognized the objective significance of trade unionism as the response of the working class to the efforts of the employers to lower their wages. In opposition to the petty-bourgeois theoretician Pierre-Joseph Proudhon, who denied the utility of both trade unions and strikes on the grounds that increases in wages achieved through their efforts led only to increases in prices Marx insisted that both formed necessary components of the struggle of the working class to defend its standard of living.

Marx was certainly correct in his criticism of the views of Proudhon, but it is necessary to bear in mind that these early writings were produced at a time when the trade unions themselves were still in their swaddling clothes. The experience of the working class with this new organizational form was extremely limited. The possibility could not be foreclosed, at that time that the trade unions could yet evolve into potent instruments of revolutionary struggle, or at least as the direct forerunners of such instruments. This hope was expressed in Marx's observation in 1866 that as "centers of organization" the trade unions were playing for the working class the same role "as the medieval municipalities and communes did for the middle class."

Even by then, however, Marx was concerned that "the Trades" Unions have not yet fully understood their power of acting against the system of wages slavery itself." But it was in this direction that they had to evolve:

"Apart from their original purposes, they must now learn to act deliberately as organizing centers of the working class in the broad interest of its complete emancipation. They must aid every social and political movement tending in that direction. Considering themselves and acting as champions and representatives of the whole working class, they cannot fail to enlist the non-society men into their ranks. They must look carefully after the interests of the worst paid trades, such as the agricultural laborers, rendered powerless by exceptional circumstances. They must convince the world at large that their efforts, far from being narrow and selfish, aim at the emancipation of the downtrodden millions."

Marx sought to impart to the trade unions a socialist orientation. He warned the workers "not to exaggerate to themselves" the significance of the struggles engaged in by the trade unions. At most, the unions were "fighting with effects, but not with the causes of those effects; that they are retarding the downward movement; that they are applying palliatives, not curing the malady." It was necessary for the unions to undertake a struggle against the system that was the cause of the workers' miseries; and, therefore, Marx proposed to the trade unions that they abandon their conservative slogan, "A fair day's wage for a fair day's work," and replace it with the revolutionary demand, "Abolition of the wages system."

But Marx's advice made little impression, and by the late 1870s, the observations of Marx and Engels on the subject of trade unionism had assumed a far more critical character. Now that bourgeois economists were expressing greater sympathy toward the trade unions, Marx and Engels took pains to qualify their earlier endorsement. They distinguished their views from those of bourgeois thinkers like Lujo Brentano, whose enthusiasm for the trade unions was dictated, according to Marx and Engels, by his desire "to make the wage-slaves into contented wage-slaves."

By 1879, it was possible to detect in Engels' writings on the subject of trade unionism an unmistakable tone of disgust. He noted that the trade unions had introduced organizational statutes that prohibited political action, thus barring "any participation in any general activity on the part of the working class as a class." In a letter to Bernstein, dated June 17,

Contd...

Notes

1879, Engels complained that the trade unions had led the working class into a dead end. "No attempt should be made to conceal the fact that at this moment a genuine workers' movement in the continental sense is non-existent here, and hence I don't believe you will miss much if, for the time being, you don't get any reports on the doings of the TRADE UNIONS here."

In an article written six years later, in which he contrasted the England of 1885 to that of 1845, Engels made no attempt to conceal his contempt for the conservative role played by the trade unions. Forming an aristocracy within the working class, they cultivated the friendliest relations with the employers, in order to secure for themselves a comfortable position. The trade unionists, Engels wrote with scathing sarcasm, "are very nice people indeed nowadays to deal with, for any sensible capitalist in particular and for the whole capitalist class in general."

But the trade unions had all but ignored the great mass of the working class, for whom "the state of misery and insecurity in which they live now is as low as ever, if not lower. The East-end of London is an ever-spreading pool of stagnant misery and desolation, of starvation when out of work, and degradation, physical and moral, when in work."

Engels' hopes were aroused, toward the end of the 1880s, by the development of a new and militant trade union movement among more exploited sections of the working class. Socialists, including Eleanor Marx, were active in this new movement. Engels responded to these developments with enthusiasm, and noted with great satisfaction that "These new Trades Unions of unskilled men and women are totally different from the old organizations of the working-class aristocracy and cannot fall into the same conservative ways ... And they are organized under quite different circumstances all the leading men and women are Socialists, and socialist agitators too. In them I see the real beginning of the movement here."

But Engels' hopes were not fulfilled. It was not too long before these "new" unions began to exhibit the same conservative tendencies as the old ones. This was an early verification of the theoretical conception we consider critical to the analysis of the trade unions i.e., that the essential character of these organizations is not determined by the social position and status of the particular sections of workers organized within them. These are factors, which, at most, only influence certain secondary aspects of trade union policy perhaps making some unions more or less militant than the average. Yet, in the final analysis, the trade union form, whose structure is drawn from, and embedded in, the social and production relations of capitalism, and, we must add, the nation-state framework, exercises the decisive influence that determines the orientation of its "content" the working class membership.

The theory of modern Socialism is inseparable from the constructive thought of Karl Marx. The theory of modern Socialism does not admit of arbitrarily constructed Utopian ideals. The philosophical basis of Marxian Socialism is a synthesis of the theories of the economic interpretation of history, of the class-struggle and of surplus value.

2. ***Webb's Theory of Industrial Democracy:*** Webb's book 'Industrial democracy' is the Bible of trade unionism. According to Webb, trade unionism is an extension of democracy from political sphere to industrial sphere. Webb agreed with Marx that trade unionism is a class struggle and modern capitalist state is a transitional phase which will lead to democratic socialism. He considered collective bargaining as the process which strengthens labour.

3. ***Cole's Theory of Union Control of Industry:*** Cole's views are given in his book "World of Labour", 1913. His views are somewhere in between Webb and Marx. He agrees that unionism is class struggle and the ultimate is the control of industry by labour and not revolution as predicted by Marx.

Notes

4. ***Common's Environment Theory:*** He was sceptical of generalisations and believed only that which could be proved by evidence. He agreed that collective bargaining was an instrument of class struggle, but he summarised that ultimately there will be partnership between employers and employees.

5. ***Mitchell's Economic Protection Theory of Trade Unionism:*** Mitchell, a labour leader, completely rejected individual bargaining. According to him unions afford economic protection too.

6. ***Simon's Theory of Monopolistic, Anti-democratic Trade Unionism:*** He denounced trade unionism as monopoly founded on violence. And he claimed monopoly power has no use, save abuse.

7. ***Perlman's Theory of the "Scarcity Consciousness" of Manual Workers:*** He rejected the idea of class consciousness as an explanation for the origin of the trade union movement but substituted it with what he called job consciousness. According to him, 'working people in reality felt an urge towards collective control of their employment opportunities, but hardly towards similar control of industry.' Perlman observed that three dominant factors emerged from the rich historical data:

   (a) The capacity or incapacity of the capitalist system to survive as a ruling group in the face of revolutionary attacks (e.g., failure in Russia).

   (b) The source of the anti-capitalist influences being primarily from among the intellectuals in any society.

   (c) The most vital factor in the labour situation was the trade union movement. Trade unionism, which is essentially pragmatic, struggles constantly not only against the employers for an enlarged opportunity measure in income, security and liberty in the shop and industry, but struggles also, whether consciously or unconsciously, actively or passively, against the intellectual who would frame its programmes and shape its policies.

   But Perlman also felt that a theory of the labour movement should include a theory of the psychology of the labouring man. For instance, there was a historical continuity between the guilds and trade unions, through their common fundamental psychology; the psychology of seeking a livelihood in the face of limited economic opportunity. It was when manual workers became aware of a scarcity of opportunity, that they banded together into unions for the purpose of protecting their jobs and distributing employment opportunities among themselves equitably, and to subordinate the interests of the individual to the whole labour organism. Unionism was ruled thus by this fundamental scarcity consciousness (Perlman, 1970, pp. 4-10, 237-47, 272-85).

8. ***Hoxies Functional Classification of Unionism:*** He classified Unionism on the basis of its functions. His classifications were Business Unionism for protecting the interest of various craftsmen, "uplift unionism" for the purpose of contributing better life such as association of sales engineers, etc., "Revolutionary Unionism" which is eager to replace existing social order and "Predatory Unionism" which rests on the support of others.

9. ***Tannenaum's Theory of Man vs. Machine (1951):*** According to him, Union is formed in reaction to alienation and loss of community in an individualistic and unfeeling society. In his words, the union returns to the workers his society, which he left behind him when he migrated from a rural background to the anonymity of an urban industrial location. The union gives the worker a fellowship and a value system that he shares with others like him.

Notes

Task The liberalization, privatization and globalisation era has virtually compelled both labour and management to have a relook at their collective roles and discharge their duties with sufficient care and caution. Discuss

11.3 Types of Trade Unions

11.3.1 Types based on Ideology

1. ***Revolutionary Unions:*** Believe in destruction of existing social/economic order and creation of a new one. They want shift in power and Authority and use of force - Left Unions.
2. ***Reformist or Welfare Unions:*** Work for changes and reforms within existing socio-political framework of society – European Model.
3. ***Uplift Unions:*** They advocate extensive reforms well beyond the area of working condition, i.e., change in taxation system, elimination of poverty, etc.

11.3.2 Types based on Trade

Many unions have memberships and jurisdictions based on the trades they represent. The most narrow in membership is the craft union, which represents only members certified in a given craft or trade, such as pipe fitting, carpentry and clerical work. Although very common in the western world, craft unions are not common in countries like India and Sri Lanka.

At the other extreme, in terms of the range of workers represented in the general union, which has members drawn from all trades. Most unions in India and Sri Lanka are in this category.

Did u know? Another common delineation of unions, based on trades or crafts, is that between so-called blue-collar workers and white-collar workers. Unions representing workers employed on the production floor or outdoor trades such as in construction work are called blue-collar unions. In contrast, those employees in shops and offices and who are not in management grades and perform clerical and allied functions are called white-collar workers.

In addition, trade unions may be categorised on the basis of the industries in which they are employed. Examples of these are workers engaged in agriculture or forestry: hence, agricultural labour unions or forest workers' unions.

11.3.3 Types based on Agreement

Another basis on which labour agreements are sometimes distinguished is on basis of the type of agreement involved, based on the degree to which membership in the union is a condition of employment.

1. ***Closed Shop:*** Where management and union agree that the union would have sole responsibility and authority for the recruitment of workers, it is called a Closed Shop agreement. The worker joins the union to become an employee of the shop. The Taft-Hartley Act of 1947 bans closed shop agreements in the USA, although they still exist in the construction and printing trades. Sometimes, the closed shop is also called the 'Hiring Hall.'

Notes

2. ***Union Shop:*** Where there is an agreement that all new recruits must join the union within a fixed period after employment it is called a union shop. In the USA some states are declared to be having 'right-to-work'.
3. ***Preferential Shop:*** When a Union member is given preference in filling a vacancy, such an agreement is called Preferential Shop.
4. ***Maintenance Shop:*** In this type of arrangement there is no compulsory membership in the union before or after recruitment. However, if the employee chooses to become a member after recruitment, his membership remains compulsory right throughout his tenure of employment with that particular employer. This is called maintenance of membership shop or maintenance shop.
5. ***Agency Shop:*** In terms of the agreement between management and the union a non-union member has to pay the union a sum equivalent to a member's subscription in order to continue in employment with the employer. This is called an agency shop.
6. ***Open Shop:*** Membership in a union is in no way compulsory or obligatory either before or after recruitment. In such organisations, sometimes there is no union at all. This is the least desirable form for unions. This is referred to as an open shop.

The above classifications are more usual in the west than on the Indian subcontinent.

11.4 Trade Union Movement in India

Trade unions in India, as in most other countries, have been the natural outcome. Institutionally, the trade union movement is an unconscious effort to harness the drift of our time and reorganise it around the cohesive identity that men working together always achieve of the modern factory system. The development of trade unionism in India has a chequered history and a stormy career.

11.4.1 Early Period

Efforts towards organising the workers for their welfare were made during the early period of industrial development by social workers, philanthropists and other religious leaders mostly on humanitarian grounds. The first Factories Act, 1881, was passed on the basis of the recommendations of the Bombay Factory Commission, 1875. Due to the limitations of the Act, the workers in the Bombay Textile Industry under the leadership of N. Lokhande demanded reduced hours of work, weekly rest days, mid-day recess and compensation for injuries. The Bombay Mill owners' Association conceded the demand for weekly holidays. Consequently, Lokhande established the first Workers' Union in India in 1890 in the name of Bombay Mill-hands Association. A labour journal called Dinabandu was also published.

Some of the important unions established during the period are: Amalgamated Society of Railway Servants of India and Burma (1897) Management and Printers' Union, Calcutta (1905) and the Bombay Postal Unions (1907), the Kamgar Hitavardhak Sabha (1910) and the Social Service League (1910). But these unions were treated as ad hoc bodies and could not serve the purpose of trade unions.

11.4.2 Modest Beginning

The beginning of the labour movement in the modern sense started after the outbreak of World War I in the country. Economic, political and social conditions of the day influenced the growth of trade union movement in India. Establishment of International Labour Organisation in 1919 helped the formation of trade unions in the country. The Madras Labour Union was formed on systematic lines in 1919. A number of trade unions were established between 1919

Notes

and 1923. Category wise, unions like Spinners' Union and Weavers' Union came into existence in Ahmedabad under the inspiration of Mahatma Gandhi. These unions were, later, federated into an industrial union known as Ahmedabad Textile Labour Association. This union has been formed on systematic lines and has been functioning on sound lines, based on the Gandhian Philosophy of mutual trust, collaboration and non-violence.

11.4.3 All India Trade Union Congress

The most important year in the history of Indian Trade Union movement is 1920 when the All India Trade Union Congress (AITUC) was formed consequent upon the necessity of electing delegates for the International Labour Organisation (ILO). This is the first All India trade union in the country. The first meeting of the AITUC was held in October, 1920 at Bombay (now Mumbai) under the Presidentship of Lala Lajpat Rai. The formation of AITUC led to the establishment of All India Railwaymen's Federation (AIRF) in 1922. Many Company Railway Unions were affiliated to it. Signs of militant tendency and revolutionary ideas were apparent during this period.

1. ***Period of Splits and Mergers:*** The splinter group of AITUC formed the All India Trade Union Federation (AITUF) in 1929. Another split by the communists in 1931 led to the formation of All India Red Trade Union Congress. Thus, splits were more common during the period. However, efforts were made by the Railway Federation to bring unity within the AITUC. These efforts did bear fruit and All India Red Trade Union Congress was dissolved. Added to this, All India Trade Union Federation also merged with the AITUC. The unified AITUC's convention was held in 1940 in Nagpur. But the unity did not last long. World War II brought splits in the AITUC. There were two groups in the AITUC, one supporting the war while the other opposed it. The supporting group established its own central organisation called the Indian Federation of Labour. A further split took place in 1947, when the top leaders of the Indian National Congress formed another central organisation.
2. ***Indian National Trade Union Congress:*** The efforts of the Indian National Congress resulted in the establishment of the Indian National Trade Union Congress (INTUC) by bringing a split in the AITUC. INTUC started gaining membership right from the beginning.
3. ***Other Central Unions:*** The Socialists separated from the AITUC and formed the Hind Mazdoor Sabha (HMS) in 1948. The Indian Federation of Labour merged with the HMS; the Radicals formed another union under the name of the United Trade Union Congress in 1949. Thus, the trade union movement in the country was split into four distinct central unions during the short span of 1946 to 1949.

Some other central unions were also formed. They were Bharatiya Mazdoor Sangh (BMS) in 1955, the Hind Mazdoor Panchayat (HMP) in 1965 and the Centre of Indian Trade Unions (CITU) in 1970. Thus, the splinter group of the INTUC formed the Union Trade Union Congress – the split in the Congress Party in 1969 resulted in the split in INTUC and led to the formation of the National Labour Organisation (NLO).

11.4.4 Present Position

There are over 9,000 trade unions in the country, including unregistered unions and more than 70 federations and confederations registered under the Trade Unions Act, 1926. The degree of unionism is fairly high in organised industrial sector. It is negligible in the agricultural and unorganised sectors.

Though the number of unions has greatly increased in the last four decades, the union membership per union has not kept pace. The National commission on labour has stated that only 131 unions

had a membership of over 5,000. More than 70% of the unions had a membership of below 500. Over the years, the average membership figures per union have fallen steadily from about 1387 in 1943 to 632 in 1992-93 (Pocket Book of Labour Statistics 1997). Unions with a membership of over 2000 constitute roughly 4 per cent of the total unions in the country.

Notes

There is a high degree of unionisation (varying from 30% to over 70%) in coal, cotton, textiles, iron and steel, railways, cement, banking, insurance, ports and docks and tobacco sectors. White collar-unions have also increased significantly covering officers, senior executives, managers, civil servants, self-employed professionals like doctors, lawyers, traders, etc., for safeguarding their interests.

Caution There are as many as 10 central trade union organisations in the country (as against one or two in UK, Japan and USA). The criteria for recognition as Central Trade Union have been that the combined strength should be 5 lakhs in numbers with a spread over to at least 4 states and 4 industries as on 31.12.89. Ten such Trade Unions are; (1) BMS (2) INTUC (3) HMS, (4) U.T.U.C - LS (5) AITUC (6) CITUC (7) NLO (8) UTUC (9) TUCC (10) NFITU. As per the latest survey (Economic Times, 24.9.97) the five leading Trade Unions' strength are as follows:

BMS	-	33l Lakhs
INTUC	-	27l Lakhs
AITUC	-	18 Lakhs
HMS	-	15 Lakhs
CITU	-	3.4 Lakhs
27/12/06	-	Economics Times
BMS	-	60 Lakhs
INTUC	-	38 Lakhs
AITUC	-	33 Lakhs
HMS	-	17 Lakhs
CITU	-	26 Lakhs

The number of central unions has swelled from eight to around a dozen, with SEWA, DMK's Labour Progressive Front, CPI-ML's AICCTU and Forward Bloc-backed TUCC joining the club. AITUC, expand from nine lakhs members to 33 lakhs, while the BMS has a membership of around 60 lakh, up from 28 lakhs, INTUC has increased from 25 lakhs to nearly 38 lakhs & HMS has grown by around 17 lakh members. However, the growth in membership is lowest in the CITU, which has strength of approximately 26 lakhs.

Unorganized Union-splintering of Unions

As central trade unions are not managing themselves well, there are many sub-groups within them. Those are known as splintering of unions. They are pressure groups with vested interest and they create all the trouble for them. But they are such splinter groups which cannot be generally neglected either by Industry or the trade unions.

This also causes intra- union rivalry, leading to litigations and violence.

Notes

11.5 Problems of Trade Union

Over the years, trade unions in India have been taken for a ride by outside political leaders. In the process, the interests of workers and their aspirations have been totally neglected. The Trade Union Act, 1926, did not go for recognising a representative union. As a result, multiple unions have cropped up, often with blessings from management and outsiders. The union finances have not been very sound in the beginning. The average membership figures for each union remain poor and have not improved. The forces of liberalisation unleashed in the early '90s have strengthened the hands of employers in closing down unviable units. The new corporate 'mantras' – productivity, performance, efficiency, survival of the fittest-have virtually pushed them to the wall, where their very survival looks uncertain. Let's recount the factors responsible for their ever-increasing woes and depreciated status thus:

11.5.1 Trade Union Leadership

The nature of leadership significantly influences the union-management relations as the leadership is the linchpin of the management of trade unions. The leadership of most of the trade unions in India has been outside leadership mainly drawn from political parties.

11.5.2 Reasons for Emergence of Outside Leadership

Outside leadership has been playing a pivotal role in the Indian Trade Union Movement due to the inability of insiders to lead their movement. In view of the low education standards and poor command over English language which is still the principal language of labour legislation and negotiations, low level of knowledge about labour legislation, unsound financial position, fear of victimisation by the employer and lack of leadership qualities, outside leaders have come to stay. The main reason for this trend is that the Trade Unions Act, 1926, itself provided the scope for outside leadership. Section 22 of the Act requires that ordinarily not less than half of the officers of the reregistered union shall be actively engaged or employed in an industry to which the union relates. Thus, this provision provides the scope for outsiders to the tune of 50% of the office bearers. The Royal Commission of Labour (RCL) 1931 recommended for the reduction of the statutory limit of outsiders from 1/2 to 1/3 but no efforts were taken in this direction.

11.5.3 Evil Effects of Outside Leadership

The evil effects of outside leadership analysed by the National Commission on Labour are as follows:

1. Outside leadership undermined the purposes of Trade Unions and weakened their authority. Personal benefits and prejudices, sometimes, weighed more than unions.
2. Outside leadership has been responsible for the slow growth of Trade Unions.
3. Internal leadership has not been developed fully.
4. Most of the leaders cannot understand the workers' problems as they do not live the life of a worker.

Even though outside leadership is permissible in the initial stages it is undesirable in the long run because of many evils associated with it. Political differences of leaders have been inhibiting the formation of one union in one industry. Most of the Trade Union leaders fulfill their personal aspirations with their knowledge and experience gained in the Trade Unions.

11.5.4 Measures to Minimize the evil Effects of Outside Leadership

In view of the limitations of outside leadership, it is desirable to replace the outside leaders progressively by the internal leaders. The National Commission on Labour, 1969, also stated that outsiders in the Trade Unions should be made redundant by forces from within rather than by legal means.

Both the management and trade unions should take steps in this direction. The steps may be:

1. Management should ensure that the victimisation will be at zero level, even if the trade unions are led by insiders;
2. Extensive training facilities in the areas of leadership skills and management techniques and programmes should be provided to the workers;
3. Special leave should be sanctioned to the office-bearers.

Union rivalry has been the result of the following factors:

1. The desire of political parties to have their bases among the industrial workers;
2. Personal-cum-factional politics of the local union leaders;
3. Domination of unions by outside leaders;
4. Attitude and policies of the management, i.e., divide and rule policy; and
5. The weak legal framework of trade unions.

   (a) *Measures to minimise Union Rivalry:* In view of the evil effects of inter-union rivalry and the problem of formation of one union in one industry, it may be necessary to consider the recommendations of the National Commission on Labour, 1969. The recommendations of NCL to minimise union rivalry are:

      (i) Elimination of party politics and outsiders through building up of internal leaders

      (ii) Promotion of collective bargaining through recognition of sole bargaining agents

      (iii) Improving the system of union recognition

      (iv) Encouraging union security

      (v) Empowering labour courts to settle inter-union disputes if they are not settled within the organisation.

   (b) *Multiple unions:* Multiple unionism, both at the plant and industry levels, poses a serious threat to industrial peace and harmony in India. The situation of multiple unions is said to prevail when two or more unions in the same plant or industry try to assert rival claims over each other and function with overlapping jurisdiction. The multiple unions exist due to the existence of crafts unions and formations of two or more unions in the industry. Multiple unionism is not a phenomenon unique to India. It exists even in advanced countries like UK and the USA. Multiple unionism affects the industrial relations system both positively and negatively. It is, sometimes, desirable for the democratic health of labour movement. It encourages a healthy competition and acts as a check to the adoption of undemocratic practice, authoritative structure and autocratic leadership. However, the negative impacts of multiple unions dominate the positive impacts. The nature of competition tends to convert itself into a sense of unfair competition resulting in inter-union rivalry. The rivalry destroys the feeling of mutual trust and cooperation among leadership. It is a

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major cause for weakening the Trade Union Movement in India. Multiple unionism also results in the small size of the unions, poor finances, etc.

(c) *Union Rivalry:* The formal basis for Trade Union Organisation is provided by the Indian Trade Union Act, 1926. The relevant article reads as follows:

"Any seven or more members of a trade union may be subscribing their name to the roles of the trade union and by otherwise complying with the provisions of this Act with respect to the registration, apply for registration of the trade union under this Act."

This provision has led to the formation of multiple unions and resulted in inter-union rivalry in different industries. But the inter-union rivalry breaks the very purpose of the trade unions by weakening the strength of collective bargaining. On the other hand, the existence of a single, strong union not only protects the employee interests more effectively but also halts the various unproductive activities of the unions and forces the leaders to concentrate on the strategic issues. Further, it helps to bring about congenial industrial relations by bringing about a system of orderliness in dealing with the employees and by facilitating expeditious settlement of disputes.

The state of rivalry between two groups of the same union is said to be inter-union rivalry. Inter and intra-union rivalries have been a potent cause of industrial disputes in the country. They are responsible for weak bargaining power of trade unions in collective bargaining. These rivalries are responsible for slow growth of trade union movement in the country.

(d) *Finance:* Sound financial position is an essential ingredient for the effective functioning of trade unions, because in the process of rendering services or fulfilling their goals, trade unions have to perform a variety of functions and organise programmes which require enormous financial commitments. Hence, it is imperative on the part of a trade union to strengthen its financial position.

But it is felt that the income and expenditure of the trade unions in India over the years is such, with few exceptions, that the financial position of the unions is generally weak, affecting their functioning. It is opined that the "… trade unions could be more effective, if they paid more attention to strengthening their organisations and achieving higher degree of financial solvency."

The primary source of income to the unions is membership subscription. The other sources of union finances are donations, sale of periodicals, etc. The items of expenditure include: allowances to office bearers, salaries to office staff, annual convention/meeting expenses, rents, stationery, printing, postage, telegrams, etc.

Did u know? Most of the trade unions in India suffer from inadequate funds. This unsound financial position is mostly due to low membership and low rate of membership fee. The Trade Union Act, 1926, prescribed the membership fee at 25 paise per member per month. But the National Commission on Labour recommended the increase of rate of membership subscription from 25 paise to Re. 1 in the year 1990. But the Government did not accept this recommendation.

As the National Commission on Labour observes, "an important factor limiting the effective functioning of unions in our country has been their financial weakness. In most unions, poor finances are the result of inadequate membership strength. This, in turn, can be traced to the small size of units. In a majority of unions, the rate of contributions required of members is also small. With a relatively low rate of unionisation, total funds collected are small. The general picture of finances of unions is disappointing."

(e) *Other problems:* The other factors responsible for the unsound functioning of trade unions in India are:

(i) Illiteracy: Workers in India fail to understand the implications of modern trade unionism. Their illiteracy coupled with ignorance and indifference account for the predominance of outside leadership.

(ii) Uneven Growth: Trade unionism activities are, more or less, confined to major metros in India and are traceable only in large scale units (especially cotton textile industry). The degree of unionism also varies from industry to industry, varying between to 30-70 per cent in coal, cotton textiles, iron and steel, tobacco, railways, cement, banking, insurance, ports and docks, etc. The degree of unionism is quite negligible in the agricultural and unorganised sectors.

(iii) Low Membership: The average membership figures of each union are quite depressing. In 1992-93 the average membership figure was 632, a steady fall from 3,594 per union from 1927-28. Because of their small size, unions suffer from lack of adequate funds and find it difficult to engage the services of experts to aid and advise members in times of need. They can't bargain with the employer effectively on their own.

(iv) Heterogeneous Nature of Labour: Since workers come to the factory with varying backgrounds, it is difficult for them to preset a joint front in case of trouble. Employers exploit the situation, under the circumstances, by dividing workers on the basis of race, religion, language, caste, etc.

(v) Lack of Interest: For a large majority of workers, unionism even today remains a foreign issue. In fact, workers avoid union activities out of sheer disinterestedness. Those who become part of the union, do not also participate in the union work enthusiastically. In such a scenario, it is not surprising to find outside political leaders exploiting the situation to serve their own personal agenda.

(vi) Absence of Paid Office Bearers: Weak finances do not permit unions to engage the services of full time, paid office bearers. Union activists, who work on a part-time basis, neither have the time nor the energy to take up union activities sincerely and diligently.

11.6 Functions of Trade Unions

1. ***Militant or protective or intra-mutual functions:*** These functions include protecting the workers' interests, i.e., hike in wages, providing more benefits, job security, etc., through collective bargaining and direct action such as strikes, gheraos, etc.

2. ***Fraternal or extramural functions:*** These functions include providing financial and non-financial assistance to workers during the periods of strikes and lock-outs, extension of medical facilities during slackness and casualties, provision of education, recreation, recreational and housing facilities, provision of social and religious benefits, etc.

3. ***Political functions:*** These functions include affiliating the union to a political party, helping the political party in enrolling members, collecting donations, seeking the help of political parties during the periods of strikes and lock-outs.

4. ***Social functions:*** These functions include carrying out social service activities, discharging social responsibilities through various sections of the society like educating the customers etc.

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11.7 Measures to Strengthen Trade Unions

The following are some of the measures to minimise trade union problems and to strengthen the Trade Union Movement of India:

1. ***United Labour Front:*** Unions must present a joint front. Splinter groups/multiple unions dissipate their energies, dilute their power and reduce their effectiveness. Trade unions should form a sort of labour party and all the trade unions in the country should be affiliated to it. It gives adequate strength to the trade unions both in industry and Parliament.

2. ***Efficient Leadership:*** Outside political leadership has developed due to the absence of internal leadership. Outside leadership is the main cause for the multiple problems of the trade unions. These problems can be eradicated through the development of leadership talents from within. Management should encourage internal workers to lead their own movement. Management and trade unions should provide educational and training facilities for the development of internal leadership.

3. ***Membership Fees:*** The membership fees should be raised as the amount of wages of the workers increased significantly, compared to the situation in 1926 when Trade Union Act provided for the collection of 25 paise per month per member as subscription fee. Even the amended ₹ 1/- is not sufficient. Some other source of finance may also explored to make trade union financially healthy.

4. ***Other Measures***

   (a) Trade unions should extend welfare measures to the members and actively pursue social responsibilities. Social-responsibility of Trade Unions should go beyond their limited constituency within members only.

   (b) The Trade Union Act, 1956 should be amended and the number of members required to form a trade union should be increased from 7 to 50% of the employees of an organisation. Similarly, the scope for the outside leadership should be reduced from 50% to about 10%. The membership subscription should be enhanced from 25 paise to 1% of the monthly wage of the worker.

   (c) Trade Unions should make efforts to raise their declining membership. This is a worldwide phenomenon:

      (i) Japan 50% (1950) - 25% (in 1991)

      (ii) U.S.A. 30% (1959) - 16% (in 1989)

      (iii) India - 2% (in 1989)

      (iv) Trade Unions must broaden their base membership-unorganised sectors, which constitute about 92% of the workforce and IT sectors/BPO-Call Centres - from where most of the employment is coming

      (v) Attracting and retaining new breed of workers by monitoring them.

   (d) Trade Unions must reorient themselves:

      (i) From political/ideology obsession to Business Union-Partners in progress, sharing the gains

      (ii) Protesting organisation to Partnering organisation

      (iii) Bureaucratic organisation to democratic and service organisation

      (iv) Complacency to struggle

      (v) Power-hunger to service orientation

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(e) Trade Unions should be smart, IT savvy; on-line working to have connectivity to employees abroad as also International Trade Unions and other Trade bodies.

(f) Trade Unions have to adapt to new realities in new business environment. "The simple notion of solidarity is now outdated, a narrow concept to encompass the mutual support of those whose positions and interests are different."

   (i) (Zoll - 1996): Solidarity concept is getting diluted because of diversities in work force and increasing individualisation.

   (ii) In order to make members updated Trade unions must organise continuous training and developmental programmes.

   (iii) Future needs smart and responsive Trade Unions, if they have to survive and thrive.

(g) The Trade Union Act should be amended in order to avoid dual membership in central legislation also.

(h) There should be legal provision for the recognition of the representative union.

(i) Unions should not intervene in day-to-day matters. They must focus on important issues affecting workers.

11.8 Trade Union Act, 1926

The Trade Union Act 1926 legalises the formation of trade unions by allowing employees to form trade union. It allows trade union to get registered under the Act. Registration provides legal status to the trade union and it becomes body corporate. It can hold moveable and immoveable property and can enter into contract and can sue and can be sued. The Act also provides immunities to the unions from civil and criminal prosecution for *bona fide* trade union activities. The Union can generate General Fund for the day-to-day activities and Political Fund for political activities (For details - Refer Act).

Though labour organizations came into existence in India in the last decade of the 19th century, it was only after the outbreak of First World War in 1914 that they appeared in the form of modern trade unions. Subsequently, as their numbers increased, membership expanded and they became active in seeking to promote and safeguard the interests of workers, they had to face the open hostilities of the employers and the public authorities. In the absence of any special legislation protecting their status, they received the same set-back under the Common law as their British counterparts did much earlier. Thus, the interpretations given to section 120(B) of the Indian Penal Code dealing with criminal conspiracy, raised considerable doubts regarding the legality of trade unions. Besides, their activities could also be considered in restraint of trade under Section 27 of the Indian Contract Act which provided, "Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind is to that extent void."

The legal position of trade unions under the existing statutes and the Common Law became clearer following a decision of the High Court of Madras in 1921, in a case between *M/s. Binny and Company (Managing Agents of the Buckingham Mills) vs. the Madras Labour Union.* The court basing its decision on the Common Law of England, considered the trade unions as illegal conspiracy and issued injunctions on the leaders of the Madras Labour Union restraining them from instigating workmen to break their contracts with their employer, and ordered their imprisonment. Though the case was withdrawn, the attitude of the courts towards trade unions became obvious. The decision aroused considerable resentment amongst the unionists, and it was rightly apprehended that the history of legal prosecution of the British trade unions during their early days would be repeated in India, also, if the Common Law was not adequately amended by a specific statute guaranteeing to the workers the right to organize. Strong demands were made for a legislation recognizing workers' right to organize and to engage in concerted activities.

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The same year, the Legislative Assembly adopted a resolution moved by N.M. Joshi, the then general secretary of the AITUC, urging immediate steps for registration of trade unions and protection of the legitimate trade union activities. Subsequently, the local governments were requested to ascertain the view of public bodies and private persons on certain connected issues such as the principle of proposed legislation, recognition of strikes, protection of trade unions from civil and criminal liabilities, management of unions, and others. After receiving the view of the local governments, the Government of India drew up a Bill which was introduced in the Legislative Assembly on 31st August 1925. The Bill was passed the next year as the Indian Trade Unions Act, 1926. The Act with subsequent amendments is still in force in the country.

As a result of this legislation, the Indian trade unions escaped that long process of prosecution which the trade unions in Great Britain had to undergo, for about hundred years under the Common Law and the Combination Acts. It is apparent that legal protect to trade unions was made available very early in the history of the Indian trade unions movement. It may not be derogatory to the Indian trade unions to say that, because of this early protection, they have come to miss much of the tightening of muscles, the toughness and the solidarity which the trade unions in Great Britain came to acquire during their struggle for existence.

The Trade Unions Act, 1926 and Legal Framework

Registration

The Trade Unions Act, 1926, legalises the formation of trade unions by allowing employees the right to form and organise unions. It permits any 7 persons to form their union and get it registered under the Act. They must agree to abide by the provisions of the Act relating to registration and submit a copy of the rules of the trade union in their application to the Registrar of Trade Unions. If the union has been in existence for more than one year, the application must be accompanied by a statement of assets and liabilities of the union. The application must contain (a) the names, occupations and addresses of the members (b) name of the union, its head office (c) details about office bearers. After verifying the particulars, the Registrar will issue a certificate of registration in the prescribed form.

Status of a Registered Union

A trade union enjoys the following advantages after registration:

1. It becomes a body corporate
2. It gets a common seal
3. It can buy and hold movable and immovable property
4. It can enter into contracts with others
5. It can sue and be sued in its name.

Cancellation of Registration (Sec. 10)

The Registrar of Unions can cancel the registration of a union on the following grounds:

1. On the application by the union
2. Where the application was obtained by fraud or mistake
3. Where the union has ceased to exist

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4. Where it has willfully and after notice from the Registrar contravened any provisions of the Act or allowed any rule to continue in force which is inconsistent with any provisions of the Act
5. Where the union has rescinded any rule providing for any matter, provision for which is required by Section 6
6. Where the primary objects of the union are no longer in agreement with the statutory objects.

Obligations (Sec. 21)

Under the act it is obligatory for the union to:

1. Allow anyone above the age of 15 years to be a member of the union
2. Collect membership fees not less than 25 paise per month and per member
3. Specify that 50% of office bearers must be from the persons actually employed
4. Maintain membership register, get the books of account audited and make them available to members
5. State the procedure for change of its name, its merger with other unions and its dissolution
6. Spend uniform funds for the purposes specified in the Act.

Rights (Sec. 18)

1. Claim immunity from civil and criminal prosecution for bonafide trade union activities
2. Create a political fund
3. Spend general funds on salaries of staff and meet certain other expenses as stated in the Act
4. Can represent workers to the works committee

If a union is formed by giving wrong information or registration is obtained through fraudulent means, the Registrar of Trade Unions can cancel such registration by giving 2 months' notice stating reasons.

Liabilities

1. A registered union should maintain books of account and a list of members
2. Should keep books and the list open for inspection by members
3. Should have office bearers who do not suffer from the disqualifications prescribed under the TU Act, 1926
4. Should submit statements of receipts, expenditure, assets, liabilities etc., to the registrar of trade unions
5. Should give correct information to persons intending to become members.

Notes

Recognition of Trade Union

The Bombay Industrial Relations Act, 1946, classified the registered unions as:

1. Representative union having a membership of not less than 25% of the total employees as members in an industry;
2. Qualified union having at least 5% of membership in an industry; and
3. Primary union having a membership of at least 15% of employees in an undertaking.

The rights of a Representative union under the Act are:

1. First preference to appear or act in any proceedings under the Act as the representative of employees;
2. Right to submit a dispute for arbitration;
3. To make a special application to the Labour Court to hold an inquiry; and
4. Office-bearers of the union cannot be dismissed or discharged.

One of the long pending problems of the Indian Industrial Relations System is to evolve a satisfactory and acceptable means of setting the problem of recognising a bargaining agent from out of rival unions. Collective bargaining cannot exist and function without recognising the bargaining agent. Since there is no law for compulsory recognition of trade unions, it is left to the choice of the employees. In view of the union rivalry and multiple unions, the employer finds it is difficult to recognise a union in the context of political affiliation. The employer may recognise those unions with the highest number of members. But more than one union may claim the highest number of membership in view of dual and multiple memberships. Efforts have been made to bring about legislative measures for compulsory recognition of unions immediately after Independence.

The Bombay Industrial Relations Act 1946 provided for the largest trade union in an undertaking with a total membership of at least 15% of the workforce. Madhya Pradesh and Rajasthan laid down, more or less, similar conditions for the recognition of a representative union. In other States, unfortunately, there is no statutory provision for union recognition (they follow the Code of Discipline adopted in 1958).

The underlying idea of forming a trade union is to negotiate and bargain with employers to improve the service and employment conditions of workers on their behalf. This collective bargaining process can be possible only when the employer recognises the trade union as a bargaining agent and agrees to negotiate with it because it is difficult to negotiate with multiple trade unions in a single organisation.

The Trade Union Act, 1926, the only Central Law, which regulates the working of the unions, does not have any provision for recognition of trade unions. Some attempts were made to include compulsory recognition in the Trade Union Act in 1947, 1950, 1978 and 1988, but these did not get materialised.

There are, however, state legislations like the Maharashtra Recognition of Trade Union and the Prevention of Unfair Labour Practices Act 1971, the Madhya Pradesh Industrial Relations Act, 1960 and other states like Gujarat, Andhra Pradesh and Orissa, etc., which have gone for such legislations, of late.

Notes

The usual methods used to determine union strength, which is the basis for recognition are the following:

1. ***Election by Secret Ballot:*** Under this system, all eligible workers of an establishment may vote for their chosen union and the elections are to be conducted by a neutral agent, generally the Registrar of Unions, in a manner very similar to the conduct of general elections. Once held, the results of the elections would remain valid for a minimum period, usually for two years.

2. ***Check-off Method:*** Under this each individual worker authorises management in writing to deduct union fees from his wages and credit these to the chosen union. This gives management concrete evidence about the respective strengths of the unions. But the system is also prone to manipulation, particularly collusion between management and a favoured union. Sometimes, genuine mistakes may occur, particularly when the number of employees are large. It also depends on all unions accepting the method and cooperating in its implementation.

3. ***Verification*** of the union membership method by the labour directorate has been adopted as for a resolution in the session of the ILC and is used widely in many establishments. This process is carried out by the labour directorate, which on the invitation of the union and the management of an organisation or industry, collects particulars of all unions in a plant with regard to their registration and membership. The claim lists of the unions, their fees books, membership records and accounts books are scrutinised for duplicate membership. Under a later amendment, unions also made lists of members in order to avoid dual membership. After cross-checking of records, physical sampling of workers, particularly in cases of doubt or duplication, a final verified list is prepared for employers, unions and the government.

4. ***Rule of Thumb*** or intelligent guessing by management or general observation to assess the union strength, either by the response at gate meetings, strikes or discussions with employees. This is not a reliable method, particularly in large establishments and can also be subject to change at short intervals.

Of the above methods, the first one is an universally accepted method used all over the world but there has been no consensus among the trade unions on that in India.

Did u know? The Second National Commission of Labour (2003) considered the issues seriously and made the following recommendations:

1. We recommend that the negotiating agent should be selected for recognition on the basis of the check off system. A union with 66% membership is entitled to be accepted as the single negotiating agent, and if no union has 66% support, then, union that has the support of more than 25% should be given proportionate representation on the negotiating table.

2. Secret ballot is logically and financially a difficult process in certain industries. Check-off system has the advantage of ascertaining the relative strength of trade unions. Check-off system should be made compulsory for all establishments employing 300 or more workers. For establishments employing less than 300 workers also, the check-off system would be the preferred mode. Recognition, once granted, should be valid for a period of four years, to be coterminous with the period of settlement.

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Voluntary Recognition under the Code of Discipline, 1958

With the consensus of employers, employees and the Government, the following criteria for the recognition of unions was drawn up under the Code of Discipline which was adopted at the 16th Indian Labour Conference.

1. Where there is more than one union, a union claiming recognition should have been functioning for at least one year after recognition. This condition does not apply where there is only one union.
2. The membership of the union should cover at least 15% of the workers in the establishment concerned. Membership should be counted only of those who had paid their subscriptions for at least three months during the period of six months immediately preceding recognition.
3. A union may claim to be recognised as a representative union for an industry in a local area if it has a membership of at least 25 per cent of the workers of that industry in that area.
4. When a union has been recognised, there should be no change in the position for a period of 2 years.
5. When there are several unions in an industry or establishment, the one with the largest membership should be recognised.
6. A representative union for an industry in an area should have the right to represent workers in all the establishments in the industry, but if a union of workers in a particular establishment has a membership of 59% or more of workers it should have the right to deal with matters of purely local interest, such as, for instance, the handling of the grievances of its own members. All other workers who are not members of that union might either operate through the representative union for the industry or seek redress directly.
7. Only those unions which follow the Code of Discipline would be entitled to recognition.
8. In the case of trade union federations not affiliated to any of the four central organisations of labour, the question of recognition will have to be dealt with separately.

Verification of Trade Union Membership

Employers often face difficulties (even when observing the above criteria) while verifying the majority character of the union to be recognised when there is more than one union. At present the Labour Department, on the request of the management, does the verification work taking the following things into account:

1. Details of existing unions in the unit, date of registration; whether the existing recognised union has completed a two year period, whether any of the unions violated any stipulations of the Code of Discipline etc. Within 10 days the unions claiming recognition and other existing unions will have to produce documentary proof to the verification officer: details about membership, subscription list of members who have paid subscriptions for 3 months out of the preceding 6 months, money receipt counterfoils, books of account, bank statements, etc.
2. Where there are two or more unions, all of them have to furnish the above details. If they fail to produce the above data, the verification officer may, after giving 10 days' notice, decide the issue as per the evidence collected and facts obtained.
3. The verification process is done in the presence of unions furnishing the above data. The muster rolls of the firm are generally checked to see whether the names tally with the employment register.

4. The concerned unions can recheck the verified list and forward objections, if any, to the verification officer. In case of objections regarding dual membership, the officer talks to the concerned workers and draws his own conclusions (based on personal interrogation).
5. The officer will then submit the report to the Government as well as the management of the firm.

Verification, thus, is a contentious and time-consuming process. Most trade unions in India do not maintain their membership records properly and even after several requests from the Labour Department do not furnish membership register as well as receipts. Again, verifying common names appearing in the Trade Union registers is not an easy task, with claims and counter-claims coming from various quarters. Some of the unions do not agree to the secret ballot too, which is adopted to find out the truth behind the curtain. The 'secret ballot' itself is a dangerous proposition because it creates an election-like atmosphere with some leaders making promises which they will never fulfil. The leaders may try to divide workers along caste, community, religion, linguistic and regional lines. For short-term gains, the leaders may divide the illiterate workers playing on sentimental and emotional issues and, in the process, damage the harmonious relations within the unit permanently.

The Check-off System

Check-off system is, often, being advocated as a useful way of verifying the membership claims of rival unions within a unit. In this system the membership fee is collected through the payroll at the time of payment of wages. The amount so collected by the employer will directly go into the account of the concerned union. The subscription figures of each union following the check-off system, thus, offer reliable evidence of its membership and the same can be used to determine its representative character or otherwise rights of a Representative Union.

The rights of Representative union under the Act are:

1. First preference to appear or act in any proceedings under the Act as the representative of employees;
2. Right to submit a dispute for arbitration;
3. To make a special application to the Labour Court to hold an inquiry; and
4. Office-bearers of the union cannot be dismissed or discharged.

The Code of Discipline mentions the following rights of a recognised union: (a) enter into a collective agreement with employer regarding terms of employment and service conditions (b) collect subscription from members within the premises (c) put up a notice board within the unit and use it for its regular announcements relating to meetings etc. (d) hold discussions with its members inside the unit (e) discuss the grievances of its members with the management (f) inspect any place in the undertaking where any member of the union is employed (g) finally, appoint its nominees on joint consultative bodies and committees.

Multiplicity of trade unions creates problems for both the employer and the trade unions. Therefore, recognition of a trade union as a negotiating agent is a business necessity. Sooner a central legislation is passed and industry and business houses start dealing with recognised unions, the better it will be. Such a device is beneficial for both the employer and the trade unions. It provides strength, it provides opportunity for understanding and mutual appreciation and, thus, provides opportunity for a matured employer-union relationship.

Task Do you think that trade unions in India have served the objectives for which they were formed? Why and why not?

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11.9 Judicial Activism

Indian Constitution provides three limbs of government for its effective functioning. They are; Legislative, Executive and Judiciary. Their functioning is based on the principles of "checks and balances". During the run of government and after a passage of time there are certain legislations which become obsolete and outdated, some became irrelevant, some legislations leave gaps and there are some areas where legislature does not enact law because of political considerations. There are some aberrations that are noticed during the execution of these laws by the Executive wings, which requires either removal or strengthening. The Indian Constitution gives judiciary the power of "judicial review" by which it can intervene and interpret the existing laws in correct perspective and in the best interest of the society. It can invent and reinvent new laws to match the needs of society. Of late, judiciary has moved beyond the beaten track and have gone to intervene in the cases of social and national interest suo moto or through public interest litigations. These are beyond classical jurisprudence practices. The result is that many of the land mark judgements in the field of Child Labour, Bonded Labour, Industrial Pollution and many other vital areas have come and compelled judiciary to take unprecedented stands and give verdict to bring balance and order in the society.

Classical role of judiciary is to follow law/rule/precedent blindly. But today, it takes inspirations from Human Rights Conventions, UNO's charters, ILO's conventions and recommendations and reasoning and logics provided by various national and international bodies. It takes into account the requirements of technological developments, communications through media and unhealthy and unbalanced growth/developments because of these new phenomenon and gives instructions and directions to society to move in right direction. These forces have pressurised judiciary to expand and stretch its role and do social-engineering and by cutting undesirables and adding desirable ones. Social-justice, Economic justice and Political justice enshrined in the preamble of our Constitution gives it the right to intervene in any sphere of Society's functioning. This has given birth to concepts like "Creative justice" or "Innovative justice". This phenomenon is also known as "Judicial Activism". Critics call it "judicial Anarchism" or "judicial despotism" or judicial "adventurism". Whatever it may, it has come to stay and it has impacted our living and working and will continue to do in future also.

After independence we entered the age of socialism and egalitarianism, therefore judiciary was busy in protecting the interest of weaker sections of society by advocating the principles of "social justice", "distributive justice" and "discriminative justice". Such a stance have produced many land marked judgements protecting the interests of workers, some of which have hampered the interest of industry and business. However, trends got reversed after we have entered the age of liberalisation and globalisation where our corporations have to compete with multinationals. Judiciary has realised that our labour and trade unions have been too much protected and pampered. Therefore, time has come to take realistic stand on issues affecting on business and industries. The result is that of late there have been a number of judgements where the High Courts and Supreme Court have given their judgements against populist stand held by our Trade Unions and workers. There are a number of judgements in which both employers and workers have been happy or unhappy.

Both employees and workers have been affected by some judgements. Closure of polluting industries and prohibition of mining activities in forest areas have been resisted by both the parties. Closure and shifting of factories in Agra to prevent pollution to Taj was opposed by owner and workers.

Courts have now started giving importance to Consumer Rights as well as social rights of the workers. Consumers are no more silent spectators. We have a Consumer Protection Act, 1986 which is meant to redress the grievances of the consumers. Both Consumer Courts and Civil Courts are telling workers and their unions that rights are theirs only if in exercising them they do not stand on the right of others.

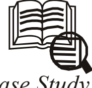
Notes

Caution

Examples of judgements which make Employers happy	Examples of judgements which make Workers happy
Imposition of fine on trade union leaders for indulging in arson, loss of company property, etc. Strike is not a fundamental right.	Regularisation of casual/contract labour. Absorption organization contract labour as regular labour when the system of contract labour is abolished.
Ruling that a strike has not only to be legal, but also justified; Application of the norm of no work no pay in the case of strikes and for those who do union work as against company work.	Striking off of the contents of service conditions and standing orders in matters like treating unauthorised absence for over a week as abandonment of employment.
Restrictions on protest demonstration, political bundhs, etc.	Requirement of a notice of change when the Voluntary Retirement Scheme is introduced because work done by more people will now be required to be done by fewer people.
Decision of the Karnataka High Court upholding the dismissal of the president of the employees' association of a public sector establishment for having criticised its chairman in the media and for having made representation to the Governor.	Ruling of the Supreme Court that the service of employees in an organisation cannot be terminated arbitrarily and abruptly by giving notice of one or three months or pay in lieu of notice.
Decision that in the case of accidents by a bus or lorry, the compensation payable to the victims should be recovered from the earning of drivers.	Abolition of child labour in hazardous industries.

Political bundhs and protest should not penalise our civil rights. The court questions the collective bargaining rights of workers in LIC, when it was found that their agreement was pre-judicial to the interest of policy holders. Telcom Unions in Orissa and Mathadi workers in Mumbai have been asked to pay damage for causing loss to the consumer. Courts are fixing responsibility not only on organisation, but also on individual employees/unions/associations leaders. In some cases, courts are empowering employers to recover money from the Sacred Provident Fund money. The courts have upheld the privatisation of public sectors (BALCO case), despite the protest by public sector workers.

Task Is union influence on the decline? If yes, illustrate arguments with examples from the corporate world.


Case Study

Norman (I) Limited

The Company

The first wall tile manufacturing plant in India was established by Kay Pee in 1963 at Thane in Mumbai under the name Norman tiles. The company was using the brand name 'Norman', a leading international tile manufacturer, Norman International Limited and was paying royalty for the same. The Norman International Limited owned 49% equity in this venture since its inception. With growth in sight the company set up another manufacturing unit at Rampur in the state of Uttar Pradesh with an investment of ₹ 85 million in the year 1981. Initially, at Rampur unit the company was carrying out only partial operations with semi-finished products being supplied by Thane unit. It was only in 1984, that the company started carrying out full operations at the Rampur unit. Since, the market for ceramic tiles started expanding, the company expanded its operations, accordingly. The process of manufacturing wall tile was such that it needed unskilled manpower barring few

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Notes

fitters and electricians. Accordingly, the company hired 400 workers mostly uneducated and unskilled from nearby villages. Few of them were taken for the fitter and mechanic positions. Apart from these, there were sixty staff members looking after the other support functions. The workers were paid low wages and were employed on temporary basis at the beginning and till 1986 most of them were not made permanent. The human resource department was headed by R.C. Jain, who was an experienced professional and was with the firm since its inception.

The Genesis

In 1986, the company ventured into floor tile manufacturing and set up another facility at Rampur unit. This plant was semi-automatic as compared to the wall tile plant which needed manual operations. The machinery of floor tiles unit was bought from Italy and due to the nature of process some experienced workers were shifted from wall tile facility. Slowly, two distinct groups of workers emerged based on the nature of their job and subsequent skills required. First group was that of unskilled workers mostly associated with manual operations and the second group was that of skilled workers looking after technical operations. The second group was paid higher wages than the first group. This disparity led to discontentment among workers but in the absence of union, it never came out as an organised reaction. The first such organised attempt was made by workers in 1988, but a prompt and harsh action from management aborted the workers' bid to form union. However, this event drew management's attention towards workers' grievances and management helped workers to form a union in 1989. The union was named "Bhartiya Crystallisation Mazdur Sangh". However, since most of the workers barring few technical ones were uneducated, they were unaware of roles and responsibilities of union.

The Management started negotiations with the newly formed union and the first wage settlement agreement was signed on January 19, 1990. In this agreement, though the management agreed to increase wages to the extent of ₹ 250 per month, it linked wages to production targets. After three months of this agreement, the union leader left the organisation to join government service. The union was left leaderless. After some time the workers started voicing their concern about the target-linked wages, but in the absence of a leader their concerns could not get a voice. It was at this point that some external labour leaders started inciting the workers. A gate meeting was organised to exploit the situation on September 21, 1990. After this incident, the industrial relations situation further worsened and led to a go-slow movement by workers in January 1991. This affected the productivity of the plant severely. Due to the absence of union leadership, management too, found it difficult to control the situation, since external leaders' influence was very much visible and company's HR Manager R.C. Jain refused to talk to the outsiders. He remained adamant and left the job in March 1991 and the go-slow by the workers continued. In another development, the incumbent, HR Manager Arun Joshi, who took over after Jain left converted variable DA to a fixed DA rate. Since, at that time inflation was spiralling and the rate of DA, elsewhere, was high, the workers refused to accept this provision. Ultimately, under pressure from external leaders as well as workers of the firm, Joshi withdrew the fixed DA and accepted the variable DA provision.

In the meantime, K. N. Trivedi took over as the unit head on May 5, 1991. Before joining this plant, he had served the Indian Air Force for seventeen years and was a strict disciplinarian. The organisational situation demanded quick action to stop go-slow because the company had market share of forty per cent in both the tile categories and the demand for tiles was still going up. The management did not want to lose a single day's production. In a calculated move, the management suspended thirty five workers who were on a go-slow. This was for the first time that any worker was suspended from the plant which instilled a sense of fear in the minds of the workers. As a result of this, workers started working and the productivity of the plant started showing improvement.

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Meanwhile, the management had terminated some of the suspended employees who later on moved to the labour court against management's action on the presumption that labour courts are generally sympathetic to the workers. At the same time, Trivedi started dialogue with the external leaders to end the stalemate. The external leaders put pressure on the management to reinstate the suspended workers. Management agreed to make permanent those employees who were working with the company since its inception and did it with immediate effect. Suspension of some of the workers was also cancelled. Though these efforts helped management in streamlining the production, the attitude of the workers could not be changed totally. The ownership spirit amongst workers could not be developed.

The situation took another ugly turn in February, 1992 when the workers who were suspended earlier tried to create disturbances in the plant. The discontent was further fuelled by bad food provided to the workers in the unit's canteen in March, 1992. Ultimately, this led to formation of a new union "Bhartiya Yuva Sanitary and Crystallisation Mazdur Sangh". This union was not affiliated to any national labour union. However, the leaders were under the influence of Bhartiya Mazdur Sangh (BMS). This union submitted a charter of demands to the management. The demands included grain loan which was a contentious issue because the company had never given any grain loan to the workers. The demands were not accepted by the management. The workers gheraoed Trivedi but the management did not accede to the demands and called the police to intervene.

On March 17, 1992, the workers went on strike, on the call of the union without giving any prior notice. The management terminated seventeen workers during the strike. The strike continued till May 5, 1992. The workers were not paid any wages during the strike period. Since the workers were low wage earners, they were unable to continue the strike for a longer period. The management used the situation to their advantage and accepted only minor demands of sanctioning an advance of ₹ 500 to the workers. The workers accepted the management decision and were willing to restart production. Management reemployed the suspended workforce gradually over a period of fifteen-twenty days. Since, the workers did not receive wages for the strike period, they had realised the importance of their employment.

In October, 1993, the second agreement was signed between management and the union. Between October, 1993 and December, 1996 the productivity and industrial relations were improved. In 1996 the organisation started receiving export orders for its products. The quality requirements for the export orders were stringent. Therefore, the organisation decided to go in for ISO 9000 certification for their Rampur plant. The management realising the importance of workers' involvement in ISO 9000 certification process started training workers on a continuous basis in June, 1996. The in-house training emphasised on house keeping, general hygiene of the workers, standard operation procedure and awareness about all kinds of losses. As a result of continued efforts, ISO 9002 certification was received by the plant in January, 1997. Meanwhile, the third wage agreement was signed between the management and the union for a period of three years in January, 1997. To reinforce the training process, HRD cell with well-equipped in-house training tools was developed in January, 1998. Training programmes focussed on shop-floor excellence and total productive maintenance (TPM). Quality manual for internal use was also developed. The goals for 2000-2001 for the plant were devised as under:

1. Laying of natural gas pipeline
2. ISO 14000 certification
3. Control of losses

Contd...

Notes

4. Reduction in personnel expenditure
5. Team building training

The Rampur plant of Norman had come a long way since its inception. In the words of Trivedi "despite all the bottlenecks we have achieved a satisfactory level of productivity. We still intend to continue doing so by various means. However, I want to build this plant as a community where each member's commitment with the plant remains high. This can only be achieved by inculcating the ownership value. We sincerely believe that this can only be developed by creating a community of Norman in which every member is ensured of a minimum standard of living with all basic amenities and worry free life away from work. We intend to do so by providing medical, educational and vocational training facilities for their families, thereby developing trust between the management and the workers:"

The case was developed by Dr. S.S. Bhakar, Prof. Prashant Mishra (Prestige Institute of Management and Research, Indore), Dr. Ravindra Jain (Pt. Jawahar Lal Nehru Institute of Business Management, Vikram University, Ujjain), Prof. Shantiswaroop (Dayalbagh Educational Institute, Agra) and Mr. K. Shivappa (Kousali Institute of Management Studies, Karnatak University, Dharwad) in the Fourth National Case Writing Workshop organised by Prestige Institute of Management and Research, lndore and sponsored by IMS (Association of Indian Management Schools) on March 11 -13, 2000.

Questions

1. Does formation of trade unions help organisations improve industrial relations?
2. Was it a right strategy to nurture pro-management union leaders?
3. Was it a right strategy adopted by Jain not to recognise and encourage outside leadership for the plant union?
4. "The strategy to instill fear in the minds of workers to improve their productivity was in the interest of the organization." Discuss.
5. In your view, what action should have been taken by the management at various stages to improve labour-management relations?
6. In your view, what are the thrust areas in HR strategy which may improve the competitive strength of the workers?

11.10 Summary

- A trade union is a continuous association of wage-earners for the purpose of maintaining and improving the conditions of their working lives.
- Under the Trade Union Act of 1926, the term is defined as any combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workers and employers or for imposing restrictive conditions on the condition of any trade or business and includes any federation of two or more unions.
- Trade unions in India, as in most other countries, have been the natural outcome institutionally, the trade union movement is an unconscious effort to harness the drift of our time and reorganise it around the cohesive identity that men working together always achieve of the modern factory system. The development of trade unionism in India has a chequered history and a stormy career.
- In 1920 All India Trade Union Congress (AITUC) was formed. The first meeting of the AITUC was held in October, 1920 at Bombay (now Mumbai) under the presidentship of Lala Lajpat Rai. The formation of AITUC led to the establishment of All India Railwaymen's Federation (AIRF) in 1922. Many Company Railway Unions were affiliated to it.

Notes

- There are over 9,000 trade unions in the country, including unregistered unions and more than 70 federations and confederations registered under the Trade Unions Act, 1926.
- Outside leadership has been playing a pivotal role in the Indian Trade Union Movement due to the inability of insiders to lead their movement. The Royal Commission of Labour (RCL) 1931 recommended for the reduction of the statutory limit of outsiders from 1/2 to 1/3 but no efforts were taken in this direction. Outside leadership has been responsible for the slow growth of Trade Unions.
- In view of the evil effects of inter-union rivalry the recommendations of the National Commission on Labour, 1969. To minimise union rivalry are: Elimination of party politics and outsiders through building up of internal leaders, Promotion of collective bargaining through recognition of sole bargaining agents, and Empowering labour courts to settle inter-union disputes if they are not settled within the organisation.
- To minimise trade union problems and to strengthen the Trade Union Movement. Unions must present a joint front. Trade unions should form a sort of labour party and all the trade unions in the country should be affiliated to it.
- Trade unions should extend welfare measures to the members and actively pursue social responsibilities.
- The Trade Union Act, 1956 should be amended and the number of members required to form a trade union should be increased from 7 to 50% of the employees of an organisation.
- The Government of India drew up a Bill which was introduced in the Legislative Assembly on 31st August 1925. The Bill was passed the next year as the Indian Trade Unions Act, 1926. The Act with subsequent amendments is still in force in the country.
- The federation of trade unions also requires registration. It was held in National Organisation of Bank Workers' Federation of Trade Unions vs. Union of India and others (Bombay -1993) that where a federation of Trade Unions is not registered, it is not a trade union under the Act.
- The Supreme Court upheld the writ petition, brought as a class action by certain social activists and NGOs, concerning the fundamental rights of working women with particular reference to the evil of sexual harassment of women at workplaces.

11.11 Keywords

AITUC: All India Trade Union Congress

AIRF: All India Railwaymen's Federation

BMS: Bhartiya Mazdoor Sangh

Reformist or Welfare Unions: Work for changes and reforms within existing socio-political framework of society - European Model.

Revolutionary Unions: Believe in destruction of existing social/economic order and creation of a new one. They want shift in power and Authority and use of force - Left Unions.

Trade Union: A trade union is an association of wage earners for the purpose of maintaining and improving the conditions of their working lives.

Uplift Unions: They advocate extensive reforms well beyond the area of working condition, i.e., change in taxation system, elimination of poverty, etc.

Notes

11.12 Self Assessment

Fill in the blanks:

1. A trade union wants that new laws should be created and old ones should be totally scrapped. This is a ………………….. union.
2. The development of ……………………. in India has a chequered history and a stormy career.
3. A union wants all new recruits to join within a week of employment. Such a compulsion comes under ………….. shop.
4. ………………… unions work for the eradication of social evils like poverty and un-education.
5. …………………… was the first trade union in India.
6. Due to low level of knowledge of members of unions, …………………. has become prominent.
7. In order to stop outside leaders form entering the union extensive ……………… facilities should be provided to the insiders.
8. The formal basis of trade unions in India, is provided by ……………………..
9. A firm has several unions at different levels that have conflicting views. This is a situation of ……………………….
10. Labors conflict with each other due to caste differences. This is due to …………… nature of the labors.
11. Trade unions can be made financially healthy by raising ……………………
12. Registration of trade unions can be cancelled if they obtained it by …………………..

11.13 Review Questions

1. Discuss the objectives and functions of trade unions in India.
2. What is a trade union? How can you make trade unions an effective tool for human relations in India?
3. State briefly the weaknesses of trade unions in India. What should be done to strengthen the trade union movement in the country?
4. Are unions necessary? Should unions be recognised? If yes, how? What should be done to improve trade union finances?
5. Should the Indian industry have a single trade union? Why?
6. How are unions striving to save jobs in the LPG (Liberalisation, Privatisation, Globalisation) era?
7. Why have labour and management tended to treat each other as adversaries in the Indian labour relations system?
8. State the reasons for the formation of Employers' Associations in India, tracing their origin and growth.
9. Do you think that when compared to Labour Unions, Employers' Associations have met the expectations of their members? If yes, how? If not, state the reasons.

Notes

10. Employers' Associations are "rich mens' poor club". Comment.
11. In the light of challenges brought about by new technology, methods and processes, do you think the employer-employee relationship has changed completely? If yes, did the Labour Unions and EAs learn to dance with the times?

Answers: Self Assessment

1.	revolutionary	2.	trade unionism
3.	union	4.	Uplift
5.	Madras Labour Union	6.	outside leadership
7.	training	8.	Indian Trade Union Act, 1920
9.	multiple unions	10.	heterogeneous
11.	membership fees	12.	fraud

11.14 Further Readings

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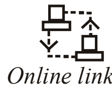
Online links

en.wikipedia.org/wiki/Industrial_relations

www.ilo.org/public; labour.nic.in

Unit 12: The Factories Act, 1948

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Objectives

After studying this unit, you will be able to:

- Discuss objectives of the Act
- Explain scope and applicability of the Act
- Discuss welfare measures
- Describe administrative machinery
- Explain national recommendation of second national commission on labour

Introduction

With the establishment of the Cotton Mill in 1851 and Jute Mill in Bengal in 1855, modern factory system was founded in India. Women and children were employed. There were excessive and long hours of work with little recreation. In 1881, Indian Factories Act was passed which gave protection to the employees especially to the children. The factory commission was appointed in 1890 by the Government of India. On the basis of the recommendation passed by the commission, an Act was passed in 1891 whereby the factory was amended to include premises in which fifty persons or more were employed. The acts were amended from time to time. The Act 1911 was amended in 1922 to implement the inventions on the hours of the work.

In year 1948, the Factories Act, 1934 was revised and its scope extended to include welfare, health, cleanliness, overtime payment and similar measures. The Factories Act was to ensure proper, safe and healthy working conditions in the factories, so the workers may feel interest and while in factories devote their time and labour in the working process of the factory without the fear of accidents and bodily strain. All the provisions of the Factories Act came into force with the effect from 1st December 1987.

12.1 The Factories Act, 1948

The object of the Act is to protect human beings from being subject to unduly long hours of bodily strain or manual labour. It also seeks to provide that employees should work in healthy and sanitary conditions, so far as the manufacturing process will allow and that precautions should be taken for their safety and for the prevention of accidents.

12.1.1 Scope and Applicability of the Act

The Act extends to whole of India. It applies to all factories, including factories belonging to Central or any State Government unless otherwise excluded. The benefits of this Act are available to persons who are employed in the factory and be covered within the meaning of the term "worker" as defined in the Act. It would be desirable to discuss the meaning and definition of the term "factory" and "worker". Since the term "factory" refers to manufacturing process, it would be helpful to know the meaning of the term "manufacturing process" as defined by the Act.

Applicability of the Factories Act, 1948: The Act is applicable to the premises wherein:

(i) 10 or more workers are employed with use of power

(ii) 20 or more workers are employed without the use of power

(iii) Less than 10 workers, if activity is notified by the State Government.

Engaged in manufacturing activities

1. Factories act 1948, is a central act, enforced by the state governments making the relevant rules to extend scope and objectives of the Act.
2. Karnataka State has formulated its rules as envisaged under the Act, and they are called "The Karnataka Factories Rules, 1969".
3. The Act is applicable to all the factories including state, and Central Government.
4. Onus is on the part of the factory management to comply with the provisions of the Act and Rules made there under.

12.1.2 Definitions

1. ***Factory***

   Section 2(m) of the Factories Act, 1948 defines "factory" to mean-

   Any premises including the precincts thereof:

   (i) whereon ten or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on.

   (ii) whereon twenty or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

   It specifically excludes a mine subject to the operation of the Mines Act, 1952, or a mobile unit belonging to the armed forces of the Union, a railway running shed or a hotel, restaurant or eating place.

2. ***Manufacturing Process***

   The expression "manufacturing process" has been defined in Section 2 (k) to mean any process-

   (i) making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing, or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal; or

   (ii) pumping oil, water, sewage, or any other substance; or

   (iii) generating, transforming or transmitting power; or

   (iv) composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding; or

3. ***Worker***

   Section 2 (I) of the Factories Act, 1948 defines a "worker" to mean-

   A person employed, directly or through any agency (including a contractor) with or without knowledge of principal employer, whether for remuneration or not, in any manufacturing process, or in cleaning any part of the machinery or premises used for a manufacturing process or in any other kind of work incidental to, or connected with, the manufacturing process, or the subject of the manufacturing process but does not include any member of the armed forces of the Union.

   Therefore, worker is a person -

   (i) who is employed;

   (ii) who is employed either directly or through any agency;

   (iii) who is employed in any manufacturing process, or in clearing any part of the machinery or premises used for a manufacturing process or in any other kind of work, incidental to or connected with the manufacturing process or the subject of the manufacturing process.

4. ***Occupier***

   Section 2 (n) of the Act defines "occupier" of a factory to mean: The person who has ultimate control over the affairs of the factory.

Provided that:

(i) in the case of a firm or other association of individuals, any one of the individual partners or members thereof shall be deemed to be the occupier;

(ii) in the case of a company, any one of the directors shall be deemed to be the occupier;

(iii) In the case of a factory owned or controlled by the Central Government or any State Government, or any local authority, the person or persons appointed to manage the affairs of the factory by the Central Government, the State Government or the local authority, as the case may be shall be deemed to be the occupier.

Provided further that in the case of a ship which is being repaired, or on which maintenance work is being carried out, in a dry dock which is available for hire:

1. The owner of the dock shall be deemed to be the occupier for the purposes of any matter provided for by or under:

    (a) Section 6, Section 7, Section 7-A, Section 7-8, Section 11 or Section 12;

    (b) Section 17, in so far as it relates to the providing and maintenance of sufficient suitable lighting in or around the dock;

2. The owner of the ship or his agent or master or other officer-in-charge of the ship or any person who contracts with such owner, agent or master or other officer-in-charge to carry out the repair or maintenance work shall be deemed to be the occupier for the purpose of any matter provided for by or under Section 13, Section 14, Section 16. In relation to:

    (a) The workers employed directly by him or by or through any agency; and

    (b) The machinery, plant or premises in use for the purpose of carrying out such repair or maintenance work by such owner, agent, master or other officer-in-charge or person.

12.2 Approval, Licencing and Registration of Factories

The factory has got to be approved and registered, after obtaining a licence by the occupier in accordance with the rules framed by the State Government. The State Governments are empowered to frame rules requiring the occupier of a factory for the purposes of this Act for the submission of plans of any class or description of factories to the Chief Inspector or State Government and to obtain previous permission of the Chief Inspector of Factories with regard to site where factory is proposed to be constructed, or extension, in case the factory already exists.

A factory shall not be deemed to be extended by reason only of the replacement of any plant or machinery, if such replacement or addition does not reduce the minimum clear space required for safe working around the plant or machinery or adversely affect the environmental conditions from the evolution or emission of steam, heat or dust or fumes injurious to health. The occupier is required to submit full building plans, along with necessary particulars of specifications according to which the building has got to be approved in accordance with the rules. The registration, obtaining of licence or renewal of licence, as the case may be, is to be done by the occupier, in accordance with the rule by paying the prescribed fees.

The permission relating to site on which the factory is proposed to be constructed or extension to be executed in the existing factory in accordance with the plan is to be given within 3 months by the authority to which the request is made. If no reply is received within the aforesaid period, the permission is presumed. In case permission is refused, then in that case, the applicant may

appeal to the State Government if the permission is refused by the Chief Inspector or to the Central Government if the permission is refused by the State Government, within 30 days. No license or renewal of license shall be granted unless the occupier gives at least 15 days notice in writing to the Chief Inspector of factories before he proposes to occupy or use any premises as factory.

The notice shall state the full particulars of the factory, namely:

1. the name and situation of the factory;
2. the name and address of the occupier ;
3. the name and address of the owner of the premises or building;
4. the nature of manufacturing process;
5. the total rated horse power installed or to be installed in the factory, which shall not include the rated horse power of any separate standby plant;
6. the name of manager of the factory for the purpose of this Act;
7. the number of workers likely to be employed in the factory;
8. the average number of workers per day employed during the last twelve months, in case the factory is in existence on the date of the commencement of this Act;
9. such other particulars as may be prescribed under the rules [Section 7 (I)].

The occupier is required to give notice to the Chief Inspector of Factories containing the above particulars with regard to those factories which were already functioning before this Act, within 30 days from the commencement of the Act [Section 7 (2)]. Before a factory is engaged in a manufacturing process which is ordinarily carried on for less than 180 working days in a year resumes working, the occupier is required to send full particulars of the factory to the Chief Inspector within 30 days of such resumption of work [Section 7 (3)]. Any change in the appointment of a manager or the factory is to be intimated within 7 days by the occupier to the Chief Inspector, [Section 7 (4)]. During the time no manager functions in the factory, the occupier is deemed as manager for the purpose of the Act. Non compliance with the provisions of Sections 6 and 7 is an offence for which the occupier can be punished.

12.3 The Inspecting Staff

Appointment

For the enforcement of the provisions of the Act, the State Government is empowered to appoint Inspectors having prescribed qualifications. They are of six types: (i) Chief Inspector (ii) Additional Chief Inspectors (iii) Joint Chief Inspectors (iv) Deputy Chief Inspectors (v) Inspectors and Additional Inspectors.

A Chief Inspector shall be appointed by the State Government. Chief Inspector in addition to the powers conferred on him may exercise the powers of an Inspector throughout the State. Likewise, every Additional Chief Inspector, Joint Chief Inspector, Deputy Chief Inspector and every other officer so appointed shall, in addition to the powers of a Chief Inspector, exercise the powers of an Inspector throughout the State.

No person shall be appointed or having been so appointed, shall continue to hold office, which is or becomes directly or indirectly interested in a factory or in any process or business carried on therein or in any patent or machinery connected therewith.

Every District Magistrate shall be an Inspector for his district.

The State Government may also appoint such public officers that it thinks fit to be Additional Inspector for all or any of the purposes of this Act, within such local limits as it may assign to them respectively.

In any area where there are more Inspectors than one, the State Government may declare the powers which such Inspectors shall respectively exercise.

Power of Inspectors

According to Section 9, an Inspector is vested with the following powers, which he may exercise within the local limits under his control. The powers are to be exercised in accordance with the roles framed for this purpose.

(a) he may enter any premises which is used or which he has reason to believe is used, as a factory. He may be accompanied by such assistants, who are in the service of the Government or any local or public authority or with an expert as he thinks fit;

(b) make examination of the premises, plant, machinery, article or substance;

(c) inquire into any accident or dangerous occurrence, whether resulting in bodily injury, disability or not, and take on the spot or otherwise statements of any person which he may consider necessary for such inquiry;

(d) require the production of any prescribed register or any other document relating to the factory;

(e) seize or take copies of an register, record or other document or any portion thereof as he may consider necessary in respect of any offence under this Act, which he has reason to believe, has been committed;

(f) direct the occupier that any premises or any part thereof or any thing lying therein shall be left undisturbed (whether generally or in particular aspects) for so long as is necessary for the purpose of any examination under clause (b);

(g) take measurements and photographs and make such recordings as he considers necessary for the purpose of any examination under clause (b), taking with him any necessary instrument or equipment;

(h) in case of any article or substance found in any premises, being an article or substance which appears to him as having caused or is likely to cause danger to the health or safety of the workers, direct it to be dismantled or subject it to any process or test (but not so as to damage or destroy it unless the same is in the circumstances necessary for carrying out the purposes of this Act) and take possession of any such article or substance or a part thereof and detain it for so long as is necessary for such examination.

Duties of the Inspectors

The Inspectors are required:

(i) to carry out duties as laid down under Section 9 (b) and (c);

(ii) to ensure that statutory provisions and rules framed are carried out properly; and

(iii) to launch prosecutions against factory-owners under the provision of Chapter X of the Act.

Save as is otherwise expressly provided in this Act and subject to the provisions of section 93, if in, or in respect of, any factory there is any contravention of any of the provisions of this Act or of any rules made thereunder or of any order in writing given thereunder, the occupier and manager of the factory shall each be guilty of an offence and punishable with imprisonment for a term which may extend to two years or with fine which may extend to one lakh rupees or with both, and if the contravention is continued after conviction, with a further fine which may extend to one thousand rupees for each day on which the contravention is so continued :

Provided that where contravention of any of the provisions of Chapter IV or any rule made thereunder or under section 87 has resulted in an accident causing death or serious bodily injury, the fine shall not be less than twenty-five thousand rupees in the case of an accident causing death, and five thousand rupees in the case of an accident causing serious bodily injury.

Explanation: In this section and in section 94 "serious bodily injury" means an injury which involves, or in all probability will involve, the permanent loss of the use of, or permanent injury to, any limb or the permanent loss of, or injury to, sight or hearing, or the fracture of any bone, but shall not include, the fracture of bone or joint (not being fracture of more than one bone or joint) of any phalanges of the hand or foot.

Liability of Owner of Premises in Certain Circumstances

1. Where in any premises separate buildings are leased to different occupiers for use as separate factories, the owner of the premises shall be responsible for the provision and maintenance of common facilities and services, such as approach roads, drainage, water supply, lighting and sanitation.
2. The Chief Inspector shall have, subject to the control of the State Government, power to issue orders to the owner of the premises in respect of the carrying out of the provisions of sub-section (1).
3. Where in any premises, independent or self-contained, floors or flats are leased to different occupiers for use as separate factories, the owner of the premises shall be liable as if he were the occupier or manager of a factory, for any contravention of the provisions of this Act in respect of -
   (i) latrines, urinals and washing facilities in so far as the maintenance of the common supply of water for these purposes is concerned;
   (ii) fencing of machinery and plant belonging to the owner and not specifically entrusted to the custody or use of an occupier;
   (iii) safe means of access to the floors or flats and maintenance and cleanliness of staircases and common passages;
   (iv) precautions in case of fire;
   (v) maintenance of hoists and lifts; and
   (vi) maintenance of any other common facilities provided in the premises.
4. The Chief Inspector shall have, subject to the control of the State Government, power to issue orders to the owner of the premises in respect of the carrying out the provisions of sub-section (3).
5. The provisions of sub-section (3) relating to the liability of the owner shall apply where in any premises independent rooms with common latrines, urinals and washing facilities are leased to different occupiers for use as separate factories :

Provided that the owner shall be responsible also for complying with the requirements relating to the provisions and maintenance of latrines, urinals and washing facilities.

6. The Chief Inspector shall have, subject to the control of the State Government, the power to issue orders to the owner of the premises referred to in sub-section (5) in respect of the carrying out of the provisions of section 46 or section 48.
7. Where in any premises portions of a room or a shed are leased to different occupiers for use as separate factories, the owner of the premises shall be liable for any contravention of the provisions of -
   (i) Chapter III, except sections 14 and 15;
   (ii) Chapter IV, except sections 22, 23, 27, 34, 35 and 36:

   Provided that in respect of the provisions of sections 21, 24 and 32 the owners liability shall be only in so far as such provisions relate to things under his control:

   Provided further that the occupier shall be responsible for complying with the provisions of Chapter IV in respect of plant and machinery belonging to or supplied by him; (iii) section 42.
8. The Chief Inspector shall have, subject to the control of the State Government, power to issue orders to the owner of the premises in respect of the carrying out of the provisions of sub-section (7).
9. In respect of sub-sections (5) and (7), while computing for the purposes of any of the provisions of this Act the total number of workers employed, the whole of the premises shall be deemed to be a single factory.

Enhanced Penalty After Previous Conviction

1. If any person who has been convicted of any offence punishable under section 92 is again guilty of an offence involving a contravention of the same provision, he shall be punishable on a subsequent conviction with imprisonment for a term which may extend to three years or with fine which shall not less than ten thousand rupees but which may extend to two lakh rupees or with both:

   Provided that the court may, for any adequate and special reasons to be mentioned in the judgment, impose a fine of less than ten thousand rupees:

   Provided further that where contravention of any of the provisions of Chapter IV or any rule made thereunder or under section 87 has resulted in an accident causing death or serious bodily injury, the fine shall not be less than thirty five thousand rupees in the case of an accident causing death and ten thousand rupees in the case of an accident causing serious bodily injury.
2. For the purposes of sub-section (1), no cognizance shall be taken of any conviction made more than two years before the commission of the offence for which the person is subsequently being convicted.

Penalty for Obstructing Inspector

Whoever wilfully obstructs an Inspector in the exercise of any power conferred on him by or under this Act, or fails to produce on demand by an Inspector any registers or other documents in his custody kept in pursuance of this Act or of any rules made thereunder, or conceals or prevents any worker in a factory from appearing before, or being examined by, an Inspector,

shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to ten thousand rupees or with both.

Penalty for Wrongfully Disclosing Results of Analysis under Section 91

Whoever, except in so far as it may be necessary for the purposes of a prosecution for any offence punishable under this Act, publishes or discloses to any person the results of an analysis made under section 91, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to ten thousand rupees or with both

Penalty for Contravention of the Provisions of Sections 41b, 41c and 41h

1. Whoever fails to comply with or contravenes any of the provisions of section 41B, 41C or 41H or the rules made thereunder, shall, in respect of such failure or contravention, be punishable with imprisonment for a term which may extend to seven years and with fine which may extend to two lakh rupees, and in case the failure or contravention continues, with additional fine which may extend to five thousand rupees for every day during which such failure or contravention continues after the conviction for the first such failure or contravention.
2. If the failure or contravention referred to in sub-section (1) continues beyond a period of one year after the date of conviction, the offender shall be punishable with imprisonment for a term which may extend to ten years.

Offences by Workers

1. Subject to the provisions of section 111, if any worker employed in a factory contravenes any provision of this Act or any rules or orders made thereunder, imposing any duty or liability on workers, he shall be punishable with fine which may extend to five hundred rupees.
2. Where a worker is convicted of an offence punishable under sub-section (1), the occupier or manager of the factory shall not be deemed to be guilty of an offence in respect of that contravention, unless it is proved that he failed to take all reasonable measures for its prevention.

   Whoever knowingly uses or attempts to use, as a certificate of fitness granted to himself under section 70, a certificate granted to another person under that section, or who, having procured such a certificate, knowingly allows it to be used, or an attempt to use to be made, by another person, shall be punishable with imprisonment for a term which may extend to two months or with fine which may extend to one thousand rupees or with both.

   If a child works in a factory on any day on which he has already been working in another factory, the parent or guardian of the child or the person having custody of or control over him or obtaining any direct benefit from his wages, shall be punishable with fine which may extend to one thousand rupees unless it appears to the Court that the child so worked without the consent or connivance of such parent, guardian or person.

   Omitted by the Factories (Amendment) Act, 1987, w.e.f. 1-12-1987 Earlier section 100 was amended by the Factories (Amendment) Act, 1976, w.e.f. 26-10-1976

12.4 Welfare Measures for Workers

This Act provides the general welfare measures for the laborers working in the factory premises. It is a statutory requirement on the part of the employers to provide these basic necessities for the health and safety of the workers. They are of two types – health measures and welfare measures.

12.4.1 Health Measures

Cleanliness

Section 11 of the Factories Act, 1948 provides for general cleanliness of the factory. It lays down that dust, fumes and refuse should be removed daily; floors, stair-cases and passages should be cleaned regularly by sweeping and other effective means, while washing of interior walls and roofs should take place at least once in 14 months and where these are painted with washable water paint, be repainted after every three years and where oil paint is used at least once in five fears.

Disposal of Wastes and Effluents

Section 12 of the Factories Act makes it obligatory on the owner of every factory to make effective arrangements for the treatment of wastes and effluents due to the manufacturing process carried on therein, so as to render them innocuous and for their disposal.

Ventilation and Temperature

The occupier is required to make effective and suitable provisions for securing and maintaining adequate ventilation for the circulation of fresh air at workplaces and to maintain such temperature as will secure to workers reasonable conditions of comfort and prevent injury to health.

Dust and Fume

Section 14 (I) deals with the measures, which should be adopted to keep the workrooms free from dust and fume. Every factory in which by reason of the manufacturing process carried on, there is given off any dust or fume or other impurity of such a nature and to such an extent as is likely to be injurious or offensive to the workers employed therein, or any dust in substantial quantities, effective measures shall be taken to prevent its inhalation and accumulation in any work-room. If any exhaust appliance is necessary for the above purposes, it shall be applied as near as possible to the point of origin of the dust, fume or other impurity and such point shall be enclosed as far as possible.

Artificial Humidification

Section 15 (I) lay down that in respect off all factories in which the humidity of the air is artificially increased, the State Government may make rules:

1. Prescribing standard of humidification;
2. Regulating the methods used for artificially increasing the humidity of the air;
3. Directing prescribed tests for determining the humidity of the air to be correctly carried out and recorded;

4. Prescribing methods to be adopted for securing adequate ventilation and cooling of the air in the workroom.

Overcrowding

The Factories Act, 1948 prescribes that no room of any factory shall be overcrowded to the extent that it is injurious to the health of the workers. In every work-room, each worker should be provided with a minimum space of 9.9 cubic meters.

Lighting

Section 17 (I) provides that in every part of the factory, where workers are working or passing, there shall be provided and maintained sufficient and suitable lighting, natural, artificial or both.

Drinking Water

Section 18 deals with the provisions relating to arrangements for drinking water in factories. In every factory, effective arrangements shall be made to provide and maintain at suitable points conveniently situated for all workers employed therein, a sufficient supply of wholesome drinking water.

Conservancy Arrangements

In every factory, there shall be provided and maintained, separate arrangement for toilets for male and female workers at convenient places. These should be adequately lighted, ventilated and maintained in a clean sanitary condition.

Spittoons

Section 20 (1) lay down that in every factory, there shall be provided a sufficient number of spittoons in convenient places. They shall be maintained in a clean and hygienic condition.

12.4.2 Welfare Measures

(A) ***Washing and Sitting Facilities:*** In every factory, adequate and suitable separate facilities for washing, conveniently situated, should be provided and maintained for the use of both male and female workers. The above facilities provided for the use of female workers, should be adequately screened in order to provide privacy to female workers.

(B) ***The Facilities of First Aid Appliances and Ambulance Room:*** The occupier of factory is required to provide the facility of first aid boxes to be made use of by the workers in an emergency. The first aid boxes or cupboards should be readily accessible and equipped with the prescribed contents. The number of boxes and cupboards should not be less than one for every 150 workers ordinarily employed at any time in a factory. Each first aid box or cupboard should be kept in the charge of a separate responsible person who holds a certificate in first aid treatment recognized by the State Government and readily available to workers during the working hours of the factory.

In every factory where more than 500 workers are ordinarily employed, there should be provided and maintained an ambulance room of the prescribed size, containing the prescribed equipment and in the charge of qualified medical and nursing staff as prescribed and the above facilities should be made available during the working hours of the factories.

(C) ***Canteen, Rest Room and Lunch Rooms Facilities:*** Where 250 workers or more are ordinarily employed, canteen facilities are required to be provided. In every factory where more than 150 workers are employed, adequate and suitable shifters or rest rooms or lunch rooms with provision for drinking water where workers can eat meals should be provided and maintained for the use of workers. These rooms should be well ventilated, sufficiently lighted and maintained in cool and clean condition.

(D) ***Crèches Facility:*** In every factory where more than thirty women workers are employed, rooms of adequate size, well lighted and ventilated, maintained in clean and sanitary condition are to be provided for the use of children below 6 years of age of women workers.

(E) ***Appointment of Welfare Officers:*** The main duty to look after the welfare of the workers lies on the welfare officer of a factory. Therefore, in every factory where more than 500 workers are ordinarily employed, the occupier of a factory is required to appoint such number of welfare officers as may be prescribed by the State Government in this respect.

(F) ***Working Hours of Adult Workers***

1. Section 51 and 54 contain general provisions regarding weekly and daily working hours. According to Section 51, no adult worker shall be required or allowed to work in a factory for more than 48 hours in a week. As regards daily working hours under Section 54, no adult worker shall be required or allowed to work in a factory for more than 9 hours in a day.
2. Section 52 speaks of weekly holiday to the workers of a factory. An adult worker shall not be allowed or required to work in a factory on the first day of the week, i.e. Sunday. But if it becomes necessary to make Sunday a working day, a substituted holiday is made compulsory.
3. Compensatory Holidays to be allowed for the worker who has been deprived of weekly holidays with equal number so lost within the month in which the holidays were due to him or within a month immediately following that month.
4. Every adult worker working in a factory are to be allowed rest during working hours of at least half an hour. This interval is to be so placed as to break the working hours for a maximum of 5 hours at a stretch. This period of 5 hours work can be extended to six hours by the permission of the State Government or subject to the control of State Government by the Chief Inspector on sufficient grounds to be recorded in the permission order.
5. A worker of a factory required to work in excess of the maximum hours of work prescribed under Section 51 and Section 54 is to be paid extra wages for overtime work done by him. Therefore, a worker required working for more than 9 hours in any day or 48 hours in any week shall be paid at twice the ordinary rate of wages for the extra hours of work done by him. Ordinary rate of wages for this purpose shall be the basic wages plus such allowances including the cash equivalent or the advantage accruing through the concessional sale of food grains and other articles made available to workers excluding bonus.

(G) ***Restrictions on Employment of Women:*** No exemption from the provisions of Sec. 54 relative to daily hours of work may be granted in respect of any woman. No woman shall be required or allowed to work in any factory, except between the hours of 6 am and 7 pm. However, there is absolute prohibition on employment of woman between the hours of 10 pm and 5 am.

(H) ***Employment of Young Persons:*** No factory can employ any person unless he has completed fourteen years of age. (Section 67). There is total prohibition in employing children below 14 years of age.

For adolescents, i.e., above the age of 15 years but below 18 years, they also cannot be employed in a factory unless

(i) He as well as the manager of a factory are in possession of certificates of fitness granted by the Certifying Surgeon and

(ii) The adolescent carries with him while at work a token giving a reference to such certificate issued to him.

An adolescent who has been granted certificate of fitness to work as an adult in a factory by the Certifying Surgeon is to be treated as an adult for the purposes of working hours and annual leave with wages.

(I) ***Working Hours for Children:*** The Act regulates the working hours for children above age of 14 years as eligible for employment in a factory. They can be employed for maximum hours of work lasting 4-1/2 hours in a day. The other prohibitions relating to their employment are:

(a) the period of work is to be limited to two shifts only;

(b) the shifts are not to overlap;

(c) the spread-over is not to exceed 5 hours;

(d) the child is to be employed only in one relay;

(e) the spread-over is not to change except once in 30 days;

(f) employment during night, i.e. between 10 p.m. and 6 a.m. is prohibited.

(J) ***Annual leave with wages:*** Section 79 of Act deal with the provisions of annual leave with wages. The basis of calculation of the annual leave to which a worker would be entitled in a year is the earlier calendar year, during which he had worked in a factory.

1. *Qualifying Period:* The minimum number of days which entitles a worker to earn leave is 240 during a calendar year, this period should include:

(i) the days of layoff which may be as a result of contract or agreement or as permissible under Standing Orders;

(ii) the leave earned in the year prior to that in which leave is applied for,

(iii) in the case of female workers, maternity leave for any number of days not exceeding 12 weeks.

If the total period comes to 240 days or more, then the worker in a factory would be entitled to leave with wages in the subsequent calendar year for a number of days calculated at the rate of:--

(i) In the case of an adult, one day for every twenty days of work performed by him during the previous calendar year.

(ii) In the case of a child, one day for every fifteen days of work performed by him during the previous calendar year.

(iii) Unavailed Leave.

If a worker has not availed of a portion of his leave in one calendar year, such remaining portion of leave shall be carried over and added to the leave to be allowed

to him in the succeeding calendar year, subject to the condition that the total number of days to be carried forward would not exceed:

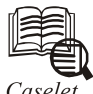
(a) in the case of adult, 30 days;

(b) in the case of child, 40 days;

However, if the worker applied for leave with wages but such leave was not granted to him in accordance with any scheme drawn up under the provisions of this section, then in that case, leave refused shall be carried forward without any limit.

2. *Procedure for Availing of Leave:* A worker who wants to avail of leave is required to make an application to the manager of the factory at least 15 days in advance, except in the case of public utility concern where the application for leave is to be made 30 days in advance. The leave can be availed in 3 installments in a year at the most.

   If the worker wants leave with wages due to him to cover a period of illness, in that case, he need not apply in advance. The wages, in such cases, admissible to him are required to be paid in advance within 15 days and in case of public utility concern, within 30 days from the date of application requesting for grant of leave.



Caselet

States and Worker's Welfare

State Governments have spent less than one-fourth of the ₹ 1,354 crores collected by them from developers and builders over the last six years for welfare measures of construction workers, a study claimed.

"Of the ₹ 1,353.92 crores collected for welfare measures of construction workers by levying one per cent cess on construction activities undertaken by various builders and developers in last six year, a meagre ₹ 305 crores has been utilised for intended purposes. Kerala is the only State which spent 90 per cent of cess amount for its construction workers welfare during the period," the Assocham report said.

According to information compiled by Assocham, Kerala collected a cess of ₹ 254 crores from 2002-08, of which ₹ 227 crores has already been spent towards welfare of its construction workers.

Until 2008, 15 States collected ₹ 1,353.92 crores as cess from the cost of construction activities in their areas but spend only ₹ 305 crores for welfare activities of workers.

The remaining States have not yet collected any cess.

Those which have collected cess include Delhi, Haryana, Rajasthan, Kerala, Gujarat, Bihar, Karnataka, Andhra Pradesh, Tamil Nadu, Himachal Pradesh, Punjab, Orissa, Mizoram, Maharashtra and Uttarakhand.

Source: thehindubusinessline.com

12.5 Administrative Machinery and Safety Measures

These are the basic safety measures to be taken care of when the workers are working near the machinery. These safety rules are designed to make the workplace area safer and to reduce the fear of accidents from the mind of the workers.

(A) ***Fencing of Machinery:*** Section 21 (1) requires that in every factory, the following must be securely fenced by safe guards of substantial construction while the machinery is in motion or use:

(i) every moving part of a prime mover and fly wheel connected to prime mover, whether the prime mover or fly-wheel is in the engine house or not;

(ii) the headrace and tailrace of every water-wheel and water turbine;

(iii) any part of stock-bar which projects beyond the head stock of a lathe; and

(iv) unless they are in such position or of such construction as to be safe to every person employed in the factory as they would be if they were securely fenced, the following, namely,

(a) Every part of electric generator, a motor or rotary converter;

(b) Every part of transmission machinery; and

(c) Every dangerous part of any other machinery.

shall be securely fenced by safeguards of substantial construction, which shall be consistently maintained and kept in position while the parts of machinery they are fencing are in motion or in use.

(B) ***Work on or Near Machinery in Motion:*** Section 22 (I) requires that, where in the factory it is essential to examine any part of the machinery (referred to in Section 21) while it is in motion or as a result of such examination, it is necessary to carry out:

(a) lubrication or other adjusting operation; or

(b) any mounting or shipping of belts or lubrication or other adjusting operation.

Such examination or operation shall be made or carried out only by a specially trained adult male worker wearing tight-fitting clothing (which shall be supplied by the occupier) whose name has been recorded in the register prescribed in this behalf and who has been furnished with a certificate of his appointment, and while he is so engaged:

(a) Such worker shall not handle a belt at a moving pulley unless:

(i) the belt is not more than fifteen centimeters in width;

(ii) the pulley is normally for the purpose of drive and not merely a flywheel or balance wheel (in which case a belt is not permissible);

(iii) the belt joint is either laced or flush with the belt;

(iv) the belt, including the joint and the pulley rim, are in good repair;

(v) there is reasonable clearance between the pulley and any fixed plant or structure;

(vi) secure foothold and, where necessary, secure handhold, are provided for the operator; and

(vii) any ladder in use for carrying out any examination to operation aforesaid is securely fixed or lashed or is firmly held by a second person.

(b) Without prejudice to any other provision of this Act relating to the fencing of machinery, every set screw, bolt and key on any revolving shaft, spindle, wheel, or pinion, and all spur, worm and other toothed or friction gearing in motion with which such worker would otherwise be liable to come into contact, shall be securely fenced to prevent such contact.

(c) Employment of Young Person on Dangerous Machine Section 23 prohibits the employment of a young person on dangerous machine unless he has been fully instructed as to the dangers arising from machine and the precautions to be observed and (i) has received sufficient training in work at the machine, or (ii) is under adequate supervision by a person who has a thorough knowledge and experience of the machine.

(d) Striking Gear and Devices for cutting off power in order to move the driving belt to and from fast and loose pulleys in transmission machine and prevent the belt from creeping back onto the fast pulley, suitable striking gear or other efficient mechanical appliance shall be provided, maintained and used. No driving belt when unused shall be allowed to rest or ride upon shafting in motion. Suitable devices are also maintained in every workroom for cutting off power emergencies.

(e) Self-acting Machines: Section 25 of the Factories Act provides further safeguards to the workers injured by self-acting machines. It provides:

No traversing part of a self-acting machine in any factory and no material carried thereon shall, if the space over which it runs is a space over which any person is liable to pass, whether in the course of his employment or otherwise, be allowed to run on its outward or inward traverse within a distance of forty five centimeters from any fixed structure which is not part of the machine.

(C) ***Casing of New Machinery***: Section 26 (I) provides that in all machinery driven by power, every set screw, bolt or key on any revolving shaft, spindle, wheel or pinion shall be sunk, encased or effectively guarded as to prevent danger. Further, all spur, worm and other toothed or friction gearing not requiring frequent adjustment while in motion shall be completely encased, unless they are safely situated.

Section 26 (2) provides that, whoever sells or lets on hire or, as agent of the seller or hirer, cares or procures to be sold or let on hire, for use in a factory any machinery driven by power which does not comply with the provisions of sub-section (I), or any rules made under sub-section (3), shall be punishable with imprisonment for a term which may extend to three months or with fine which may extend to ₹ 500 or with both. Under the Act, the State Government is empowered to make rules for the safeguards to be provided from dangerous part of the machinery.

(D) ***Hoists and Lifts:*** Section 28 (I) requires that hoists and lifts must be of good mechanical construction, sound material and adequate strength. They should be properly maintained & thoroughly examined at least twice a year by competent persons.

(E) ***Revolving Machinery:*** Section 30 (I) provides that a notice indicating the maximum safe working peripheral speed of the grindstone or abrasive wheel, the speed of the shaft, or spindle, must be permanently affixed on all rooms in a factory where grinding is carried on the speeds indicated in notices under sub-section (I) shall not be exceeded.

Care shall be taken not to exceed tile safe working peripheral speed of every revolving machine like revolving vessel, cage, basket, fly-wheel, pulley, disc or similar appliances run by power.

(F) ***Pressure Plant***: Section 31 (I) provides that effective measures should be taken to ensure safe working pressure of any part of the plant or machinery used in the manufacturing process operating at a pressure above the atmospheric pressure.

(G) ***Pits, Sump and Opening in Floors:*** Section 33 (I) requires that every fixed vessel, sump, tank, pit or opening in the ground or in the floor in every factory should be covered or securely fenced, if by reason of its depth, situation, construction or contents, they are or can be a source of danger.

Section 33 (2) empowers the State Government to grant exemption from compliance of the provision of this section (i) in respect of any item mentioned in the section, (ii) to any factory or class of factories, and (iii) on such condition as may be provided in the rules.

(H) ***Precautions against Dangerous Fumes and Gases:*** In order to prevent the factory workers against dangerous fumes, special measures have been taken under the Factories Act. The Act prohibits entry in any chamber, tank, vat, pit, pipe, flue, or other confined space in any factory in which any gas, fume, vapor or dust is likely to be present, to such an extent as to involve risk to persons being overcome thereby, except in cases where there is a provision of a manhole of adequate size or other effective means of egress.

No person shall be required or allowed to enter any confined space such as is referred to in sub-section (1), until all practicable measures have been taken to actually remove the gas, fume or dust, which may be present so as to bring its level within the permissible limits and to prevent any ingress of such gas, fume, vapor or dust unless.

(I) ***Precaution against using Portable Electric Light:*** The Act prohibits any factory to use portable electric light or any other electric appliance of voltage exceeding 24 volts in any chamber, tank, vat, pipe, flue or other confined space, unless adequate safety devices are provided. The Act further prohibits the factory to use any lamp or light (other than that of flame-proof construction) if any inflammable gas, fume or dust is likely to be present in such chamber, tank, vat, pet, pipe, flue or other confined space.

(J) ***Explosive or Inflammable Materials:*** These measures include: (i) effective enclosures of the plant or machinery used in the process; (ii) removal or prevention of the accumulation of such dust, gas or vapor; (iii) exclusion or effective enclosure of all possible sources of ignition.

(K) ***Precaution in Case of Fire:*** In every factory, all practical measures shall be taken to prevent outbreak of fire and its spread, both internally and externally, and to provide and maintain (i) safe means of escape for all persons in the event of fire, and (ii) tile necessary equipment and facilities for extinguishing fire. Further effective measures should be taken to ensure that in every factory all the workers are familiar with the means of escape in case of fire and have been trained in the routine to be followed in such cases.

(L) ***Safety of Building and Machinery:*** If it appears to the Inspector that any building or part of building or any part of the ways, machinery or plant in a factory is in such a condition that it is dangerous to human life or safety, he may serve on the occupier or manager or both the factory an order in writing specifying the measures which in his opinion should be adopted, and requiring them to be carried out before a specified date.

(M) ***Maintenance of Buildings:*** In order to ensure safety, the inspector is empowered to serve on tile occupier or Manager (or both) of the factory an order specifying the measures to be taken and requiring the same to be carried out, if it appears to him that any building or part of a building in a factory is in such a state of disrepair as is likely to lead to conditions detrimental to the health and welfare of the workers.

(N) ***Safety Officers:*** In order to prevent accidents, the Act provides for the appointment of Safety Officers in factories employing 1,000 or more workers or where any manufacturing process or operations carried on, which process or operation involves any risk of bodily injury, poisoning or disease, or any other hazard to health, to the persons employed in the factory.

Task Assuming that you are the owner of the big chemical factory where more than 500 workers are working. List down all the welfare measures you will take, in your opinion, which are necessary as per the Factories Act, 1948.

12.6 Provisions relating to Hazardous Processes

Section 2 (cb) of the Factories (Amendment) Act, 1987 defines the term "hazardous process" as any process or activity in relation to an industry specified in the First Schedule where, unless special care is taken, raw materials used therein or the intermediate or finished products, by-products, wastes or effluents thereof would:

(i) Cause material impairment to the health of the persons engaged in or connected therewith, or

(ii) Result in the pollution of the general environment.

Provided that the State Government may, by notification in the Official Gazette, amend the First Schedule by way of addition, omission or variation of any industry specified in the said Schedule.

The State Government has set up a committee for the critical analysis of the factory location before granting the permission to set up the hazardous process or expansion of such factories.

Notes

Constitution of Site Appraisal Committee

The State Government may, for purposes of advising it to consider applications for grant of permission for the initial location of a factory involving hazardous process or for the expansion of any such factory, appoint a Site Appraisal committee consisting of:

(a) the Chief Inspector of the State who shall be its Chairman;

(b) a representative of the Central Board for the prevention and control of water pollution appointed by the Central Government under Section 3 of the Water (Prevention and Control of Pollution) Act, 1974;

(c) a representative of the Central Board for the prevention and control of air pollution referred to in Section 3 of the Air (Prevention and Control of Pollution) Act, 1981;

(d) a representative of the State Board appointed under Section 4 of the Water (Prevention and Control of Pollution) Act, 1974;

(e) a representative of the Central Board for the prevention and control of air pollution referred to in Section 5 of the Air (Prevention and Control of Pollution) Act, 1981;

(f) a representative of the Department of Environment in the State;

(g) a representative of the Meteorological Department of the Government of India;

(h) an expert in the field of occupational health; and

(i) a representative of the Town Planning Department of the State Government, and not more than five other members who may be co-opted by the State Government who shall be:

    (i) A scientist having specialized knowledge of the hazardous process which will be involved in the factory,

    (ii) A representative of the local authority within whose jurisdiction tile factory is to be established, and

    (iii) Not more than three other persons as deemed fit by the State Government.

Contd...

The Site Appraisal Committee shall examine an application for the establishment of a factory involving hazardous processes and make its recommendation to the State Government within a period of ninety days of the receipt of such application in the prescribed form.

Where any process relates to a factory owned or controlled by the Central Government or to a corporation or a company owned or controlled by the Central Government, the State Government shall co-opt in the Site Appraisal Committee a representative nominated by the Central Government as a member of that Committee.

The State Appraisal Committee shall have power to call for any information from the person making an application for the establishment or expansion of a factory involving a hazardous process.

Where the State Government has granted approval to an application for the establishment or expansion of a factory involving a hazardous process, it shall not be necessary for an applicant to obtain a further approval from the Central Board or the State Board established under the Water (Prevention and Control of Pollution) Act, 1974 and Air (Prevention and Control of Pollution) Act, 1981.

12.6.1 Compulsory Disclosure of Information by the Occupier

1. The occupier of every factory involving a hazardous process shall disclose in the manner prescribed all information regarding dangers, health hazards and the measures to overcome them arising from the exposure to or handling of the materials or substances in the manufacture, transportation, storage and other processes to: (i) Workers employed in the factory (ii) the Chief Inspector, (iii) the local authority within whose jurisdiction the factory is situated and (iv) general public in the vicinity.
2. Section 41-B (2) provided that at the time of registering the factory involving a hazardous process, the occupier shall lay down a detailed policy with respect to the health and safety of the workers and intimate such policy to the Chief Inspector and the local authority.
3. Such information shall include accurate information as to the quantity, specifications and other characteristics of wastes and manner of their disposal (Sub-section 3).
4. Every occupier, with the approval of the Chief Inspector, shall draw up an on site emergency plan and detailed disaster control measures for his factory and make known to the workers employed therein and to the general public living in the vicinity of the factory the safety measures required to be taken in the event of an accident taking place. [Sub-section 4]
5. Every occupier of the factory is under an obligation to inform the Chief Inspector of the nature and details of the process in such form and in such manner as may be prescribed. [Sub-section 5].
6. On contravention of the provisions of sub-section (5), the licence issued under Section 6 to such factory shall, be cancelled and the occupier shall be liable to penalty. (Sub-section 6).
7. The occupier of the factory involving a hazardous process shall, with the previous approval of the Chief Inspector, lay down measures for the handling, usage, transportation and storage of hazardous substances inside the factory premises and the disposal of such substances outside the factory premises and publicise them in the prescribed manner among the workers and the general public living in the vicinity. (Sub-section 7).

12.6.2 Powers of Central Government to Appoint Inquiry Committee

1. The Central Government may, in the event of the occurrence of an extraordinary situation involving a factory engaged in hazardous process, appoint an Inquiry Committee to inquire into the standards of health and safety observed in the factory with a view to finding out the causes of any failure of neglect in the adoption of any measures or standards prescribed for the health and safety of the workers employed in the factory or the general public affected, or likely to be affected, due to such failure or neglect and for the prevention and recurrence of such extraordinary situations in future in such factory or elsewhere.
2. The Committee appointed under sub-section (1) shall consist of a Chairman and two other members and the terms of reference of the Committee and the tenure of office of its members shall be such as may be determined by the Central Government according to the requirements of the situation.
3. The recommendation of the Committee shall be advisory in nature.

12.6.3 Emergency Standards

1. Where the Central Government is satisfied that no standards of safety have been prescribed in respect to a hazardous process or class of hazardous processes, or where the standards so prescribed are inadequate, it may direct the Director-General of Factory Advice Service and Labour Institutes (DGFASLI) or any institution specialized in matters relating to standards of safety in hazardous processes, to lay down emergency standards for enforcement of suitable standards in respect of such hazardous processes.
2. The emergency standards laid down under sub-section (I) shall, until they are incorporated in the rules made under this Act, be enforceable and have the same effect as if they had been incorporated in the rules made under this Act.

12.6.4 Worker's Participation is Safety Management

1. The occupier shall, in every factory, where a hazardous process takes place, or where hazardous substance are used or handled, set up a Safety Committee consisting of equal number or representative of workers and management to promote co-operation between the workers and management in maintaining proper safety and health at work and to review periodically the measure taken in that behalf:

   Provided that the State Government may, by order in writing and for reasons to be recorded, exempt the occupier of any factory or class of factories from setting up such a Committee.
2. The composition of the Safety Committee, the tenure or office of its members and their rights and duties shall be such as may be prescribed.

12.6.5 Right of Workers to Warn about Imminent Danger

1. Where the workers employed in any factory engaged in a hazardous process have reasonable apprehension that there is a likelihood of imminent danger to their lives or health due to any accident, they may bring the same to the notice of the occupier, agent, manager or any other person who is in charge of the factory or the process concerned directly or through their representatives in the Safety Committee and simultaneously bring the same to the notice of the Inspector.

2. It shall be the duty of such occupier, agent, manager or the person in charge of the factory or process to take immediate remedial action, if he is satisfied about the existence of such imminent danger and send a report forthwith of the action taken to the nearest Inspector.

3. If the occupier, agent, manager or the person in charge referred to in Sub-section (2) is not satisfied about the existence of any imminent danger as apprehended by the worker, he shall, nevertheless, refer the matter forthwith to the nearest Inspector whose decision on the question of the existence of such imminent danger shall be final.

12.7 Recommendation of the National Commission on Labour

The Government of India has set up the second national labour on 15th October, 1999. The commission has made valuable suggestions to improve the harmonious relations among the laborers working in the factory premises. It is an umbrella of the legislation to ensure a minimum level of protection to the workers in the unorganized sector. It has recommended that-

1. Existence of child labour in hazardous industries is a major obstacle for Indian government and steps should be taken to eradicate it from the country. For this, a special scheme of establishing the special schools to provide the non-formal education, vocational training, supplementary nutrition, stipends, health care, etc. should be provided to children withdrawn from employment in hazardous industries.

2. Ministry of labour in 1978 formulated a scheme for the rehabilitation of the bonded laborers. The responsibility for the identification, release and rehabilitation of the free bonded laborer rest entirely with the state government. Bonded laborers on release is paid immediately ₹ 1000/- as subsistence allowance and is rehabilitated as per the situation with a rehabilitation packages of ₹ 10,000 keeping in view the price escalation and increase in the cost of the rehabilitation packages.

3. With the intention to focus on the heath of the women workers & to improve their conditions, a women cell has been set up which provides the opportunities for increasing the employment opportunities for women & providing grants & aids to the voluntary organizations for carrying out the research on the problems faced by the women workers. It also helps the women to be aware of their rights and opportunities so as to become economically independent.

4. To achieve for the occupational safety and health of the workers, the Directorate General of Mines Safety (DGMS) and Directorate General of Factory Advice Services and labour Institutes(DGFASLI) have been set-up in mines, ports and factories. It monitors the working environment, man-machinery interface training and safety requirements of the workers.

5. It also recommended that the formation of the craft and occupation trade unions should be discouraged and formation of the industrial trade unions and industrial federations should be encouraged.

6. Penalties may be legally provided to curb a management policy of victimization and similar unfair labour practices which prevent the emergencies of internal leadership.

7. It also entrusts the labour bureau to be responsible for collection, compilation and publication of the labour statistics and other information regarding employment, wages, earnings, industrial relations, working conditions, etc. It also complies and publishes the data related to consumer price index numbers for industrial and agriculture workers.

8. It also recommends educating the workers to help them avoid the wasteful expenditure, adopting cost effectiveness and by enhancing productivity of the qualitative nature. It

includes rural awareness programmes, adult literacy classes, participative management, etc.

9. It is also responsible for the social security and welfare of the working laborers through certain Acts like the Workmen's Compensation Act, 1923, the Employees State Insurance Act, 1948, etc.

Case Study

Variable Pay

Nitin Arora was wrapping up for the day, when his phone rang.

"Hi, Nitin, Anil here. Can I pop in for a few minutes?"

"Yes, if you can be here in two minutes flat" Arora said.

"You got it," the other man said and hung up.

Anil Mathur was a Brand Manager at Care Soft, a large fast-moving consumer products company. In fact, it was Arora who had, as the Chief of HR at Care Soft, recruited Mathur from a medium-sized company in Mumbai. Over the years, they had built up a good rapport. In any case, Arora was known to be one of the more friendly top executives in the company. He had to be; he was after all the HR guy.

Arora had a vague idea of what Mathur might want to discuss, but he decided to frame his replies as he went along.

As promised, the 36-year-old brand manager was in Arora's room in less than two minutes.

"When was the last time we had a semi-formal meeting like this one?" Arora asked his guest.

"I don't remember, may be six months ago," Mathur replied.

"8:30 on a Friday evening, you've made me stay back. So this had better be important," Arora pretended to threaten his colleague.

"You are darn right, this is important," said Mathur. "I am unhappy with my pay hike for last fiscal."

"But you got your letter a month ago, why are you bringing it up only now?" Arora asked.

"I have been thinking about it, and trying to find out if I am the only one feeling let down by the new variable pay scheme," said Mathur.

A little over a year ago, Care Soft had decided to replace its fixed compensation system with variable pay. In fact, the whole exercise was done in three months flat, and implemented with little advance notice to the employees, who were not altogether surprised since the word had gotten around as soon as the HR consultancy was hired to draw up the new compensation structure. An article in the in-house magazine and an e-mail from the CEO announced the scheme.

The company, which had a turnover of ₹ 1,200 crore the previous fiscal, hadn't yet moved to stock options, but it had introduced a profit-sharing plan. The variable component, usually paid out annually, was linked to the performance of both the individual and his

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team. Understandably, individual performance had a higher weightage than team performance. That apart, there were peer incentives for team and individual performances. These rewarded performance in kind – a paid holiday, gift vouchers, or gifts.

Since the concept of variable pay was new to Care Soft, it had decided to implement it at only the senior and middle management levels, apart from shopfloor workers, leaving out the junior management. The senior management – starting from a general manager to the CEO – had a variable component ranging from 15-40 per cent. Those below had just 5-15 per cent in variable pay.

Mathur, as a brand manager, came in at the general manager level. And last year had been particularly bad for the toothbrush division he headed. Volume sales had dropped by 5 per cent, and rupee sales by 15 per cent because of price cuts, promotions, and discounts. Besides, a new toothbrush that had been slated for launch in the second half of last year hadn't been launched. This was a low-end brush that was expected to rake in ₹ 1 crore in sales.

Fiscal 2001-02 was the first full year of variable pay, and Arora could tell that the executives weren't happy with it. Already, a VP and another general manager had made their displeasure known to Arora. Mathur leaving would not only encourage the other two to follow suit, but also impact the new pay plan.

"My performance targets were unreal," continued Mathur. "Show me one company that has increased its toothbrush sales and I'll walk out of this room and never complain."

"True," said Arora. "But look at it from the organisation's point of view. There are other units that have taken a hit, with the result that our sales for last year were down. We've tried to do the best under the circumstances."

"Probably, but why penalise me for somebody else's fault," Mathur complained.

"I don't understand."

"I am referring to the new toothbrush that my team was supposed to launch in the second half of last year," Mathur explained. "We couldn't introduce it because the design team sat on it for a long time, and then the engineering team took its own sweet time bringing it into production. By the time we were ready to go, we realised that the launch expense wouldn't be worth it. The variable component in my compensation is 20 per cent and it's been a double-whammy for me. The fact that we didn't meet our targets ensured zero-increase in my incentives, and the increase in base pay doesn't even beat the rate of inflation."

"Anil, don't forget that most of us in Care Soft are in the same boat. That said, I do think we have an issue here. Here's what I can promise: I'll put forth these issues to the compensation committee. I cannot promise anything else."

Both men looked at the clock on Arora's table. It was well past 10.

"I have to pick up medicines for my son," said Arora. "If I don't find a chemist open now, I'll be signing my divorce papers tomorrow." Both men laughed and parted.

On Monday, the first thing Arora did was to call his CEO, Rishab Patel, and advise him to convene a Compensation Committee meeting.

"This week I have a diary so full that a knife wouldn't go through it," the CEO told Arora. "Do me a favour, Nitin. I'll send out the meeting request, but could you handle it?"

"But how can we decide on anything without you being there?" Arora asked.

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"Don't. Flesh out the issues and keep them ready for me. Let me finish with our foreign partners' visit this week"

"Should we have the meeting next week in that case?"

"No, go ahead. We can have a second meet next week."

One thing that had irked Arora all along was the fact that Patel seemed inadequately concerned with HR problems. He was more concerned about what he called "strategic issues".

By afternoon, Arora had got a confirmation to the meeting request sent out by Patel. The committee would meet on Wednesday pre-lunch. ("Can't tackle HR post lunch," somebody had wise-cracked in acknowledgement.)

Care Soft's Compensation Committee comprised, apart from Patel and Arora, the CFO Narayan Shastri, coo Niranjan Roy, Director (Marketing) Utpal Sinha, a principal from the consulting company that had drawn the new compensation structure Anurag Kesaria, and an independent director, who was a chartered accountant by profession, and widely regarded for his management wisdom – Raman Behl.

The agenda for the meeting had already been circulated the previous day. Therefore, all the men were aware of the issues at hand.

"How widespread is the discontent, Nitin?" Coo Roy set the ball rolling.

"I have reason to believe that it is quite widespread," said Arora, "although only a handful of people have taken it up with me so far."

"In that case, may be we are over-reacting," said Shastri. "We need to give the new system more time. After all, it's just a year old."

"I don't think one can possibly over-react to such an issue," noted Behl. "The worst thing that we can do now is to let the morale take a hit."

"I agree," said Arora.

"I couldn't agree more," added Sinha, Director of Marketing. "I just can't afford to lose any of my men. And certainly not good men like Anil Mathur. I don't care if we have to pay him more."

"That's not a good idea," pointed out Arora... "We cannot be seen as being selective in our rewards. The whole idea behind variable pay was to motivate people across the board with the promise of greater rewards for better performance. We cannot make changes arbitrarily."

"Then, may be we didn't implement the new structure properly," bristled Sinha. "Or may be we should simply revert to the old fixed system, which according to me worked just fine."

"You are right about poor implementation," consultant Kesaria said. "But it would be a strategic mistake to bring back the old system. After all, the reasons why we introduced variable pay still hold. The business environment is changing, and we cannot afford to reward people based on the quaint notion of entitlement. Executives have to justify what they earn."

"Besides," the Chief Financial Officer, Shastri, intervened, "variable pay is a great way to control costs and improve productivity. Not to mention that such a system automatically attracts high-calibre people."

"Yes, when the going is good in the market, there is no problem with variable pay," noted Sinha. "But when the markets crash, like they have now, your profits shrink. Do you then

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ask people to forget all the hard work they've done, and say 'sorry, can't give you any increments because we've had a bad year'. Believe me, it will take less than six months to clean out talent from this company. Don't forget that the next year is going to be equally bad for FMCG companies."

"The IT industry is not only benching people, but asking them to take pay cuts," pointed out Shastri.

"May be," retorted Sinha. "But how many code-jocks can join insurance, banking, pharma, or any other industry as marketing heads or even CEOS? And asking people to deliver 15 per cent growth in a market that is shrinking is the surest way of losing them."

"Actually it is worth looking at what is going wrong with the system," said Behl. "As I understand it, even shop-floor workers – whose variable pay is linked to productivity – are affected since the company has cut back on production to liquidate dealer inventory."

"As far as I can see," said Kesaria, "it seems to be a problem of implementation. May be we didn't communicate adequately, perhaps we need to tweak our measurement systems, review them more frequently and reward people closer to the date of their achievements."

"That is a good idea," said Behl. "Money may not be the only reason why people work, but it is one of the biggest reasons. Besides, a change like this needs significant lead time. It's a cultural change and people must be prepared for it."

"I would have loved to do this over a period of one year," defended Arora. "But I was asked to implement it within three months of the board deciding on it. Besides, where is the top management commitment to this initiative? Who is the champion of this variable pay? I could be, but it will have more credibility if the CEO also showed that he was committed to it."

Questions

1. How to convince people like Mathur that variable pay will actually help them in the long run?
2. How to achieve a buy-in across the organisation?
3. How to rectify some of the errors the company may have made in its implementation?
4. Finally, should the company scrap variable pay and return to the fixed system?

Source: Business Today, June 9, 2002.

12.8 Summary

- The Factories Act, 1948 protects human beings from being subject to manual laborer and long hours of bodily strain.
- This Act is applicable to whole of India.
- Occupier has the control over the affairs of the factory.
- Responsibility for getting the premises approved when the factory is to be established lies on the responsibility on the occupier.
- There are health, safety and welfare measures included in this Act.
- Second national commission on labor provided recommendation on welfare measures of the workers.

12.9 Keywords

DGFSALI: Director-General of Factory Advice Services & Labour Institutes.

Health: It is a general state of physical, mental and emotional well-being.

Industrial hygiene: The promotion and maintenance of highest degree of physical, mental and social well-being of workers.

Occupier: It is the person who has ultimate control over the affairs of the factory.

Precincts: It is the space enclosed by the wall.

Premises: It is the open land or land with building or building alone.

Safety: It is the protection of a person's physical health.

Welfare officer: The person who is appointed to look after the welfare of the workers in the factory.

Worker: Any person employed directly or indirectly in any manufacturing process.

12.10 Self Assessment

State whether the following statements are true or false:

1. If an unsafe working condition exists, an employee should quit.
2. Today employees are not obliged to give their employees safe, healthy & secure safety efforts.
3. Designing of the safety policies & rules is an important aspect of factories act, 1948.
4. Every factory should have canteen if the number of workers are 50.
5. The factories act make provisions for the recreational facilities for the workers & their children.
6. In every factory suitable arrangements for sitting shall be maintained & provided for all workers obliged to work in a standing position.

Fill in the blanks:

7. …………………. is appointed in to investigate the factory premises before granting the licence.
8. A person who is employed directly or through agency in the factory premises is called……………….
9. Registration and renewal of licence is done by the ……………….. of the factory.
10. …………………. are appointed in factories employing 1000 or more workers.
11. ……………..is entrusted by the government to lay down the emergency standards for the enforcement of hazardous process.

12.11 Review Questions

1. You are the owner of the factory. Elaborate on your responsibilities in the factory.
2. What are the provision for women and children working in a factory? Are they sufficient? Justify.

3. What are the shift working provisions? Do they require change? Elaborate.
4. Analyse the consequences if occupier fails to discharge his responsibility properly.
5. Analyse the recommendations of second National Commission on Labour for the welfare. Are they meeting the requirements? Justify giving recent examples from the industry.
6. Elaborate the leave provisions as per Factories Act, 1948. Do you think they are sufficient?
7. What are the provisions of working hours, closing and opening hours and holidays?
8. Taking the example of TISCO, elaborate the welfare measures taken by the company for its workers.
9. Why do you think there is need for the safety measures in the factories?
10. "An unhealthy work environment can lower the productivity, contribute to low morale & increases medical & workers compensation cost". Did you agree? Justify.
11. Analyse the provisions which the factories owner must take in order to set up the process where hazardous affluent will be received?
12. Do you think there is a need for the inspecting officer in the factory? Why?
13. While working near the machines, there are certain precautions to be observed. Elaborate on the safety measures while working near the machines.
14. You are appointed as inspecting officer for a factory. What do you think is your role and powers for the profile you are appointed.
15. Bring out the procedure for getting the licence for the factory.

Answers: Self Assessment

1. False
2. False
3. True
4. False
5. False
6. True
7. inspecting officer
8. worker
9. occupier
10. safety officer
11. DGFASLI

12.12 Further Readings

Books

B D Singh, *Labour Laws for Managers*, Excel Books, New Delhi.

Monal Arora, *Industrial Relations*, Excel Books, New Delhi.

V S P Rao, *Human Resource Management*, Excel Books, New Delhi.

Online links

www.opm.gov

www.ncci.com

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Unit 13: Industrial Law

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Objectives

After studying this unit, you will be able to:

- Discuss Employees' Provident Funds and Miscellaneous Provisions Act, 1952
- Describe Employees' Provident Fund Scheme, 1952
- State Employees' Pension Scheme, 1995
- Understand Employees' Deposit-linked Insurance Scheme, 1976.
- Explain Payment of Gratuity Act, 1972

Notes

Introduction

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 is a social welfare legislation enacted for the purpose of institution of provident fund for employees in factories and other establishments. The provisions are intended for the better future of the industrial worker on his retirement and also for his dependents, in the event of his death in the course of employment. Gratuity is the gift or a present received by the employee from his organisation for the services rendered by him. The Payment of Gratuity Act, 1972 provides a scheme for the gratuity payment to employees engaged in factories, mines, oilfields, plantations, ports, railways, etc. welfare measures like pension, provident fund, gratuity, etc are in confirmation with the directive principles of State Policy of the Constitution of India.

13.1 Workmen Compensation Act, 1923

Workmen Compensation Act is an Act to provide for the payment by certain classes of employers to their workmen of compensation for injury by accident. Where as it is expedient to provide for the payment by certain classes of employers to their workmen of compensation for injury by accident.

Object: The objective of this Act is that in the case of an employment injury Compensation is provided to the injured workman and in case of his death to his dependants.

Employer to pay compensation: In case a individual injury is caused to a workman by accident arising out of and in the course of his employment, his employer is liable to pay compensation in accordance with the provision of the Act within 30 days from the date when it fell due otherwise he would also be liable to pay interest and penalty.

When employer is not liable: In case the disablement of workman is three or less days; except in case of death when the injury is caused due to influence of drink or drug taken by the workman or upon his wilful disobedience to obey safety rules or removal of safety guards by him.

Amount of compensation: In case of death:- an amount equal to 50% of the monthly wage multiplied by the relevant factor as given in Schedule IV of the Act or ₹ 80,000/- whichever is more. In case of permanent total disablement, it is 60% or ₹ 90,000/- whichever is more In case of permanent partial disablement occurs then the compensation is proportionate to the disability arrived as at (2) above.

Notice: An injured person or his dependants have to give a notice to the employer to pay compensation.

Claim: Upon the failure or refusal of an employer to give compensation, an application is to the made in Form - F to the Commissioner under the Workmen’s Compensation Act, 1923 who is the Assistant Labour Commissioner or the Labour-cum-Conciliation Officer of the area where the accident took place or where the claimant ordinarily resides or where the employer has his registered office. After hearing both the parties, the Commissioner decides the claim.

Contracting out: Any contract or agreement whereby an injured person or his dependant relinquishes or reduce his right to receive compensation is null and void to that extent

Appeal: An appeal lie to the High Court against the orders of the Commissioner with regard to the awarding or refusing to award compensation, or imposing interest or penalty, or regarding distribution of compensation etc.

Recovery: The amount of compensation awarded by the Commissioner is to be recovered as arrears of land revenue.

13.2 The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

This Act provides for the institution of Compulsory Provident Fund, Family Pension Fund and Deposit Linked Insurance Fund for the benefit of the employees. The object of the Act and the scheme framed there under is to ensure that all industries, to which the Act has been made applicable, establish compulsory provident fund for employees with effect from the date when the scheme has been declared applicable to them.

Object of the Act: The Act was passed with a view to making some provision for the future of the industrial worker after his retirement or for his dependents in case of his early death and of inculcating the habit of saving among the workers. The object of the Act is to provide substantial security and timely monetary assistance to industrial employees and their families when they are in distress and/or unable to meet family and social obligations and to protect them in old age, disablement, early death of the bread-winner and in some other contingencies.

The Act provides for a scheme for the institution of provident fund for specified classes of employees. Accordingly, the Employees' Provident Fund Scheme was framed under Section 5 of the Act, which came into force on 1st November 1952.

Applicability of the Act: The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 is applicable from the date of functioning or date of set-up of establishments, provided the factory/establishment employed twenty or more persons. The Act, however, does not apply to co-operative societies employing less than 50 persons and working without the aid of power. The Central Government is empowered to apply the provisions of this Act to any establishment employing less than 20 persons after giving not less than two months' notice of its intention to do so by a notification in the Official Gazette. Once the Act is applied, it does not cease to be applicable, even if the number of employees falls below 20. An establishment/factory, which is not otherwise coverable under the Act, can be covered voluntarily with the mutual consent of the Act.

Employees Entitled: Every employee, including the one employed through a contractor, who is in receipt of wages up to ₹ 6500/- p.m. shall be eligible for becoming a member of the funds.

Notes

1. If the pay of a member-employee increases beyond ₹ 6500 after his having become a member, he shall continue to be a member but the contribution payable in respect of him shall be limited to the amount payable on monthly pay of ₹ 6500.
2. An employee ceases to be member of the Employees' Family Pension Fund at the age of 60 years. The Employees' Family Pension Fund has been replaced by Employees' Pension Fund w.e.f. 16.11.95.

13.3 The Employees' Provident Fund Scheme, 1952

The statutory rate of contribution to the provident fund by the employees and the employers, as prescribed in the Act, is 10% of the pay of the employees. The Act provides that the Central Government may enhance the statutory rate of contribution to 12% of wages in any industry or class of establishments.

The contributions received by the Provident Fund Organisation from unexempted establishments as well as by the Board of Trustees from exempted establishments shall be invested, after making payments on account of advances and final withdrawals, according to the pattern laid

Notes

down by the Government of India from time to time. The exempted establishments are required to follow the same pattern of investments as is prescribed for the unexempted establishments. The provident fund accumulations are invested in government securities, negotiable securities or bonds, 7-year national saving certificates or post office time deposits schemes, if any.

13.3.1 Employer's Obligations

1. The employer is required to contribute towards Employees' Provident Fund and Pension Fund as:

   (a) In case of establishments employing less than 202 persons or a sick industrial (BIFR) company or 'sick establishments' or any establishment in the jute, beedi, brick, coir or gaur gum industry – 10% of the basic wages, dearness allowance and retaining allowance, if any.

   (b) In case of all other establishments employing 201 or more persons – 12% of the wages, D.A., etc.

   An amount equal to 8.33% of the employees' pay shall be remitted to the Pension Fund and the balance of employer's contribution will continue to remain in Provident Fund account.

   Where, the pay of the employee exceeds ₹ 5,000 p.m., the contribution to Pension Fund shall be limited to 8.33% of his pay of ₹ 5,000 only. The employee may voluntarily opt for the employer's contribution @ 8.33% of the full wages to be credited to Pension Fund.

2. Towards Deposit-Linked Insurance Fund, he has to pay: - 0.5% of the wages, D.A., etc.

3. The employer cannot reduce the wages or other benefits such as pension, gratuity or provident fund of an employee, on account of the employer's contribution or administrative charges payable by him.

4. The employer is required to deduct the employee's contribution from his wages and deposit the same into the provident fund account along with his own contribution. The employee's contribution shall be equal to the employer's contribution, i.e. 10% or 12% as the case may be. The employee is not required to contribute towards Deposit-linked Insurance Fund.

5. The employer is required to pay the following administrative charges also:

   (a) w.e.f. 1.8.1998 @ 1.10% (0.65% up to 31.7.98) of the employees' wages, subject to a minimum of ₹ 5 every month, for administration of Provident Fund.

   (b) 0.01% of the employee's wages, subject to a minimum of ₹ 2 every month, for administration of Deposit-Linked Insurance Fund.

6. The employer should, within 15 days of the close of every month, deposit the total amount of the employer's and employees' contributions and administrative charges with P.F. Commissioner into the respective accounts maintained at the State Bank of India.

Did u know? The amounts deposited into the Provident Fund Account are invested in specified securities and under Special Deposits Scheme. The Commissioner shall credit to the provident fund account of each member interest at such rate as the Central Government may determine, on the balance standing to his credit on first day of April each year. The rate of interest notified for the year 1998-99 was 12% p.a. The rate of interest had been reduced to 11% w.e.f. 1.4.2000 and further reduced to 9.5% w.e.f. 1.4.2001. Interest is also earned on the Family Pension Fund and Deposit-linked Insurance Fund Accounts.

Notes

Under the Employees' Provident Fund Scheme, the Central Government, on the recommendation of the Central Board of Trustees, declares the rate of interest to be credited annually to the accounts of provident fund subscribers.

7. The employer is required to prepare a contribution card in Form 3-A, in respect of each member-employee. The card shall be valid for a period of one year and thereafter a new card shall be prepared for the next year. The wages of employee, provident fund and family pension fund contribution recovered and remitted every month and break in reckonable service should be entered therein.

8. The employer is required to send to the Commissioner, a Monthly Return of Contributions within 25 days of close of each month, along with receipted triplicate copies of challans for the amount of Provident Fund, Family Pension Fund and Deposit-linked Insurance Fund contributions and the administrative charges deposited into the State Bank of India.

9. If no contributions have been recovered during a month, a nil return shall be furnished by the employer. The employer should retain a duplicate copy of the statement and the fourth copies of the challans with himself.

10. The employer should send to the Commissioner a Consolidated Annual Contribution Statement in Form 6A within one month of the close of the year, showing the employer's and employee's contribution in respect of each employee made during the year. The employer should retain a duplicate copy of the statement with himself.

13.3.2 Employees Benefits under the Scheme

1. Under the scheme, a member can withdraw the full amount standing to his credit in the fund, in the event of:

    (a) Retirement from service after attaining the age of 55;

    (b) Retirement on account of permanent and total incapacity;

    (c) Migration from India for permanent settlement abroad; and

    (d) Termination of service in the course of mass retrenchment (involving 3 or more persons). The membership for this purpose is reckoned from the time of joining the covered establishment till the date of the settlement of the claim.

2. A member can withdraw up to 90% of the amount of provident fund at credit after attaining the age of 54 years or within one year before actual retirement on superannuation, whichever is later.

3. The Scheme provides for non-refundable partial withdrawals/advances to meet certain contingencies:

    (a) Financing of life insurance policies;

    (b) House-building;

    (c) Purchasing shares of consumer co-operative credit housing societies;

    (d) During temporary closure of establishments;

    (e) Illness of member, family members;

    (f) Member's own marriage or for the marriage of his/her sister, brother or daughter/son and post-matriculation education of children;

Notes

(g) Damages to movable and immovable property of members due to a calamity of exceptional nature;

(h) Unemployment relief to individual retrenched members;

(i) Cut in supply of electricity to the factory/establishment; and

(j) Grant of advance to members who are physically handicapped for the purchase of equipment.

4. If there is no nominee, the amount shall be paid to the members of the family in equal shares except:

   (a) Sons who have attained majority;

   (b) Sons of a deceased son who have attained majority;

   (c) Married daughters whose husbands are alive;

   (d) Married daughters of a deceased son whose husbands are alive.

5. The nomination form shall be filled in duplicate and one copy duly accepted by the provident fund office will be kept by members. In case of change, a separate form for a fresh nomination should be filled in duplicate.

6. When a member leaves service in one establishment and obtains re-employment in another establishment, whether exempted or unexempted, in the same region or in another region, he is required to apply for the transfer of his provident fund account to the Regional Provident Fund Commissioner in the prescribed form. The actual transfer of the provident fund accumulations with interest thereon takes place, in cases of:

   (a) Re-employment in an establishment whether exempted or unexempted, in another region/sub-region;

   (b) Re-employment in an exempted establishment in the same region/sub-region;

   (c) Leaving service in an exempted establishment and re-employment in an unexempted establishment;

   (d) Re-employment in an establishment not covered under the Act.

7. A member of the fund is entitled to get full refund of both the shares of contributions made by him as well as by his employer with interest thereon immediately after leaving the service.

8. After the completion of each accounting year, every member of the fund shall be supplied with an account slip showing:

   (a) The opening balance;

   (b) The amount contributed during the year;

   (c) The amount of interest credited or debited during the year; and

   (d) Closing balance.

   Errors, if any, should be brought to the notice of the Commissioner within six months.

Notes

Notes **Exemption**

An establishment/factory may be granted exemption under Section 17 if, (i) in the opinion of the appropriate government, the rules of its provident fund with respect to the rates of contributions are not less favourable than those specified in Section 6 of the Act, and (ii) if the employees are also in enjoyment of other provident fund benefits, which on the whole are not less favourable than the benefits provided under the Act or any scheme in relation to the employees in any other establishment of a similar character. While recommending to the appropriate government, grant of exemption under this section, the Employees' Provident Fund Organisation usually takes into consideration, the rate of contribution, the eligibility clause, the forfeiture clause and the rate of interest. Also, the totality of the benefits provided under the rules of the exempted funds is taken into consideration.

The Central Government is empowered to grant exemption to any class of establishments from the operation of the Act for a specified period, on financial or other grounds under section 16(2). The exemption is granted by issue of notification in the Official Gazette and subject to such terms and conditions as may be specified in the notification. The exemption does not amount to total exclusion from the provisions of the Act. The exempted establishments are required to constitute a Board of Trustees, according to the rules governing the exemptions to administer the fund, subject to overall control of the Regional Provident Fund Commissioner. The exempted establishments are also required to maintain proper accounts, submit prescribed returns, invest provident fund accumulations in the manner prescribed by the Central Government from time to time, and to pay inspection charges. Exemption is liable to be cancelled for breach of any of these conditions.

13.4 The Employees' Pension Scheme, 1995

Employees' Pension Scheme 1995 has been made applicable on 16.11.1995 retrospectively with effect from 1.4.1993. This new Scheme replaces the erstwhile Family Pension Scheme, 1971.

Membership

1. Every member of the Employees' Provident Scheme, 1952 and those who opted for Employees Family Pension Scheme, 1971.
2. All new entrants to the Employees' Provident Fund Scheme, 1952 will become member of the Employees' Pension Scheme, 1995 on compulsory basis.
3. Every employee who has ceased to be a member of the Employees Family Pension Scheme, 1971 during 1.4.1993 and 15.11.1995 was given option to become member of the Employees' Pension Scheme, 1995 up to 31.3.1998.
4. Every existing member of the Employees' Provident Fund Scheme, 1952 not being member of Family Pension Scheme, 1971 has option to become member of Employees' Pension Scheme, 1995.

Option Requirement

1. Members who have died between 1.4.1993 and 15.11.1995 shall be deemed to have exercised the option of joining Employees' Pension Scheme, 1995 with effect from the date of death.

Notes

2. Members who are alive may exercise option to become member of the Employees' Pension Scheme, 1995 on the date of exit from the employment by depositing amount along with interest at the rate of 8.5 per cent per annum from the date of such withdrawal.
3. Members will have option to join Employees' Pension Scheme, 1995 by depositing the contribution along with up to date interest under ceased Employees' Family Pension Scheme, 1971, with effect from 1.3.1971.

Contribution

Employee is not required to contribute separately under the Employees' Pension Scheme, 1995. Employer's share of provident fund contribution at the rate of 8.33% is diverted to pension fund every month.

Service for Pension

Actual service rendered after 16.11.1995 together with the service for which the contribution has been made under the ceased Family Pension Scheme, 1971, if any, will be treated as service for pension.

A person is entitled for pension after completing the age of 58 years, with a minimum service of 10 years.

Six months or more shall be treated as one year and service less than six months shall be ignored.

Determination of Pensionable Salary

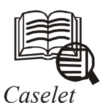
Pensionable salary shall be the average monthly pay drawn in any manner, including on piece rate basis during the contributory period of service in the span of 12 months preceding the date of exit from membership of the Employees Provident Fund.

13.5 Benefits under Pension Fund Scheme, 1995

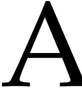
1. A member shall be entitled to superannuation pension, if he has rendered eligible service of 20 years or more and retires at the age of 58 years, or retirement pension if he has rendered eligible service of 20 years or more and retires before the age of 58 years, or short service pension if he has rendered eligible service of 10 years or more but less than 20 years.
2. A monthly reduced pension shall be allowed at the option of the member, from a date earlier than 58 years of age but not earlier than 50 years.
3. A member may opt for commutation of pension up to a maximum of 1/3 of the normal pension. The commuted value shall be 100 times the amount of pension commuted. Uncommuted pension shall be paid on monthly basis as per option under clause (d).
4. A member may opt to draw Reduced Pension and avail of Return of Capital equal to 90 or 100 times the original monthly pension, under three alternative plans.
5. If a member has not rendered the minimum eligible service of 10 years on the date of retirement/superannuation, he shall be entitled to Return of Contribution at the prescribed rate.
6. A member, who is permanently and totally disabled during the employment shall be entitled to the monthly member's pension, subject to a minimum of ₹ 250 p.m.

Notes

7. A monthly widow pension ranging from ₹ 450 p.m. to an amount equal to monthly member's pension is payable from the date of member's death to the date of death of widow or her remarriage.
8. A monthly children pension, equal to 25% of monthly widow pension, subject to a minimum of ₹ 150 p.m. per child (for two children) is allowed.
9. Where widow pension is not payable, the children shall be entitled to a monthly orphan pension, equal to 75% of monthly widow pension, subject to a minimum of ₹ 250 per child.
10. Pension shall be allowed for commutation, with effect from November 1998. Member can opt for commutation up to a maximum of one third of pension.
11. A member is allowed withdrawal benefit, where a minimum of pensionable service of 10 years has not been rendered on the date of exit/on attaining age of 58 years.



Did u know? The pension scheme will be administered by the tripartite Central Board of Trustees set up under the Employees' Provident Fund and Miscellaneous Provisions Act. The Regional Committees set up under the Provident Fund Scheme shall advise the Regional Boards on matters relating to administration and implementation of the scheme in their respective regions.



Caselet

EPF Members can opt for New Pension Scheme

ALL members of the Employees Provident Fund (EPF) can also participate in the new pension scheme announced by the Government.

Though the scheme is primarily for Central Government employees who have joined the public services after January 1, 2004, the ordinance says that any person governed under the EPF may also opt to join the scheme. Under the new pension scheme, the monthly contribution of employees would be 10 percent of the salary and dearness allowance and this would be matched by the Central Government. However, it has been clarified that there will be no contribution from the Government in respect of individuals who are not Government employees.

Moreover, State Government employees are also eligible to join the new scheme, if the State, by a notification, extends it to its employees. States that are making quick progress in their pension fund reforms are Tamil Nadu, Andhra Pradesh, Rajasthan, Madhya Pradesh, Gujarat, Kerala, Orissa, Himachal Pradesh and Chhattisgarh.

Others who are eligible to opt for the new pension scheme are those who are members of the Coal Mines Provident Fund, Assam Tea Plantations PF, Jammu and Kashmir Employees PF and Seaman's PF.

However, the Ordinance caveats that subscribers cannot exit from the scheme except as specified by a Central Government notification. This notification is yet to be issued.

The five-member Pension Fund Regulatory and Development Authority (PFRDA) will permit one or more pension funds to receive contributions, accumulate them and make payments to subscribers.

Contd...

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> It is also understood that there would be a "default option" of a pension fund manager and a pension fund for subscribers who do not want to choose among the various service providers and their products. This default fund manager is likely to be a public sector undertaking.

Source: thehindubusinessline.com

13.6 The Employees' Deposit-linked Insurance Scheme, 1976

The scheme came into force from August 1, 1976. It is applicable to all factories/establishments to which the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 applies. All the provident fund member-employees are covered under this scheme. While the employees are not required to contribute to the Insurance Fund, the employers are required to pay contributions to it at the rate of 0.5% of the pay of the employees who are provident fund subscribers. The Central Government also contributes to the insurance fund at the rate of 0.25% of the pay in respect of the covered employee. The employers are also required to pay administrative charges to the insurance fund at the rate of 0.01% of the pay drawn by the employees, subject to a minimum of ₹ 2 per month. The Central Government also meets partly the expenses in connection with the administration of the insurance scheme by paying into the insurance fund an amount at the rate of 0.005% of the pay drawn by the employee members, subject to a minimum of ₹ 1 per month. The employers of exempted establishments are required to pay inspection charges at the rate of 0.02% of the pay of the employee-members.

Under the scheme, the nominees/members of the family of employees of covered establishments will get, in the event of death while in service, an additional amount equal to the average balance in the provident fund account of the deceased during the preceding 12 months, wherever the average provident fund balance is less than ₹ 25,000. In cases where the average provident fund balance of preceding twelve months exceeds ₹ 25,000 plus 25% of the amount in excess of ₹ 25,000, subject to a maximum of ₹ 35,000.

There is a provision in the scheme for the exemption of factories/establishments which have an insurance scheme approved by government and conferring more benefits than those provided under this statutory scheme, provided that a majority of the employees are in favour of such exemption. Subject to certain conditions, individual employees or class of employees may also be granted exemption. The Central Government is the appropriate authority to grant exemption from the Employees' Deposit-linked Insurance Scheme under Section 17(2A).

13.6.1 Private Provident Fund Scheme

Establishments employing 100 or more persons may opt for a Private Provident Fund Scheme after getting it approved by the Commissioner u/s 16A. A private scheme shall not be approved, if it is in any way less beneficial to the employees than the government's scheme, and at least majority of employees consent to it. A private scheme is usually drawn on the pattern of the government scheme.

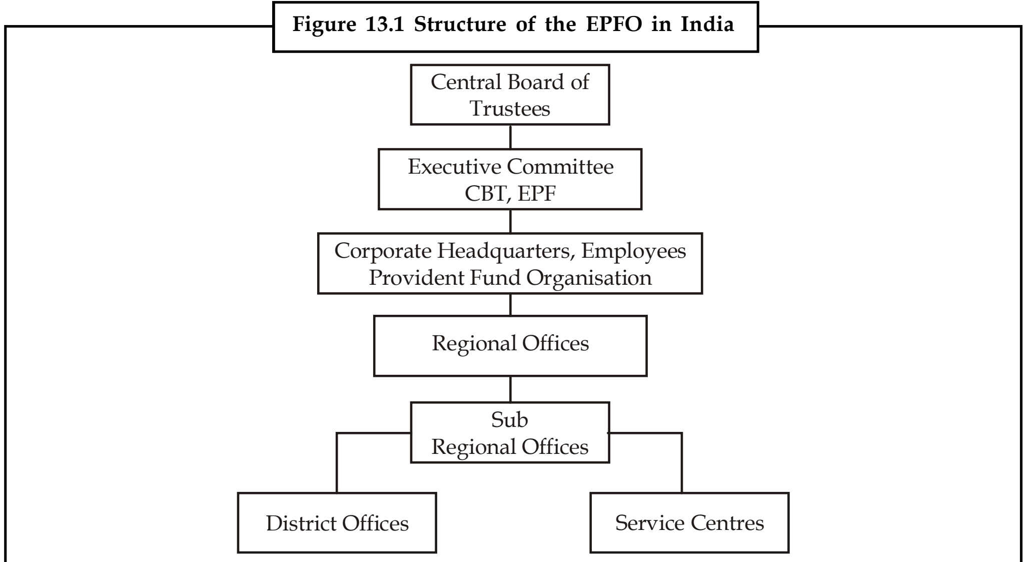
13.6.2 Settlement of Claims within 30 Days

All claims relating to provident fund and pension complete in all respects submitted along with the requisite documents shall be settled and benefit amount paid to the beneficiaries within 30 days of receipt. Any deficiency in the claim shall be recorded in writing and communicated to the applicant within 30 days. For any delay beyond 30 days without sufficient cause, interest @ 12% p.a. on the benefit amount shall be payable to the beneficiary, which shall be recoverable from the Commissioner's salary.

13.6.3 Role of Central and Regional Provident Fund Organisations

The Employees' Provident Fund Organisation (EPFO), India is a state sponsored compulsory contributory pension and insurance scheme. It is one of the largest social security organisations in the world in terms of members and volume of financial transactions undertaken. The Employees Provident Fund Organisations is the incharge of all the three schemes. The organisation functions under the overall superintendence of the policies framed by the Central Board of Trustees, a tripartite body consisting of the chairman's, nominees of the Central and State Governments and employees and employers organisations. The Chief Executive Officer of the Organisation is the Central Provident Fund Commissioner, who is also a Member of the Board and its Secretary.

Figure 13.1 Structure of the EPFO in India



He is assisted by the Regional Provident Fund Commissioner, one in each state and in Delhi. The regional committees advise the Central Board on matters connected with the administration of the scheme in their respective States. Sub-regional provident fund offices have been opened in some regions to render better services to the subscribers of the fund. Provident fund inspectors are appointed to carry out inspections and to perform an advisory role vis-à-vis the employers and workers in different covered establishments. They conduct surveys to ensure that all coverable establishments/factories are covered under the Act. They also recommend and file prosecutions in the courts against defaulting employers and pursue these cases till their final disposal.

13.6.4 Offences and Penalties

The penalties in respect of the various offences in regard to provident fund, family pension fund, etc. are as follows:

Notes

Table 13.1: Offences and Penalties

Offence	Penalty
1. Making any false statement or misrepresentation to avoid any payment towards provident fund, family pension fund or deposit-linked insurance fund.	Imprisonment up to one year of fine of ₹ 5000/- or both.
2. Default in payment of administrative charges towards Provident Fund (Para 38) or payment of inspection charges [Sec. 17(3)(a)]	Imprisonment up to 3 years and a fine of ₹ 5000/- (Minimum imprisonment for 6 months).
3. Default in payment of employees' contribution [Sec.6].	Imprisonment up to 3 years and a fine of ₹ 10,000 (Minimum imprisonment for 1 year)
4. Default in payment of contribution or administrative charges or inspection charges towards the Deposit-linked Insurance Fund.	Imprisonment up to 1 year or a fine up to ₹ 5000/-, or both. (Minimum imprisonment for 6 months).
5. Contravention of or default in complying with, any of the provisions.	Imprisonment up to 1 year or fine up to ₹ 4000 or both.
6. Contravention of or default in complying with, any of the conditions, subject to which exemption was granted u/s 17.	Imprisonment up to 6 months (minimum 1 month) and fine up to ₹ 5000.
7. Any subsequent offence committed after previous conviction (sec. 14AA)	Imprisonment up to 5 years (minimum 2 years) and fine up to ₹ 25,000.

13.6.5 Damages and Penalties

When an employer fails to remit the dues under the Scheme within 15 (20 days with 5 days grace period) days of the close of each month, the employer will be liable to pay penal damages as may be determined by the Regional Commissioner (RC) not exceeding 37% of the arrears.

Any amount outstanding from the employer can be recovered by the Regional Commissioner as an arrear of land revenue. The powers for revenue recovery and issue of recovery certificates are vested with the Regional Commissioner (with effect from 1/7/90).

An employer, who fails to remit the contributions and administrative charges and/or submit the monthly and other periodical returns, is liable to be prosecuted under Section 14 of the Act. For failure to remit employees' share recovered from the wages, the employer shall also be liable for prosecution under Section 406/409 of the I.P.C.

The employers are liable for action under the penal provisions of the Act, in case they default compliance with the provisions of the Scheme. This is apart from the provisions relating to levying of penal damages and recovery of the outstanding dues as revenue under the Revenue Recovery Act.

13.6.6 Appraisal of the Act

Corruption by the enforcement officers has been a serious problem facing the organisation, since joining the scheme is compulsory and the subscription rate being high, many of the smaller companies avoid joining the scheme. The organisation, having legal powers to prosecute such companies, and make ad-hoc assessments and recover past arrears including interest and penalty, many of the field official connive with such companies for consideration. The interest rate being offered to subscribers is still very high and the investment of the corpus of fund by the organisation is not fetching such interest, resulting in drawal from surplus. This is a major concern for government and the organisation.

Notes

Task

Critically analyse he challenges which the employees faces in getting their provident fund after leaving the organisation.

13.7 Minimum Wages Act, 1948

Minimum Wages Act, 1948 is an act to provide for fixing minimum rates of wages in certain employments. It is expedient to provide for fixing minimum rates of wages in certain employments. "The justification for statutory fixation of minimum wages is obvious. Such provisions which exist in more advanced countries are even more necessary in India, where workers organizations are yet poorly developed and worker's bargaining power is consequently poor."

Object: For fixing minimum rates of wages in certain employments.

Applicability: It extends to the whole of India and applies to scheduled employments in respect of which minimum rates of wages have been fixed under this act.

Scheduled employments: An employment specified in the schedule, or any process or branch of work forming part of such employment (Section-2g).

Fixing of Minimum Rates of Wages

1. The appropriate government shall fix the minimum rates of wages payable to employees employed in a scheduled employment.
2. Review at such intervals not exceeding five years, the minimum rates of wages so fixed and revise the minimum rates if necessary. The minimum rates of wages may be fixed as a minimum time rate or a minimum piece rate or as a guaranteed time rate (Section-3).

Advisory Board

For the purpose of co-ordinating the work of [committees and sub committees appointed under section 5] and advising the appropriate Government generally in the matter of fixing and revising minimum rates of wages, the appropriate Government shall appoint an Advisory Board.

Central Advisory Board

1. For the purpose of advising the Central and State Governments in the matters of the fixation and revision of minimum rates of wages and other matters under this Act and for co-ordinating the work of the Advisory Boards, the Central Government shall appoint a Central Advisory Board.
2. The Central Advisory Board shall consist of persons to be nominated by the Central Government representing employers and employees in the scheduled employments, who shall be equal in number, and independent persons not exceeding one-third of its total number of members; one of such independent persons shall be appointed the Chairman of the Board by the Central Government.

Payment of minimum rates of wages: The employer shall pay to every employee in a scheduled employment under him wages at the rate not less than the minimum rates of wages fixed under the Act. (Section-12).

Notes

Hours of Work, Overtime etc.

The Act also provides for regulation or working hours, overtime, weekly holidays and overtime wages. Period and payment of wages, and deductions from wages are also regulated. (Section—13 to 17).

Claims under the act (section-20): This section makes provisions to appoint authorities to hear and decide all claims arising out of payment less than the minimum rates of wages or any other monetary payments due under the Act. The presiding officers of the Labour court and Deputy Labour Commissioners are the authorities appointed.

Who can file a claim petition?

1. The Employee or
2. Any legal practitioner or any official of a regd. Trade union authorized in writing to act on his behalf or
3. Any Inspector or
4. Any person acting with the permission of the authority under Section-20 (I)

Registers and Records

Every employer shall maintain the following registers and records as required under the Kerala Minimum Wages Rules, 1958 enacted vide section-30 of the Act.

1. Register of wages in Form No. XI or Form XII
2. A muster-roll in Form No. VI
3. Register of fines, Form No. I
4. Register of deductions for damage or loss in Form No. II
5. Register of overtime in Form No. V
6. Visit book
7. A wage slips in Form No. XIII shall be issued by every employer to every person employed by him at least a day prior to the disbursement of wages.

Notice to be exhibited: A notice in Form IV containing the minimum rates of wages fixed together with the abstract of the Act, the rates made thereunder and the name and address of the inspector shall be displayed in English and in a language understood by the majority of the workers.

Annual returns: Annual returns in Form III or Form III a as per rule 21 (4) (iii) shall be submitted to the Inspector before the first day of the February of the succeeding year.

Preservation of registers: All the registers shall be preserved for a period of three years after the date of last entry made therein

Penalty: Any employer who contravenes any of the provisions of this Act other than those relating to Section 12 and 13 of any rule or any order made there under shall be punishable with fine, which may extend to ₹ 500. Any employer who contravenes the provision relating to the payment of minimum rates of wages fixed (Section- 12) hours of work stipulated for constituting a normal working day as per section 13 shall be punishable with imprisonment for a term which may extend to six months or with fine Which may extend to ₹ 500/- or with both.

Authorities Appointed under the Act

1. ***Inspector:*** (under Section-19)
    (a) Labour Commissioner
    (b) Additional Labour Commissioner (IR and E)
    (c) Regional Joint Labour Commissioners
    (d) Joint Labour Commissioner (P)
    (e) Chief Inspector of Plantations
    (f) Deputy Labour Commissioner (HQ)
    (g) Dist Labour Officer (HQ)
    (h) Additional Labour Commissioner, Kozhikode
    (i) Dist Labour Officers (E)
    (j) Inspector of plantations
    (k) Asst. Labour Officers – Grade II
2. ***Claim Authorities*** (under Section –20)
    (a) Labour Courts
    (b) Deputy Labour Commissioners
3. ***Sanctioning Authority*** (under Sec. 22)
    (a) Labour Courts
    (b) The chief inspector of plantations Kottayam.
    (c) Dist. Labour officers (E)

13.8 Payment of Gratuity Act, 1972

Gratuity as an additional retirement benefit has been secured by labour in numerous instances, either by agreement or by awards. It was conceded as a provision for old age and a reward for good, efficient and faithful service for a considerable period. In the early stages, gratuity was treated as a payment gratuitously made by an employer at his will and pleasure. In the course of time, gratuity came to be paid as a result of bilateral agreements or industrial adjudication. The Supreme Court had laid down certain broad principles to serve as guidelines for the framing of the gratuity scheme. They were:

1. The general financial stability of the concern;
2. Its profit-earning capacity;
3. Profits earned in the past;
4. Reserves and the possibility of replenishing the reserves; and
5. Return on capital, regard being had to the risk involved.

The first central legislation to regulate the payment of gratuity was the Working Journalists (Conditions of Service) and Miscellaneous Provisions Act, 1955. The Government of Kerala enacted legislation in 1971, for payment of gratuity to workers employed in factories, plantations, shops and establishments. In 1971, the West Bengal Government promulgated an ordinance,

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which was subsequently replaced by the West Bengal Employees' Payment of Compulsory Gratuity Act, 1971. After the enactment of these two Acts, some other State Governments also voiced their intention of enacting similar measures in their respective states. It became necessary, therefore, to have a Central law on the subject so as,

1. To ensure a uniform pattern of payment of gratuity to the employees throughout the country, and
2. To avoid different treatment to the employees of establishment having branches in more than one state, when under the conditions of their service, the employees were liable to transfer from one state to another.

Hence, the Government of India enacted legislation on gratuity. The Act came into force from September 16, 1972.

Object of the Act

The Act provides for a scheme of compulsory payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, motor transport undertakings, shops or other establishments and for matters connected therewith or incidental thereto.

Applicability

The Act is applicable to:

1. Every factory, mine, oilfield, plantation, port and railway companies;
2. Every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a state, in which 10 or more persons are employed or were employed on any day of the preceding 12 months;
3. To every motor transport undertaking, in which 10 or more persons are employed or were employed on any day of the preceding 12 months,
4. Such other establishments or class of establishments, in which 10 or more employees are employed or were employed on any day of the preceding 12 months, as the Central Government may, by notification, specify in this behalf.

The Act provides for the grant of exemption from the operation of the Act to any person or class of persons, if they are in receipt of gratuity or pensioner benefits not less favourable than the benefits conferred under the Act.

Employer’s Obligations

1. Every employer has to obtain insurance for his liability to pay gratuity from the LIC.
2. However, an employer who has already established an approved gratuity fund or who having at least 500 employees establishes an approved gratuity fund may claim exemption from such compulsory insurance.
3. Every employer shall get his establishment registered with the controlling authority (Assistant Labour Commissioner).
4. Premium to the insurance company should be paid without fail, or the employer shall be liable to pay the amount of gratuity payable to the controlling authority.
5. As soon as the gratuity becomes payable, the employer should determine the amount of gratuity & give a notice in Form L to the payee viz. the employee or his nominee or legal heir & to the controlling authority of that area.

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6. The employer should pay the gratuity within 30 days from the date it becomes payable or after such date along with simple interest @ 10% p.a. (or as notified by the Government from time to time) on the amount of gratuity, unless the delay is on the part of the payee.
7. The employer should deposit the amount of gratuity payable with the controlling authority, viz. Asst. Labour Commissioner (Central) of that area, if:
   (a) The nominee or the legal heir of the employee is a minor, or
   (b) There is any dispute as to the amount or admissibility of the claim of gratuity, or as to the person entitled, etc.

Benefits and Entitlement

An employee should have completed or should be in the continuous service for a period. It means if for that period, he has been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absent in respect of which an order imposing a punishment of penalty or treating the absence as break in service has been passed in accordance with the standing orders, rules or regulation governing the employees of the establishment), lay-off, strike or a lockout or cessation of work not due to any fault of the employees, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act.

1. Where an employee is not in continuous service within the meaning of the above clause for any period of one year or six months, he shall be deemed to be in continuous service under the employer, if he has actually worked for 190 days during the preceding 12 months in an establishment, which works less than 6 days a week and 240 days in any other case;
2. Further, for determining the continuous period of six months, an employee should have completed 95 days in an establishment, which works for not less than 6 days in a week and 120 days in any other case.

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1. Employee is a person employed on wages in any establishment, factory, mine, oilfield, plantation, railway company or shop, to do any skilled, semi-skilled or unskilled, manual, supervisory, technical or clerical work, where the terms of such employment are express or implied, and includes any such person, who is employed in a managerial or administrative capacity, but does not include any person who hold a civil post under the Central Government or a State Government.

   The family consists of:

   (a) In the case of male employee, himself, his wife, his children, whether married or unmarried, his dependent parents and the widow and children of his predeceased son, if any;

   (b) In the case of female employee, herself, her husband, her children, whether married or unmarried, her dependent parents, and the dependent parents of her husband, and the widow and children of her predeceased son, if any.

   A female employee can exclude her husband from her family by a notice in writing to the controlling authority. In such event, her husband and his dependent parents

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will not be deemed to be included in her family, unless the said notice is subsequently withdrawn.

2. Wages means all emoluments which are earned by an employee while on duty or on leave, in accordance with the terms and conditions of his employment and which are paid or are payable to him in cash and includes dearness allowance, overtime wages and any other allowance.

Every employee irrespective of his wages is entitled to receive gratuity after he has rendered continuous service for 5 years or more, at the time of termination of his services, either (i) on superannuation, or (ii) on retirement, or (iii) on resignation, or (iv) on death or disablement due to accident or disease. However, the condition of 5 years' continuous service is not necessary if services are terminated due to death or disablement.

Disablement means permanent inability or incapacity of an employee to do the work, which he was capable of doing before the accident or disease. In case of death of the employee, gratuity payable to him is to be paid to his nominee, and if no nomination has been made, then to his heirs.

For every completed year of service or part thereof in excess of six months, the employer has to pay gratuity to an employee at the rate of 15 days' wages based on the rate of wages last drawn by the concerned employee. In the case of piece-rated employee, daily wages are computed on the average of the total wages received by him for a period of 3 months immediately preceding the termination of his employment. For this purpose, the wages paid for any overtime work will not be taken into account.

Caution

Gratuity Payable = 15 days' wages × No. of completed years of service.

Not exceeding ₹ 3, 50,000/-

In case of seasonal establishment,

Gratuity Payable = 7 days' wages × No. of seasons for which employed.

Not exceeding ₹ 3, 50,000/-

In case of monthly rated employee,

$$\text{15 days' wages} = \frac{\text{Monthly wages last drawn}}{26}$$

In the case of an employee employed in a seasonal establishment, and who is not so employed throughout the year, the employer shall pay gratuity at the rate of 7 days wages for each season.

In case an employee has been employed on reduced wages after his disablement, his wages for the period before his disablement shall be taken into account for calculating gratuity in respect of that period and the wages so reduced shall be considered for calculating gratuity for the period subsequent to his disablement.

The employee who has become eligible for payment of gratuity should apply in Form I or J or K, respectively, within 30 days from the date of gratuity becoming payable. This application should be sent to the employer either personally or through Registered A.D.

However, where the date of superannuation or retirement is known, the employee may apply even 30 days before such date.

Besides, a legal heir may apply within one year from the date the gratuity becomes payable. Any delayed application for payment of gratuity should also be entertained by the employer, if there is sufficient cause for the delay.

The gratuity should be paid in cash, or by Demand Draft or cheques. If the amount of gratuity is less than ₹ 1000/-, then it may be paid by postal money order, at the desire of the payee. Details of payment of gratuity should be intimated by the employer to the controlling authority Assistant Labour Commissioner (Central) of the area.

Forfeiture

If the services of an employee have been terminated for any act of willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, his gratuity can be forfeited to the extent of the damage or loss so caused to the employer. The gratuity payable to an employee can be wholly forfeited, if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence or an offence involving moral turpitude committed by him in the course of his employment.

Did u know? The limit on maximum amount of gratuity exempt from the income-tax has been raised from ₹ 1, 00000 to ₹ 3, 00000 w.e.f. 1.4.1995 vide Notification No. 9959.

Nomination

1. An employee who has completed one year of service has to name his/her nominee in the prescribed form. An employee in his nomination can distribute the amount of gratuity amongst more than one nominee.
2. If an employee has a family at the time of making the nomination, it has to be made in favour of one or more members of the family.
3. If nomination is made in favour of a person who is not a member of his family, the same is void. However, if the employee has no family at the time of making a nomination, he can make the nomination in favour of any person.
4. If such employee acquires a family subsequently, then such nomination becomes invalid forthwith, and the employee has to make a fresh nomination in favour of one or more members of his family.
5. Nomination once made can be modified, after giving due notice to the employer. If a nominee predeceases the employee, a fresh nomination is required to be made.
6. A person who is entitled to gratuity has to apply himself/herself or through an authorised person to the employer for gratuity within the prescribed time, the employer has to consider the same.
7. Similarly, the employer has to give notice to the person entitled to gratuity and to the controlling authority immediately after it became payable, specifying the amount of gratuity, and thereafter make arrangements for its payment.

Settlement of Claims

The employee and the employer or any other person raising the dispute regarding the amount of gratuity, may make an application to the controlling authority to decide the dispute. No appeal by an employer shall be admitted, unless the employer produces a certificate of the

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controlling authority to the effect that he has deposited with the controlling authority an amount equal to the amount of gratuity required to be deposited or deposits with the appellate authority such amount.

An aggrieved employee can file an application to the controlling authority for recovery of the amount of gratuity. The controlling authority will issue a certificate to the collector for recovery of that amount, together with compound interest, at the rate of 9% per annum from the date of expiry of the prescribed time as arrears of land revenue, and pay the same to the person entitled to it.

Offences and Penalties

Section 9 declares certain acts as offences and prescribes penalties for them. Whoever, for the purpose of avoiding any payment, makes any false statement or false representation is punishable with imprisonment up to 6 months and/or fined up to ₹ 1000.

Offence	Penalty
1. Making a false statement or false representation to avoid any payment under the Act	Imprisonment up to 6 months of fine of ₹ 10,000/- or both.
2. Contravention or non-compliance of any provision of the Act or the Rules	Imprisonment up to 1 years or fine up to ₹ 20,000/- or both (minimum imprisonment for 3 months and fine up to ₹ 10,000
3. Non-payment of any gratuity payable under the Act	Imprisonment up to two years (minimum 6 months) or fine up to ₹ 20,000 (Minimum ₹ 10,000) or both
4. Failure to make payment by way of premium for compulsory insurance u/s 4A(1) or by way of contribution to an approved gratuity fund.	Fine up to ₹ 10,000 and ₹ 1,000 for each day during which the offence continues.

Appraisal of the Act

In Gratuity Act, minimum service is 5 years experience to claim the gratuity but in some cases in the company knows the particular employee(s) are reaching his 5 years period so we can terminate them due to some reasons. By that they can exempt themselves from paying the gratuity.

Case Study

15 Day's Wages

The word "15 day's wages" has been interpreted differently by different judicial authorities. Dig Vijay Woolen Mills Ltd. and Shri Mahendra Prataprai Buch appealed to the court for the calculation of 15 days wages for gratuity payment. In this appeal, the question came up how to calculate 15 days' wages for the purpose of Payment of Gratuity in terms of Section 4(2) of the Payment of Gratuity Act. The appellant-company calculated the amount of gratuity on the basis that fifteen days' were half of the company wages last drawn. The respondents demanded an additional sum as gratuity on the ground that their monthly wages should be taken as what they got for 26 working days and their daily wages should be ascertained on that basis, but not by just taking half of the wages for a month of 30 days, or fixing their daily wages by dividing monthly wages by 30. According

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to the Supreme Court, the pattern followed by the method of 26 working days appears to be legitimate and reasonable.

Question

Do you agree to the decision of the Supreme Court? Justify.

13.9 Summary

- The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 is a social welfare legislation enacted for the purpose of institution of provident fund for employees in factories and other establishments.
- This Act provides for the institution of compulsory provident fund, family pension fund and deposit linked insurance fund for the benefit of the employees.
- Gratuity as an additional retirement benefit has been secured by labour in numerous instances, either by agreement or by awards.
- The employee and the employer or any other person raising the dispute regarding the amount of gratuity, may make an application to the controlling authority to decide the dispute.
- Nomination once made can be modified, after giving due notice to the employer. If a nominee predeceases the employee, a fresh nomination is required to be made.
- The purpose of avoiding any payment makes any false statement or false representation is punishable with imprisonment up to 6 months and/or fined up to ₹1000.

13.10 Keywords

Disablement: It is the permanent inability or reduction in the earning capacity of the workmen.

Employee: Any person who is employed for wages in any kind of work, manual or in connection with the work of an establishment and who gets wages directly or indirectly from the employer and includes any person employed by or through a contractor in or in connection with the work of the establishment.

Employer: The owner or occupier of the establishment.

EPFO: Employees Provident Fund Organisation

Gratuity: It is a sort of an award which an employer pays out of his gratitude, to an employee for his long and meritorious service, at the time of his retirement or termination.

Retirement: It is defined as the termination of the service of an employee other than on superannuation.

Superannuation: It is the attainment of such age by the employee as is fixed in the contract or conditions of service as the age on the attainment of which he has to leave the employment.

Wages: The compensation received by the worker for his services.

13.11 Self Assessment

State whether the following statements are true or false:

1. To qualify for the old-age insurance benefits, a person must have reached the retirements age & be fully insured.

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2. An employee ceases to be the member of the provident fund at the age of 60 years.
3. At present the rate of interest on provident fund is 12%.
4. Profit-earning capability of the firm is one of the guiding principles for framing the gratuity scheme.
5. The gratuity of a person can be forfeited if his employment is terminated due to his bad health.

Fill in the blanks:

6. When an employee attains a particular age as stated in the contract after which he is entitled to leave the services is called…………………………..
7. After a period of …….. Years a person is usually eligible for the gratuity payment.
8. ………………….. is the award given by the corporates to their employees for the loyalty & services rendered by them for a long period.
9. When an employee is terminated from the services on the account of his age & not on the basis of the misconduct is ………………………………
10. ……………….. offers a fixed sum when an employee reaches a predetermined retirement age.
11. ………..% of the wage is the contribution of the employer towards the deposit linked insurance fund.

13.12 Review Questions

1. "The principles which are incorporated in the Payment of the Gratuity Act is conducive to the industrial harmony & is in consonance with public policy." Comment.
2. You are working in an organisation & every month your company deducts a part of PF from your salary. It's been 3years that you are working with the same organisation. Now you want to withdraw your PF. Examine the conditions you are required to meet before withdrawing the PF.
3. Mr. Devi is working in ABC corporation for last 4.5yrs as a senior administration officer but during the argument with the management today, he misbehaved & using abusive language at the workplace. Do you think in this case he will suffer from the forfeiture of the gratuity? Justify.
4. You are the owner of ABC estates Pvt. Ltd. You had 300 employees under your supervision. Analyse your duties & obligations towards the pension & gratuity benefits of the employees in your company.
5. Mr. Graham was working with a reputed MNC but due to certain circumstances he was absconding from his services after informing his supervisor who rejected to release him without serving the notice period. Do you think he is entitled to receive his provident fund from the company? Justify.
6. Critically analyse the paradigm shift that has occurred in the employee's provident funds & miscellaneous provisions Act.
7. You are the employee of the XYZ Pvt. Ltd. for last 5 yrs. You are entitled to receive gratuity from the company. Discuss your rights & obligations in this regard.
8. Do you think the main objective of the Provident fund Act is met in current scenario? Justify giving examples.

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9. Being the HR of the company, you are asked to calculate the gratuity amount for the employees. Design the methods you will use to calculate the gratuity. Take any example & use those methods there.

10. Analyse the penalties a corporate has to suffer for the default in making contribution towards gratuity & provident fund.

11. Do you think the Acts introduced by the government for the security of the employees have met their required purpose in today's globalized & privatized world? Justify.

12. "Merely stating that employee went on an illegal strike & so caused a heavy damage to the company is not a ground for denying gratuity." Do you agree? Justify.

13. Mrs. Renu was working with Ernesto Construction for last 12yrs & now she is retired. Examine the benefits which she can avail under the pension Fund Scheme.

14. Do you think these social legislation Acts covers all the aspects of the employees concern for the retirement & loyalty towards the company? Suggest some improvements.

15. You have joined a reputed firm & they asked you to nominate the member for the provident fund scheme at the time of joining. Examine the options you have in nominating the member for the scheme.

Answers: Self Assessment

1. True
2. True
3. False
4. True
5. False
6. Superannuation
7. five
8. gratuity
9. retirement
10. pension plan
11. 0.5

13.13 Further Readings

Books

B D Singh, *Labour Laws for Managers*, Excel Books, New Delhi.

Monal Arora, *Industrial Relations*, Excel Books, New Delhi.

V S P Rao, *Human Resource Management*, Excel Books, New Delhi.

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Unit 14: Securities and Exchange Board of India

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Objectives

After studying this unit, you will be able to:

- Discuss Securities and Exchange Board of India (SEBI)
- Explain powers and functions of SEBI
- Describe management of SEBI

Introduction

In last unit, you have studied about industrial laws. This unit provides you brief knowledge of SEBI. A stable and efficient financial system provides the foundation for implementation of effective stabilization policies, more accurate pricing of risk and more efficient use of capital. Efficiency of the financial system is governed by the role of markets in mobilizing and allocating financial resources, in providing liquidity and payment services and in gathering information on which to base investment decisions. Stability, on the other hand, is concerned with safeguarding the value of liabilities of financial intermediaries that serve as stores of wealth. This also involves questions relating to prudential supervision, financial regulation and good governance. It needs to be added here that as financial systems get increasingly globalizes, capital moves not only in response to competing monetary policies, but also to competing financial systems. Inefficient and unstable financial systems are therefore likely to be increasingly penalized. In India, as in other parts of the world, securities regulations have evolved in the face of two apparently diverging trends.

14.1 Securities and Exchange Board of India (SEBI)

Notes

Both the UK and the USA had long ago created separate boards for the regulation of the securities market. The US has the Securities and Investment Board (SIB) and the Securities and Exchange Commission (SEC). The Indian government's intention to set up a separate board for the regulation and orderly functioning of the market was first declared in the Budget Speech by Rajiv Gandhi, the then Prime Minister and the Minister of Finance, who, while presenting the Budget for the year 1987-88 stated:

"The capital markets in India have exceed ₹ 5,000 crores in 1986-87. They were only about ₹ (figure not given) crores in 1980-81. For a healthy growth of capital markets, investors must be fully protected. Trading malpractice must be prevented. The government has decided to set up a separate board for the regulation and orderly function of stock exchanges and the securities industry."

Origin

By a Notification issued on April 1, 1988, the Securities and Exchange Board of India (SEBI), was constituted as an interim administrative body to function under the overall administrative control of the Ministry of Finance of the Central Government.

In July 1988, the SEBI, constituted as aforesaid, published an approach paper on comprehensive legal for securities market.

The SEBI was given a statutory status on 30th January, 1992 by an Ordinance to provide for the establishment of SEBI. A Bill to replace the Ordinance was introduced in Parliament on 3rd March, 1992 and was passed by the President's assent. However, as provided for in Section 1(3), this Act is to be deemed to have come into on 30th January, 1992 i.e. the date on which the SEBI Ordinance was promulgated.

14.2 Powers and Functions of SEBI

Chapter IV of SEBI Act, 1992, deals with the powers and functions of the Board. Section 11 of the Act lays down that it shall be the duty of the Board to protect the interests of the investors in securities and to promote the development of, and to regulate the securities markets by such measures as it thinks fit. These measures would include:

(a) Regulating the business in stock exchanges and any other securities markets;

(b) Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

(c) Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;

(d) Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;

(e) Promoting and regulating self-regulatory organisations;

(f) Prohibiting fraudulent and unfair trade practices relating to securities markets;

(g) Promoting investors' education and training of intermediaries of securities markets;

(h) Prohibiting insider trading in securities;

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(i) Regulating substantial acquisition of shares and takeover of companies;

(j) Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds and other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;

(k) Calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;

(l) Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;

(m) Levying fees or other charges for carrying out the purposes of this section;

(n) Conducting research for the above purposes;

(o) Calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;

(p) Performing such other functions as may be prescribed.

For carrying out the duties assigned to it under the Act, SEBI has been vested with the same powers as are available to a Civil Court under the Code of Civil Procedure, 1908 for trying a suit in respect of the following matters:

(i) The discovery and production of books of account and other documents at the place and time indicated by SEBI.

(ii) Summoning and enforcing the attendance of persons and examining them on oath.

(iii) Inspection of any books, registers and other documents of any person listed in Section 12 of the Act, namely stockbrokers, sub-brokers, share transfer agents, bankers to an issue, trustee of trust deed, registrar to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and other such intermediaries associated with securities markets.

(iv) Inspection of any book or register or other document or record of the company referred to in sub-section (2A);

(v) Issuing commissions for the examination of witnesses or documents.

Power to Issue Directions

Section 11B of the Act provides that if SEBI is satisfied after making due enquiries, that it is necessary:

(i) in the interest of investors, or orderly development of securities market; or

(ii) to prevent the affairs of any intermediary or other persons referred to in Section 12 being conducted in a manner detrimental to the interests of investors or securities market; or

(iii) to secure the proper management of any such intermediary or person, it may issue such directions –

  (a) to any person or class of persons referred to in Section 12, or associated with the securities market; or

  (b) to any company in respect of matters specified in Section 11A, as may be appropriate in the interests of investors in securities and the securities market.

As per Section 11(4) SEBI, may, by an order or for reasons to be recorded in writing, take any of the following measures either pending investigation or inquiry or on completion of such investigation or enquiry:

(a) suspend the trading of any security in a recognised stock exchange.

(b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell ordeal in securities.

(c) suspend any office-bearer of any stock exchange or self regulatory organisation from holding such position.

(d) impound and retain the proceeds or securities in respect of any transaction which is under investigation.

(e) attach for a period not exceeding one month, with prior approval of a magistrate, one or more bank accounts of any intermediary or any person associated with the securities market in any of the Act or rules or regulations made there under.

(f) direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming the past of any transaction which is under investigation.

Section 11A of SEBI Act provides that SEBI may prohibit, for the protection of the investors, any company from issuing any offer document including a prospectus or advertisement soliciting money from the public for the issue of securities, and specify the conditions subject to which such offer documents can be issued. The Board may specify the matters relating to issue of capital, transfer of securities and other matters, which shall be disclosed by the companies. It may also issue a prospectus, any offer document or advertisement, soliciting money from the public for issue of securities. SEBI may also specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

Note According to clause (j) of Securities Laws (Amendment) Act, 2004 (w.e.f. 12-10-2004). "Stock exchange" means—

(a) any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under sections 4A and 4B, or

(b) a body corporate incorporated under the Companies Act, 1956 (1 of 1956) whether under a scheme of corporatisation and demutualisation or otherwise, for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

14.3 Management of SEBI

The management of SEBI vests in the board, which consists of the following members, namely:

(a) A Chairman

(b) Two members from amongst the officials of the 'Ministers of the Central Government dealing with Finance of Law'

(c) One member from amongst the official of the Reserve Bank of India

(d) Two other members, to be appointed by the Central Government

Notes

The general superintendence, direction and management of the affairs of the SEBI vest in a Board of members, which may exercise all powers and do all acts and things which may be exercised or done by the Board. Save as otherwise determined by regulations, the Chairman shall also have powers of general superintendence and direction of the affairs of the Board and may also exercise all powers and do all acts and things which may be exercised done by the Board.

The Chairman and members referred to at (a) and (b) above shall be appointed by the Central Government and the member referred to at (a) and (c) above shall be nominated by the Central Government and the Reserve Bank of India respectively.

For day-to-day functions, the activities of SEBI have been divided into five operational departments viz. many markets - policy, intermediaries, investor grievances and guidance, etc.,

1. Such management and intermediaries, investor grievances and guidance, etc.
2. Secondary market-exchange administration, inspection and non-member intermediaries etc.,
3. Institutional investment - Mutual funds and Fills, mergers and acquisitions, research and publications and internal regulation.
4. An Executive Director heads each department. Besides these five departments, there are the legal and investigation departments too.

Task Prepare a report on the performance of SEBI since its inception.

14.4 Activities

The first major activity undertaken by SEBI was preparation of an Approach paper on comprehensive legislation for the securities markets. Since inception, SEBI has issued a number of guidelines, rules, drafts regular consultative papers etc. in order to regulate and develop the securities market and protect investors in some important guidelines etc. Issues by SEBI include:

(a) Rules regarding the registration of intermediaries such as share transfer agents, bankers to the issue, detect trustees to the trust deeds, registrars to an issue, underwriters, portfolio managers and investment advisors brokers and sub-brokers associated with the securities market.

(b) Guidelines for merchant bankers stating authorized activities of merchant bankers, the authorization and the terms of authorization.

(c) Code of conduct for merchant bankers, the violation, intentional or otherwise, of which will make merchant bankers guilty of misconduct or unprofessional conduct.

(d) Categorizations of merchant bankers, under which merchant bankers have been categorized into categories. Category I merchant bankers are authorized to act in the capacity of lead management co-market advisor or consultant to an issue, portfolio manager and underwriter to an issue as mandatory required. Category II merchant bankers are authorized to act in the capacity of co-manager/advisor or consultant to an issue of portfolio manager.

(e) Guidelines on portfolio management services which cover such aspects as portfolio management and client relationship, investment tenure, fees to be paid to the portfolio manager, client's money account, investment of the client and periodical reports to the clients and administrative powers of the SEBI in this regard.

(f) Guidelines for lead managers for inter se allocation of responsibilities, which require that wherever the more than one lead manager to the issue inter se allocation of the pre-issue and post-issue activities/sub-act will be properly made and information in this regard sent to SEBI.

Regarding number of lead managers in an issue, SEBI has prescribed that for a total issue aggregation of more than ₹ 50 crores, the number of lead managers will not exceed two; for a total issue of ₹ 50 crores and above less than ₹ 100 crores the number of lead managers may go up to maximum of three and for issues agree ₹ 100 crores and above but less than ₹ 200 crores the number may go up to a maximum of five. For aggregating above ₹ 400 crores, the number of lead managers in excess of five will be prescribed by SEBI to merits of each case.

(g) Guidelines regarding purchase of non-convertible part of debentures (khokas) from the subscribers.

(h) Regulation for registrars and share transfer agents.

(i) Regulation on insider trading.

(j) Guidelines for mutual funds and asset management companies.

(k) Draft regulation for substantial acquisition of shares in listed companies.

(l) Consultative paper on free market pricing of capital issue.

(m) Guidelines on capital issues/Guidelines for Disclosure and Investor Protection along with clarification as on March 1993.

(n) Guidelines on issue of securities by Development Financial Institutions.

(o) Formation of two advisory committees; one on the primary market and the other on the secondary market, consisting of company members from profession, academic and investing public.

Note Business India (March 1-14, 2006) noted what SEBI has done so far what it still needs to do as follows:

WHAT IT HAS DONE SO FAR	WHAT IT STILL NEEDS TO DO
Registration of brokers	Appointment of nominees on exchange base
Inspection of stock exchange	Code of conduct for merchant bank
Investor protection rules	Penalising erring companies
Protection for debenture holders	Bringing UTI under mutual fund rules
Stopping misuse of Promoter's quota	Rules for new instruments
Better disclosure norms	Corporate membership in stock exchanges
RO status for merchant bankers	Postal ballot for company AGM's
Free pricing for public issues	Code for takeovers
Insider trading norms	Norms for custodial, depository services
Capital adequacy norms for brokers	Comprehensive legislation
Curbs on kerb trading	Penal powers over companies
Fighter controls over mutual funds	Uniform accounting standards
Comprehensive norms for underwriters	Capital market development fund

Contd...

Notes

Country rules for foreign intuitional investors Investor protection funds
Permission for private mutual funds
Guidelines for asset management firms
Rules for lead managers
Rules for bankers to the issue
Forms for issue of stock invests
Guidelines for bonus share issues
Rules for underwriters
Advisory panels for primary, secondary market
Investor education campaign

In one word, SEBI in its short span of existence, has performed excellently as its developmental and national role is concerned. How far it would be able to carry out its enforcement role is yet to be seen.

14.5 Self-regulation

In the foregone sections, we have discussed the regulatory framework applicable to primary and secondary rule in India. The focus of discussion has been on what may be called legislative regulation of securities.

In addition to legislative regulation, self-regulation is equally important. Indeed, in developed securities markets like the UK, the self-regulations play and important role. There exists a number of self-regulatory organizations in which really complement legislative regulation.

The spirit of self-regulation had been prevalent in the Indian securities market as well. If one looks at the given to recognized stock exchanges in India to make and enforce bye-laws under the Securities Contracts (ratio) Act, 1956, one tends to conclude that Indian stock exchanges have been envisaged as self-regulatory conditions. Just to elaborate the point, let us look at Section 9 of the Securities Contracts (Regulation) Act, which states as follows.

The recognized stock exchange may, subject to the previous approval of the Central Government (till 1991) Securities and Exchange Board of India (since 1992) make bye-laws for the regulation and control of contracts.

In particular, without prejudice to the generally of the foregoing power, such bye-laws may provide for:

(i) The opening and closing of markets and the regulation of the hours of trade.

(ii) The clearing house for the periodical settlement of contracts and difference there under, the delivery of the orders for securities, the passing on of delivery orders and the regulation and maintenance of such a clearing.

(iii) The submission to the Central Government (till 1991) and Securities and Exchange Board of India (since by the cleaning house as soon as may be after each periodical settlement of all or any of the following … the Central Government (till 1991) and Securities and Exchange Board of India (since 1992) may from to time, require, namely:

(a) The total number of each category of security carried over from one settlement period to another.

(b) The total number of each category of security contracts which have been squared up during the course of settlement period.

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(c) The total number of each category of security actually delivered at each clearing.

(d) The number and classes of contracts in respect of which settlements shall be made or different through the clearing house.

(e) The regulation, or prohibition of badlas or carry-over facilities.

(f) The fixing, altering or postponing of days for settlements.

(g) The determinations and declaration of market rates, including the opening, closing, highest and lowest for securities.

(h) The terms, conditions and incidents of contracts, including the prescription of market requirement and conditions relating there to and the forms of contracts in writing.

(i) The regulation of the entering into, making, performance, recession and termination, of contracts between members or between a member and his constituent or between a member and a person not a member, and consequences of a breach by a seller buyer, and there responsibility of member not parities to such contracts.

(j) The regulation of taravani business including the placing of limitations thereon.

(k) The listing of securities on the stock exchange, the inclusion of any security for the purpose …and the suspension or withdrawal of any such securities, and the suspension or prohibition of trade specified securities.

(l) The method and procedure for the settlement parties to contracts in any capacity.

(m) The levy and recovery of fees, fines and penalties.

(n) The regulation of the course of business between parties to contracts in any capacity.

(o) The fixing of a scale of brokerage and other charges.

14.6 Regulatory Framework of Security Market

The four main legislations governing the securities market are: (a) the SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

Legislations

SEBI Act, 1992: The SEBI Act, 1992, establishes SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporate entities in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with the securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, rules and regulations made thereunder. SEBI has full autonomy and authority to regulate and develop an orderly securities market.

Securities Contracts (Regulation) Act, 1956: It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives the Central Government/SEBI regulatory jurisdiction over (a)

Notes

stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with the prescribed conditions of the Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations, which have to conform to the minimum listing criteria set out in the Rules.

Depositories Act, 1996: The Depositories Act, 1996, provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerializing the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry, without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with.

Task Prepare an assignment on the functions and powers of SEBI in case of any Merger and Acquisition of a listed company.

14.7 Regulators

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Ministry of Company Affairs, Reserve Bank of India (RBI) and SEBI. The activities of these agencies are coordinated by a High Level Committee on Capital Markets. The orders of SEBI under the securities laws are appellable before a Securities Appellate Tribunal.

Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also concurrently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities are derived from these securities and the RBI exercises carry forward contracts in debt securities concurrently. The SEBI Act and the Depositories Act are mostly administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies.

Regulation of Secondary Market

As noted above, Securities Contracts (Regulation) Act 1956 and the rules made there under, namely the securities Contracts (Regulation) Rules, 1957 are the main laws governing stock exchanges in India.

The Preamble to the Securities Regulation Act states that it is "an act to prevent undesirables transaction in Securities by regulating the business of dealing therein, by prohibiting options and by providing certain other matters connected therewith". This Act provides for the direct and indirect control of virtually all aspects of securities leading and the running of the stock exchange. The Act makes every transaction in securities in any notified state area illegal and punishable by fine and/or imprisonment if it is not entered into between or with members of a recognized stock exchange in the state or area.

The Act thus prohibits the existence of other than recognized stock exchanges and provides the mechanism recognizing stock exchanges. Appendix 5.2 gives the list of recognized stock exchanges as of 1992. Application to the Central Government for recognition must include a copy

of the rules relating in general to the constitution of the stock exchange and in particular to, among other things, the admission into the stock exchanges of various bases of members, the exclusion, expulsion and readmission of members, and the procedure for registration of a stock exchange. In determining whether to grant recognition, the Central Government may make whatever require is necessary and impose in the rules and bye-laws of the stock exchanges, whatever conditions are required to ensure "fair dealing" and to "protect investors" These conditions concern, inter alia, the qualification for members, the manner in which contracts are to be entered into and enforced, the representation of not more than three Central Government nominees on the board of the stock exchange, and the maintenance of books and record by members and their audit by chartered accountants. The Central Government has the power to impose further conditions, other than in the rules and bye-laws, such as limiting the number of members. Finally, the Central Government has the power unilaterally to withdraw recognition.

After it recognizes a stock exchange, the Central Government exerts regulatory control over it, and reports are furnished to the Central Government. Certain books and records are maintained for a period years. The Central Government can make an equity itself, or through an appointment of a third party, into the stock exchange or any of its members. All officers, directors, members, and others who have had dealings in matters under inquiry, are required to produce requested documents, statements, or information.

The Central Government retains control over the stock exchange's bye-laws and its rule amendment. The stock exchange, subject to previous Central Government approval, has the authority to make bye-laws for regulation and control of contracts and the regulation of trading. Similarly, no rule amendments have effect unless they are approved by the Central Government. The Central Government, furthermore, has the power to direct the stock exchange to amend its rules; and if it fails to do so, the Government may directly amend the rules of such a stock exchange. The suspension of business may be complete or subject to conditions. Suspensions may not be of more than seven days initially, but may be extended from time to time. The Central Government may supervise the governing body of any exchange of declaration and then appoint any person or group of persons to exceed and perform all the power and duties of the governing body.

Other powers granted to the Central Government include the authority to stop further trading in a specified round for the purpose of preventing undesirable speculations, and the power to compel a public company "in the initial of the trade or in the public interest" to list its securities on any of the recognized exchanges.

The Securities Regulation Rules specifically provide for membership of an exchange. No person can be eligible for membership if he is less than twenty-one years of age, is not a citizen of India, has been adjudged bankrupt, or has been convicted of an offence involving fraud or dishonesty. Under Section 8, rules relative to the membership of stock exchanges are given which are reproduced as below.

Did u know? Mumbai, Feb 7 (PTI) Taking a leaf out of the ₹ 14,000 crores Satyam fraud, market regulator Sebi will recommended to the Corporate Affairs Ministry not to provide voting rights to any person related to a company to guard against related party transactions.

The Securities and Exchanges Board of India (SEBI) will suggest the rider to be included in new Companies Bill, which is expected to be brought up for passage in Parliament in the Budget session, the market regulator''s exiting chief C B Bhave said at a press conference here.

"SEBI will recommend to the MCA...disallowing interested shareholders from voting on the special resolution of the prescribed related party transaction. This will protect shareholders from abusive related party transactions. This view was taken based on the learnings from the investigation in the matter of Satyam Computer Services," Bhave said.

Notes

Related party transactions refer to dealings amongst subsidiaries, SPVs, sister concerns, individuals having an interest in the voting power, chairman and their relatives.

These transactions are a cause of concern as a company can use it to evade tax or cheat investor, and require strict monitoring.

According to clause 166 of the Companies Bill 2009, shareholders are authorised to decide on contracts and arrangements with the related party on matters like sale, purchase or supply of goods and services and property; leasing property, and appointment of agents.

In December 2008, shareholders of Satyam Computer Services had opposed and blocked the buy out of infrastructure firms – Maytas Infrastructure and Maytas Properties – the two firms promoted by the kin of the then chief of the software firm B Ramalinga Raju.

Among other things, it was felt the transaction was overvalued.

14.8 Regulation of OTCEI

The functioning and operations of the OTCEI are subject to the provision of the Securities Contracts (Regulation) Act, 1956, the Companies Act, 1956 and other relevant laws, which are applicable to Indian Stock Exchanges of operations are supervised by SEBI and Government of India. The criteria for admission of members, licensed dealers and companies on the OTCEI are prescribed as follows.

Criteria for Admission of Members

The members would be public financial institutions, scheduled banks, mutual funds, banking subsidiaries, SEBI-registered merchant banks, venture capital funds and venture capital companies, non-banking financial companies having a minimum financial net worth as specified by OTCEI. The applicant should satisfy the elegant requirements of the Securities Contracts (Regulation) Rules, 1957.

The member should posses the necessary skills, resources and capabilities to appraise project/ common establish its viability, analyze a company's financial worth, evaluate a company's management and determine value for a company's products.

The member should have the necessary status and standing to be able to carry the confidence of the members and licensed dealers while recommending any scrip for investment.

The member should have sufficient financial reserves to 'sponsor' and trade in the scrip.

The member should be authorized by SEBI for carrying out merchant banking activities.

The member should have adequate organizational infrastructure to establish and manage the OTC count (that is, office space, computers, PTI scam, telephones, telex, fax and any other data communication equipped specified).

The net worth of the member should be a minimum of ₹ 2.50 crores.

Criteria for Admission of Licensed Dealers

The licensed dealers would be a corporate body, partnership firms and individuals having minimum tangible net worth of an amount to be decided by the OTCEI governing board from time to time. The corporate bond should satisfy the eligibility requirements of the Securities Contracts (Regulation) Rules, 1957. The licensed dealers should have a minimum tangible liquid net worth which would be sufficient to carry investment, trading and market making in the scrips listed on the OTC Exchanges.

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The licensed dealers should have adequate organizational infrastructure such as office space, compound PTI scan, telephones (minimum two), telex, fax and other data communications equipment specified.

Licensed dealers should at least be graduates. Additional weightage will be given for additional ratio professional qualification. Licensed dealers should have adequate knowledge of trading, stock valuation, share transfer rules and relation.

Apart from the above, the licensed dealers will be required to comply with the following terms and conditions:

(a) If the applicant is a corporate body, the promoters should hold at least 40% of the equity capital.

(b) In case of change in dealership from individual/partnership firm to a corporate body original individual dealers/shares of the partnership firm should hold at least 40% of the capital of the new corporate body.

(c) Partnership firms and corporate applicants must nominate one of the authorized signatories whose signification will be considered for eligibility and the same person will be required to take a written test and appear in interview.

(d) Dealership is not transferable.

(e) If there is a change in shareholding of a body corporate who is a dealer, resulting in change in ownership management, the OTC Exchange of India reserves the right to review the status of dealership of that dealer.

Did u know? Stock market regulator Securities and Exchange Board of India (SEBI) on Friday banned Reliance Anil Dhirubhai Ambani Group (ADAG) Chairman Anil Ambani from investing in stock market till December.

The SEBI imposed the ban after receiving information that ADAG is raising money through external commercial borrowings and/or foreign currency convertible bonds, and investing the amount in stock market.

According to reports, Ambani and four board members of Reliance Natural Resources Limited (RNRL)- are Satish Seth, Lalit Jalan, SC Gupta and JP Chalsani-have been barred from stock market investment till SEBI completes its investigations into the case.

SEBI also banned two of Ambani's group companies-RNRL and Reliance Infrastructure from the secondary market for two years.

Criteria for Admission (for Listing) of companies

The company should be sponsored by a member of the OTCEI. The sponsor has to certify that all the scrips proposed to be offered for trading on OTC Exchange have already been subscribed to by members and licensed dealers of OTCEI.

The company has to agree to abide by all statutory and OTCEI's provisions for listing.

The company to agree to entered into an agreement with the OTCEI in a prescribed format.

The company will comply with the provisions laid down in the Notification to be issued by the Government of India; subscribed to by members and licensed dealers of OTCEI.

The company to agree to abide by all statutory and OTCEI's provisions for listing.

The company will comply with the provisions laid down in the Notification to be issued by the Government of India, for listing on the OTC Exchange of India.

Notes

The issues of securities by companies and their listing on the OTCEI will be governed by the following guidelines:

(i) The minimum issued equity share of accompany for eligibility for listing on the OTCEI will be ₹ 30 lakhs subject to a minimum public offer of equity shares worth ₹ 20 lakhs in face value.

(ii) For companies with an issued equity capital of more than ₹ 30 lakhs but less than ₹ 300 lakhs, the return public offer should be 40% of the issued capital or ₹ 20 lakhs worth of shares in value, whichever is higher in relaxation of rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957.

(iii) Companies with an issued equity capital of more than ₹ 300 lakhs seeking listing on the OTCEI will have to comply with the listing requirements and guidelines as are applicable to such companies for enlistment on other organized stock exchanges; for venture capital companies, a minimum of 20% of capital has to be issued for listing in OTCEI.

(iv) Companies covered under the MRTO Act/FERA may be listed on the OTCEI only if they satisfy the conditions for listing on other recognized stock exchanges, such as minimum issued equity capital of ₹ 300 lakhs and such other limit as may be prescribed from time to time.

(v) A company with an issued equity share capital of more than ₹ 25 crores will be eligible for listing on the OTCEI.

(vi) Companies, which are engaged in investments, leasing, finance, hire-purchase, amusement parks, etc. will not be eligible for listing on the OTCEI.

(vii) The minimum number of centres for collection of application forms in respect of issue of securities by companies, under the OTCEI shall be four, one each from the Northern, Western, Southern, Eastern regions of the country. However, OTCEI shall have the power to increase the number of centres depending upon the size and nature of securities made by a company.

(viii) The Securities and Exchange Board of India (SEBI) vide its letter dated July 16, 1992 has inter alia classified as regards issue of shares through OTC Exchange of India as follows.

(ix) Where a direct public issue is made through OTC without the sponsor taking any shares, the normal guidelines for disclosures and investor protection shall apply.

(x) Where the shares of a company have been taken by the sponsor, such shares may be offered to the public calculated at such price as the sponsor may deem fit, in accordance with the regulations of OTC subject to the following conditions.

(xi) The promoters, after such offer, retain at least 25% of the total issued capital with lock-in-period of five years from the date of the sponsor taking up the shares.

(xii) The sponsor agrees to act as market-maker for the shares at least for a period of three years on a compulsory basis and also finds an additional market maker for such compulsory market making, and

(xiii) The sponsor compulsorily gives two-way quotes based on minimum or maximum trading prices as stipulated by the OTC in respect of the scrip.

With a view to making markets more competitive and compliant, SEBI has brought in the following new regulations:

1. SEBI (Prohibition of Fraudulent and Unfair Trade Practices - relating to Securities Market) Regulations, 2003

2. SEBI (Ombudsman) Regulations, 2003

Notes

3. SEBI (Central Listing Authority) Regulations, 2003
4. SEBI (Central Database for Market Participants) Regulations, 2003
5. SEBI (Self Regulatory Organizations) Regulations, 2004
6. SEBI (Criteria For Fit and Proper Person) Regulations, 2004

As a measure of regulatory pro-activeness, the existing regulations were reviewed and the following amendment to the above regulations were notified:

1. SEBI (Foreign Institutional Investors) (Amendment) Regulations, 2003
2. SEBI (Mutual Funds) (Amendment) Regulations, 2003
3. SEBI (Depositories and Participants) (Amendment) Regulations, 2003
4. SEBI (Debenture Trustees) (Amendment) Regulations, 2003
5. SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2003
6. SEBI (Issue of Sweat Equity) (Amendment) Regulations, 2003
7. SEBI (Stock Brokers and Sub-Brokers) (Amendment) Regulations, 2003
8. SEBI (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2003
9. SEBI (Procedure for Holding Enquiry and Imposing Penalty) (Amendment) Regulations, 2003
10. SEBI (Ombudsman) (Amendment) Regulations, 2003
11. SEBI (Foreign Institutional Investors) (Amendment) Regulations, 2004

Example: Dr. K. M. Abraham, Whole Time Member, SEBI, has passed an order dated March 08, 2011 imposing a penalty of suspension of the certificate of registration of M/s. Rajendra Prasad Shah, member, Calcutta Stock Exchange Ltd. (CSE), for a period of five days in respect of its dealings in the shares of Bakra Pratisthan Ltd.

14.9 Regulation of the Investments of a Mutual Fund

The investments of a mutual fund are subject to a set of regulations prescribed by SEBI. The important ones are:

1. A mutual fund, under all its schemes taken together, will not own more than 10% of any company's paid up capital carrying voting rights.
2. A scheme shall not invest more than 15% of its NAV in debt instruments issued by a single issuer, which are rated not below investment grade by an authorised credit rating agency.
3. Barring certain exceptions, a scheme shall not invest more than 10% of its NAV in the equity shares or equity related instruments of any one company.
4. A scheme shall not invest more than 5% of its NAV in unlisted equity shares or equity related instruments in case of an open-ended scheme and 10% of its NAV in case of a close-ended scheme.
5. Mutual funds shall mark all investments to market.

Notes

Case Study

FIIs, NRIs can invest in Indian Depository Receipts

Foreign Institutional Investors (FIIs) and the Non-resident Indians (NRIs) are allowed to invest in Indian Depository Receipts, according to the operational guidelines issued by the Reserve Bank of India on Wednesday.

FIIs, including the SEBI approved sub-accounts of the FIIs, registered with SEBI and NRIs may invest, purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market, subject to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

Further, NRIs have been allowed to invest in the IDRs out of funds held in their NRE/FCNR(B) account, maintained with an authorised dealer/authorised bank, the RBI said.

Foreign companies can issue IDRs through a domestic depository. The RBI guideline will also permit residents in and outside India to purchase, possess, transfer and redeem IDRs issued by the foreign companies.

The Central Government had issued the companies IDR rules that are now being operationalised by SEBI and the RBI through issue of guidelines.

Last month, SEBI had brought out a circular modifying the listing agreement to bring down the regulatory cost of the IDR issuers from countries that are "signatories of multilateral memorandum of understanding (MMOU) of International Organisation of Securities Commissions (IOSCO)."

In its circular, the RBI has said IDRs cannot be redeemed into underlying equity shares before the expiry of one year from the date of issue.

The RBI has also said that automatic fungibility of IDRs will not be allowed.

"In case of raising of funds through issuance of IDRs by financial/banking companies having presence in India, either through a branch or subsidiary, the approval of the sectoral regulator(s) should be obtained before the issuance of IDRs".

Standard Chartered Bank is awaiting approval from the RBI for an IDR issue.

The proceeds of the issue of IDRs shall be immediately repatriated outside India by the eligible companies issuing such IDRs. The IDRs issued shall be denominated in Indian rupees and the proceeds of the issue can be immediately repatriated outside India by the company.

The Indian investors in IDRs will be regulated under the Foreign Exchange Management Regulations.

Question

Discuss the regulation of DR in India.

Hint: In India issue of ADR, GDR is regulated by SEBI regulations. The companies issuing ADRs, GDRs in India should take permission from RBI.

Source: thehindubusinessline.com

14.10 Summary

- In this unit, we have discussed two segments of Indian securities market namely, primary market on issues market and secondary market or stock market.

- We have highlighted recent trends in the primary, discussed various types of securities traded, market players and trading arrangements which exits in the can stock market.
- Different aspects of the Indian stock market viz. its origin and growth, role and functions, membership, organization and management, trading systems, stock market information system, principal weakness of directions of reform have been explained so that you, as a student of this course, are able to clearly visualize the environment in which investment and portfolio management decisions are made.
- A major development of the 1992 scenario of Indian stock exchanges namely, the promotion of Over The Counter Exchanges of India (OTCEI), its true features, trading mechanism and expected benefits to companies, investors and general environment of finance is also discussed.
- In the following unit we shall focus on the legal frame of Indian securities market.
- Companies with an issued equity capital of more than ₹ 300 lakhs seeking listing on the OTCEI will have to comply with the listing requirements and guidelines as are applicable to such companies for enlistment on other organized stock exchanges; for venture capital companies, a minimum of 20% of capital has to be issued for listing in OTCEI.
- Companies, which are engaged in investments, leasing, finance, hire-purchase, amusement parks, etc. will not be eligible for listing on the OTCEI.

14.11 Keywords

DEA: Department of Economic Affairs

MCA: Ministry of Company Affairs

Merchant bankers: are authorized to act in the capacity of lead management co-market advisor or consultant to an issue, portfolio manager and underwriter to an issue as mandatory required.

Money market: The market for short-term debt securities with maturities of less than one year.

RBI: Reserve Bank of India

SCR Act: The Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges

SEBI: Securities and Exchange Board of India

14.12 Self Assessment

Fill in the blanks:

1. The .... may specify the matters relating to issue of capital, transfer of securities and other matters, which shall be disclosed by the companies.
2. The general superintendence, direction and management of the affairs of the .... vest in a Board of members, which may exercise all powers and do all acts and things which may be exercised or done by the Board.
3. For day-to-day functions, the activities of SEBI have been divided into five ....
4. The first major activity undertaken by SEBI was preparation of an Approach paper on comprehensive legislation for the ....
5. The SEBI Act, ... which establishes SEBI to protect investors and develop and regulate securities market

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6. ...., which provides for regulation of transactions in securities through control over stock exchanges
7. .... which provides for electronic maintenance and transfers of ownership of demat securities.
8. Securities Contracts (Regulation) Act, 1956 provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to .... in securities
9. .... should have adequate knowledge of trading, stock valuation, share transfer rules and relation.
10. A ...., under all its schemes taken together, will not own more than 10 % of any company's paid up capital carrying voting rights.

14.13 Review Questions

1. Write on powers and functions of SEBI.
2. Explain briefly the organisation (management of SEBI).
3. Explain briefly the regulatory framework of the Securities Market.
4. Write a note on Securities Contracts (Regulation) Act, 1956.
5. Write about the Depositories Act, 1996.
6. Give an insight on the regulation of OTCEI.
7. What are criteria for admission of licensed dealers?
8. Write a note on the regulation of investment of a mutual fund.

Answers: Self Assessment

1. operational department
2. SEBI
3. Board
4. securities markets
5. 1992
6. The Securities Contracts (Regulation) Act, 1956
7. The Depositories Act, 1996
8. prevent undesirable transactions
9. Licensed dealers
10. mutual fund

14.14 Further Readings

Books

G. Vijayaragavan Iyengar, *Introduction to Banking*, Excel Books, New Delhi, India, 2007

S.S Gulshan, *Business Law,* Third Edition, Excel Books, New Delhi, 2006

S.S Gulshan, *Mercantile Law,* Third Edition, Excel Books, New Delhi, 2006

Online links

http://investor.sebi.gov.in/

http://www.sebi.gov.in/Index.jsp?contentDisp=Section&sec_id=3

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