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Paper No. IX

COMMERCIAL LAW AND COMPANY LAW

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CONTENTS

Lesson		Page No.
1.	Nature and Kinds of Contracts	5
2.	Discharge of Contract	19
3.	Remedies for Breach of Contract	35
4.	Offer	47
5.	Acceptance	59
6.	Bailment	67
7.	Pledge	81
8.	Contract of Sale of Goods Act 1930	87
9.	Rights and Duties of a Buyer and Seller	101
10.	Company form of Business – On Over View	108
11.	Formation of a Company	121
12.	Memorandum of Association	133
13.	Doctrine of Ultravires	149
14.	Articles of Association	156
15.	Prospectus of a Company	169
16.	Shares	185
17.	Debenture	196
18.	Directors	205
19.	Company Secretary	224
20.	Meeting	234
21.	Winding up - Compulsory Winding up by the Court	248
22.	Winding up - Voluntary Winding up	262

SYLLABUS

PAPER IX COMMERCIAL LAW AND COMPANY LAW

Objective : To enlighten the Students Knowledge on Commercial and Company Laws.

UNIT - I

Law – Meaning – Law of Contract – Definition – Classification of Contracts – Essential Elements of Valid Contract – Discharge of Contract – Remedies of Breach of Contract – Offer – and Acceptance – Legal Rules relating to Offer and Acceptance – Revocation of Offer and Acceptance.

UNIT - II

Bailment and Pledge – Essentials of Bailment – Rights and Duties of Bailor and Bailee-Pledge-Essentials-Rights and Duties of Pawnee. Contract of Sale of Goods Act 1930 –Rules regarding Delivery of Goods – Rights and Duties of a Buyer and Seller.

UNIT - III

Company – Definition-Characteristics – Kinds – Privileges of Private Company – Formation of a Company – Memorandum of Association – Meaning – Purpose – Alteration of Memorandum – Doctrine of Ultravires – Articles of Association - Meaning Forms – Contents – Alteration of Articles – Doctrine of Indoor management.

UNIT - IV

Prospectus – Definition – Contents – Deemed Prospectus – Misstatement in Prospectus - Shares and Debentures – Meaning – Types – Director and Secretary – Qualification and Disqualification – Appointment – Removal – Remuneration – Powers, Duties and Liabilities.

UNIT - V

Meeting – Requisites of Valid Meeting – Types of Meeting – Winding up – Meaning – Modes of Winding Up.

Books for Reference

1. N.D.Kapoor, “Business Law”, Sultan Chand & Sons, New Delhi 2005.
2. R.S.N.Pillai & Bagavath, “Business Law” S.Chand, New Delhi 2005
3. Bagrial A.K, “Company Law”, Vikas Publishing House, New Delhi
4. Gower L.C.B, “Principles of Modern Company Law”, Steven & Sons, London.
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LESSON-1

NATURE AND KINDS OF CONTRACTS

CONTENTS

1.0 Aims and Objectives
1.1 Introduction
  1.1.1 Definition of law
  1.1.2 Object of law
  1.1.3 Classification of law
1.2 Contract
  1.2.1 Meaning
  1.2.2 Definition
1.3 Law of contract
  1.3.1 Purpose of the law of contract
  1.3.2 Definition
  1.3.3 Nature of the law of contract
  1.3.4 Components of a contract
1.4 Classification of contract
  1.4.1 Classification according to Validity
  1.4.1 (a) Essential elements of a valid contract
  1.4.2 Classification according to formation
  1.4.3 Classification according to performance
1.5 Let us Sum Up
1.6 Questions for discussion
1.7 Model answer to check your progress
1.8 References

1.0 AIMS AND OBJECTIVES

In this lesson, we discuss the meaning, objectives, classification of law, definition of contract, classification of contract and essential elements of valid contract. After going through this lesson you will able to

1) know the meaning of Law
2) understand the definition and classification of Law
3) understand the definition of contract and classification of contract
4) study the essential elements of valid contract

1.1 INTRODUCTION

The word law is a general term and has different connotations for different people It is not possible to give a single, accurate definition. In general law includes all the rules and principles which regulate our relations with other individuals and with the state. Here, we discuss the definition of Law, objects and classification of Law.

1.1.1 Definition of Law

Professor Holland defines law as the external rule of human action enforced by sovereign political authority. In case of inanimate objects, they are governed by law of nature. In the words of Salmond, "Law is the body of principles recognised and applied by the State in the administration of justice." Law is not static, as circumstances and conditions in a society changes, Laws are changed to fit the requirements of the society.

1.1.2 Object of Law

1. The object of law is to establish socio-economic justice and remove the existing imbalance in the socio-economic structure.
2. Law has to serve as a vehicle of social change and as a harbinger of social justice.

1.1.3 Classification of Law

Law can be divided in to substantive law and Procedural law. Substantive law speaks about substantial rights and duties of parsons to enter into transactions. Procedural law speaks about procedure to be followed. Further, Law may be broadly classified as private law, public law and personal law.

Private law deals with laws that are applicable to and among individuals in society. Personal laws are laws that are applicable to various communities pertaining to marriage, divorce, adoption, succession and inheritance, etc. Public law deals with matters pertaining to rights of the individuals versus the state, rights of the state versus centre, rights inter se amongst states.

Mercantile law is that branch of law which is applicable to mercantile transactions. Commercial law is quite essential for anyone who desires to have a basic knowledge in respect of commercial transactions like sale of goods, guarantee, bailment, agency, partnership, insurance and negotiable instruments

1.2 CONTRACT

A contract is an agreement made between two or more parties which the law will enforce**.** In this section, we discuss the meaning and definition of contract

1.2.1 Meaning

Contract is an agreement between two or more parties mentally agrees upon doing or not doing a particular work.

1.2.2 Definition

William Anson	:	" a legally binding agreement between to or more persons by which rights are acquired by one or more to acts or forbearance on the part of the other or others"
Savigny	:	"the union of several persons in an accordant expression of will with the object of creating an obligation between them"
Salmond		a contract is "an agreement creating and defining obligations between the parties."

Commercial transactions are made by parties who do not expect contingencies of failure with regard to fulfilment of the obligations. It is only when parties to the transactions refuse, omitted or unable to fulfil their obligations; the question of forming a contract with legal terms becomes essential. In this connection, the ingredients of commercial obligations cannot be converted by parties into legal obligations, according to their own convenience. Hence, it is very important that the basic ingredients of a contract must be known to everyone.

1.3 LAW OF CONTRACT

Its rules define the remedies that are available in a court of law against a person who fails to perform his contract, and the conditions under which the remedies are available. The law of contract is the most important branch of commercial law .It introduces definiteness in business transactions and determines the circumstances in which promises made by the parties to a contract shall be legally binding on them. In this section we discuss definition of law, purpose of law and nature of law.

1.3.1. Purpose of the law of Contract

The purpose of the law of contract is to ensure the realisation of reasonable expectation of the parties who enter into a contract. Agreement enforceable by law becomes contract. All contracts are agreements and obligations but not vice versa.

1.3.2 Definition

John Salmond "the law of contracts is not the whole law of agreements, nor is it the whole law of obligations, but it deals with those agreements which create obligations and those obligations is which have their source in agreements"

1.3.3 Nature of the law of Contract

The law of contract differs from other branches of law in an important respect. It does not lay down a number of rights and duties which the Law will enforce; it consists rather of a number of limiting principles, subject to which the parties may create rights and duties for themselves which the law will uphold. The parties to a contract, in a sense, make the law for themselves. So long as they do riot infringe some legal prohibition, they can make what rules they like in respect of the subject-matter of their agreement, and the law will give effect to their decisions

1.3.4 Components of a Contract

Contract essentially consists of two elements viz., a) agreement and b) obligations.

1.3.4.(a)Agreement:

When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise. Every promise forming consideration for each other is called as an agreement. An agreement is an accepted proposal there must be a proposal or offer by one party and its acceptance by the other. The Law of Contract does not exhaustively deal with all types of agreements

i) it does not deal with agreements which destroy rights.

Example:

Surrender deed. When rights are surrendered there is nothing to be enforced.

(ii) it does not deal with agreements which transfer rights. Example: Assignment deed. When rights are assigned in favour of another, here also there can be no contract for enforcement,

(iii) Therefore, the law of contract deals with such type of agreements which create, define, protect and preserve rights and obligations. An agreement may be a social agreement or a legal agreement. A social agreement does not give rise to contractual obligations and is not enforceable in a court of law.

Examples:

1. Nithilan invites his friend Saminathan to come and stay with him for a week. B accepts the invitation but when he comes to Nithilan, Nithilan cannot accommodate him as his wife had died the day before. Saminathan cannot claim any compensation from Nithilan as the agreement is a social one.

2. A father promises to pay his son Rs. 200 every month as pocket allowance. Later he refuses to pay. The son cannot recover as it is a domestic agreement and there is no intention on the part of (he parties to create legal relations.

1.3.4 (b) Obligations

Obligation is a legal tie which imposes upon determinate person or persons the necessity of doing or abstaining from doing a definite act or acts. Obligations are also said to be varied, such as social obligations, obligations arising out of torts (civil wrong or breach of duty), obligations arising out of compromise decree, obligations arising out of quasi contract and obligations arising out of agreements.

1) The Law of Contract does not deal with social obligations.

2) Obligations may also arise out of torts. Tort means civil wrong which amounts to breach of duty.

3) The Law of Contract does not take notice of obligations arising out of a compromise decree in a suit between two litigants.

4) The Law of Contract again does not deal with obligations arising out of quasi contracts.

5) It is needless to say that the Contract Act deals with such obligations arising out of agreement which again creates, defines, protects and preserves rights and obligations.

Check your progress 1

Write short notes on need for the "knowledge of law"

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

1.4 CLASSIFICATION OF CONTRACT

In this section we discuss the classification of Contract under three headings

i) Classification according to Validity

ii) Classification according to formation

iii) Classification according to performance

1.4 1 CLASSIFICATION ACCORDING TO VALIDITY

From the point of view of validity a contract is classified as follows

i) Valid contract

ii) Void contract

iii) Voidable contract

iv) Unenforceable contract

v) Void agreement

vi) Illegal agreement

1.4.1.(i) Valid Contract (section 2 (h))

According section 2(h) contract is an agreement enforceable by law. All contracts are agreements but not vice versa. The formation of the contract requires certain important ingredient without which the contract cannot be constituted. **A**n agreement becomes a valid contract when all the following essential elements are present**.** If any one of these elements is missing, the contract is voidable, void, illegal or unenforceable.

1.4.1.(i) (a) ESSENTIAL ELEMENTS OF A VALID CONTRACT

The term 'agreements' it is much wider than the term 'contract'. An agreement becomes enforceable by law when it fulfils certain conditions. According to sec, 10 of the Act lay down the essentials of a valid contract. In this section, we discuss the essential elements of a valid contract.List of essential Elements:

1. Offer and Acceptance
2. Intention to create legal
3. Lawful Consideration
4. Capacity of parties
5. Free and genuine consent
6. Lawful object
7. Agreement not declared void
8. Certainty and possibility of performance
9. Legal formalities.

1. Offer and Acceptance:

An agreement is the result of an offer and its acceptance. So, there must be 'lawful offer' and a 'lawful acceptance' of the offer. In an agreement there must be atleast two parties, one of them making the offer and the other accepting it. The offer and acceptance must satisfy the requirements of the contract Act in relation thereto.

2. Intention to Create Legal Relations

There must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. If the parties do not intend to create legal obligations, there is no contract between them. An agreement which gives rise to a moral or social obligation is not contract.

Example:

Ram invited Raja for a dinner. Raja accepted the invitation. It is a social agreement. If Ram fails to serve to Raja, Raja cannot go to Courts of Law for enforcing the agreement. Similarly, if Raja fails to attend the dinner, Ram cannot go to Courts of Law for enforcing the agreement.

3. Lawful Consideration

One of the essential elements a valid contract is the presence of 'consideration'. The agreement must be supported by lawful consideration on both sides. Each party to the agreement must give or promise something and receive something or a promise in return. Consideration is the price for which the promise of the other is sought. The consideration is lawful, unless it is forbidden by law or is fraudulent.

Example:

If A offers to sell his scooter to B for Rs. 10,000 and B accepts the offer, then for A Rs. 10,000 is the consideration and for B the scooter is the consideration

4. Capacity of Parties

The parties to an agreement must be competent to a contract; otherwise it cannot be enforced by a Court of Law. If any of the parties to the agreement suffer from Minority, Lunacy, Drunkenness, idiocy, etc., the agreement is not enforceable at law, except in some special cases. Under section 11 of the act, "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject"

5.Free and Genuine Consent

“Consent” means that the parties must have agreed upon the same thing in the same sense. The consent of the parties to the agreement must be free and genuine. The consent of the parties should not be obtained by misrepresentation, fraud, undue influence, coercion or mistake. If the consent is obtained by any of these flaws, then the contract is not valid.

6. Lawful Object

For the formation of a valid contract it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered must not be illegal or immoral or opposed to public policy. If the object is unlawful, the agreement is void.

Example:

‘A’ lets his house to a prostitute to carry on prostitution; he cannot recover the rent through a court of law.

7. Agreement not declared Void

The agreements must not have been expressly declared to be void by any law in force in the country. If certain agreements are expressly declared to be void by the law of the country, f then such agreements if entered into shall not be enforceable by Courts of Law.

8. Certainty and Possibility of Performance

Agreements to form valid contracts must be certain. If it is vague and it is not possible to ascertain its meaning, it cannot be enforced. The performance of an agreement must be possible. An agreement to do an impossible act is not valid.

Example:

X agrees to sell Y hundred tons of oil. There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

9. Legal Formalities

A contract may be oral or in writing. If, however, a particular type of contract is required by law to be in writing, it must comply with the necessary formalities as to writing, registration and attestation, if necessary. If these legal formalities are not carried out, then the contract is not enforceable at law.

1.4.1. (ii) Void contract

The word ‘void’ means ‘not binding in law’. Accordingly the term ‘void contract’ implies, contract which has no legal effect at all. A void contract is that which is not enforceable by law. Sec. 2 (j) defines: “A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable”. A contract which is enforceable by law at the time it was made. But later on if it becomes legally unenforceable due to some reasons, it is called void contract.

Example:

Prasath promised to marry uma. Later on uma died. In this case, the contract becomes void on the death of uma.

A void contract is not void from its inception and that it is valid and binding on the parties when originally entered but subsequent to its formation it becomes invalid and destitute of legal effect of certain reasons. The reasons which transform a valid contract into a void contract, as the Contract Act, are as follows:

i) Supervening impossibility (Sec. 56)

A contract becomes void by impossibility of performance after the formation of the contract.

Example:

“Narayanan” and “Suba” contract to marry each other. Before the time fixed for the marriage Narayanan goes mad. The contract to marry becomes void.

ii) Subsequent illegality (Sec. 56)

A contract also becomes void by subsequent illegality. Example, A agrees to sell B 100 bags of wheat at per bag. Before delivery, the Government bans private trading in tie contract becomes void.

iii) Repudiation of a voidable contract

A voidable contract becomes void, when the party, whose consent is not free, repudiates the contract.

Example:

Kannan by threatening to murder satha’s son, makes satha agree to sell his car 3, 00,000 for a sum of Rs 1, 00,000 only. The contract, being the result of coercion is voidable at the option of satha. satha may either affirm or reject the contract. In case satha decides to rescind the contract, it becomes void.

iv) In the case of a contract contingent on the happening of an uncertain future event, if that event becomes impossible.

A contingent contract to door not to do something on the happening of an uncertain future event, becomes void, when the event becomes impossible.

Example:

Selvi to give Rs 15,000 as loan to seethe, if seetha marries loganathan.. Loganathan dies without being married to seethe. The contract becomes void.

1.4.1.(iii) Voidable Contract

According to section2 (i)"An agreement which is enforceable by law at the option of one or more of the parties thereon, but not at the option of the other or others, is a voidable contract". A voidable contract is one which is enforceable by law at the option of one of the parties, until it is avoided or rescinded by the party entitled to do so by exercising his option in that behalf, it is a valid contract.

The consent of one of the parties to the contract is obtained by coercion, undue influence, misrepresentation or fraud such a contract is voidable at the option of the aggrieved party i.e., the party whose consent was so caused (Secs. 19 and 19 A). In such cases where the consent is not free, the party whose consent is so caused becomes the aggrieved party who can either affirm the contract or set aside or rescind it. This right of recession should, however, be exercised within reasonable time and before the third party acquires rights under the contract

Example:

A agreed to sell his car to B for Rs. 50,000. The consent was obtained by use of force. The contract is voidable at the option of A. A can put an end to this contract, if he so decides.

1.4.1. (iv) Unenforceable contract

The unenforceable contracts are those which cannot be enforced in a Court of Law because of some technical defects such as absence of writing, registration, requisite stamp etc., If such formalities are not properly observed, the contract cannot be enforced is court of law. Such contracts can be enforced if the technical defect is removed.

Example:

An oral arbitration agreement is unenforceable because the law requires an arbitration agreement to be in writing. Similarly, a bill of exchange or promissory note, though valid in itself, becomes unenforceable after three years from the date of bill or note falls due, being time barred under the Limitation Act.

1.4.1. (v) Void Agreement

According to section 2 (g), "An agreement not enforceable by law is said to be void". There is absence of one or more elements of a valid contract, except that of 'free consent' in the case of a void agreement. A void agreement has no legal effect. It confers no rights on any person and creates no obligations.

Example:

An agreement with a minor is void ab-initio as against him, because a minor lacks the capacity to contract. Similarly, an agreement without consideration is void ab-initio,

1.4.1. (vi) Illegal Agreement

An agreement is illegal and void if its object or consideration: (a) is forbidden by law; or (b) is of such a nature that, if permitted, it would defeat the provisions of any law ;or (c) is fraudulent; or *(d)* involves or implies injury to the person or property of another; or *(e)* the court regards it as immoral, or opposed to public policy (Sec. 23).Thus an agreement to commit murder, robbery etc.

1.4.2 CLASSIFICATION ACCORDING TO FORMATION

From the point of view of mode of creation a contract can be classified into the following three types

i) Express contract

ii) Implied contract

iii) Quasi contract

1.Express contract

According to section 9 “In so far as the proposal or acceptance any promise is made in words the promise is said to be express”. An express promise results in an express contract. When such contract is formed, there is no difficulty in under standing the rights and obligations of the parties. In other worlds, where both the offer and acceptance constituting an agreement enforceable at law are made in words spoken or written, it is an express contract.

Example:

A tells B on telephone that he offers to sell his car for Rs 20, 000 and B in reply informs A that he accepts the offer, there is an express contract.

2. Implied contract

According to section 9 “In so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied”. The both offer and acceptance constituting in an agreement enforceable at law are made otherwise than in words such contract comes into existence on account of act or conduct of the parties.

Example:

Mr. X went to a restaurant and took a cup of coffee. In this, there is an implied contract that he will pay for the cup of coffee, even though he makes no express promise to do so.

3. Constructive or quasi contract

Quasi contract is a misnomer. If a contract does not arise by virtue of any agreement, express or implied between the parties but the law infers a contract under certain special circumstances is called as quasi contract. There are certain dealings which are not contracts strictly, the parties act as if there is a

contract. In fact, it is an obligation which the law creates in the absence of any agreement. It rests on the ground of equity that "a person shall not be allowed to enrich himself unjustly at the expense of another. Thus, a finder of lost goods is under an obligation to find out the true owner and return the goods

Example:

Mr. X supplied Y, a lunatic, with necessaries suitable to his conditions in life, this case, X is entitled to be reimbursed from Y's estate.

1.4.3 CLASSIFICATION ACCORDING TO PERFORMANCE:

From the point of view of the extent of execution a contract may be executed or executory

1. Executed contract:

When both the parties have completely performed their obligations, under the contract, the contract is said to be executed. That is, it is a contract under the terms of a contract nothing remains to be done by either the party.

Example:

Cash sales, the contract is executed at once.

Where only one of the parties to a contract has performed his share of obligation and the other party is still to perform his share of obligation, then the contract is called 'executed'.

Example:

M advertises a reward 1,000 to anyone who finds his missing son. B knowing the offer finds missing boy and brings him. As soon as B traces the boy, there comes existence an executed contract because B has performed his share of ion and it remains for M to pay the amount of reward to B.

2. Executory Contract

In this contract the obligations of the parties are to be performed at a later time. When both the parties have not performed their respective obligations under the contract, the contract is said to be executory.

Example:

Mr. A agrees to sell his bus to B for a certain amount. Delivery and payment are to be made in the month following. The contract is said to be executory. Suppose, a delivered the bus- to B, but fi has not paid the amount, the contract is still executory because B is still under obligation to pay the price. As such, the contract as a whole is executory one, though it is partly executed and partly executory.

Check your progress - 2

Distinguish between Express and implied Contract

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

1.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points. A contract is an agreement made between two or more parties which the law will enforce. An agreement may be a social agreement or a legal agreement. Essentials of contract: 1.There must be an agreement. 2. The parties must intent to create legal relationship. 3. The parties must be capable of entering into an agreement .4.The agreement must be supported by consideration on both side.5.The consent of the parties must be free and genuine 6. The object of the agreement must be lawful.7.The terms of the agreement must be certain and capable of performance.8.The agreement must not have been expressly declared as void. Contract can be classified according to Validity, according to formation and according to performance.

1.6 QUESTIONS FOR DISCUSSION

1. What are the object and nature of law of contract?
2. Discuss the essential elements of a valid contract
3. Distinguish between void and voidable contract.
4. Write short notes on i) Quasi contract and ii) Bilateral contract

1.7 MODEL ANSWER TO CHECK YOUR PROGRESS

Check- 1 Write short notes on need for the "knowledge of law"

It is not possible for a layman to learn every branch of law, yet it is to the advantage of each member of the community to know something of rules and regulations by which he is governed and as such he must acquaint himself with the general principles of the law of

the country. The law now –a-days is a matter of great intricacy. As such no sound businessman would attempt to solve important legal questions affecting his business interest without legal advice. A general knowledge of some of the more important legal principles and how they apply to certain problems will certainly help a business man in avoiding conflict with the persons with whom he comes into business contacts.

Check- 2 Distinguish between Express and implied Contract

Where both the offer and acceptance constituting an agreement enforceable at law are made in words spoken or written, it is an express contract. In executory contract the obligations of the parties are to be performed at a later time. When both the parties have not performed their respective obligations under the contract, the contract is said to be executory.

1.8 REFERENCES

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2. R.S.N Pillai & Bagavathi - Business Law
3. N.D. Kapoor - Elements of Company Law

LESSON-2
DISCHARGE OF CONTRACT

CONTENTS

2.0 Aims and objectives

2.1 Introduction

2.2 Various modes of discharge of contract

- 2.2.1 by Performance
- 2.2.2 by Agreement
- 2.2.3 by Impossibility of Performance
- 2.2.4 by Lapse of Time
- 2.2.5 by Operation of Law
- 2.2.6 by Breach of Contract

2.3 Let us sum up

2.4 Questions for discussion

2.5 Model answer to check your progress

2.6 References

2.0 AIMS AND OBJECTIVES

In the first lesson, we discussed the meaning and law of contract, definition and various kinds of contracts. Here we discuss the meaning of discharge of contract and different ways of discharge of contract. After going through this lesson, you will able to

1. know the meaning of discharge of contract
2. understand various modes of discharge of contract

2.1 INTRODUCTION

Discharge of Contract means termination of the contractual relationship between the parties. When the rights and obligations arising out of a contract are extinguished, the contract is said to be discharged or terminated.

2.2 VARIOUS MODES OF DISCHARGE OF CONTRACT

A contract may be discharged by various modes which are discussed one by one in this section

By Performance

By Agreement

By Impossibility of Performance

By Lapse of Time

By Operation of Law

By Breach of Contract

2.2.1. Discharge by Performance of contract

Performance means the doing of that which is required by a Contract. Performance of a contract is the most usual mode of discharge of Contract. It may be Actual or Attempted.

(i) Actual Performance

Actual performance mean when each party to a Contract fulfils his obligation arising under the Contract within the time and in the manner Prescribed, most of the contracts are discharged by performance in this manner.

(ii) Attempted Performance (or) Tender

Tender is not actual performance but is only an offer to perform the obligation under the Contract. When the Promisor offers to perform his obligation, but the promise refuses to accept the performance, it is called attempted performance or tender.

2.2.2 Discharge by Agreement:

A contract is created by an agreement, is the same way it can be discharged by an agreement. It means the rights and obligations created by an agreement can be discharged without their performance by another agreement which provides for the extinguishment of the earlier rights and obligations. A contract can be discharged by the following two types of agreements.

(1) Express consent

(2) Implied consent

1) Express consent

Express consent can be classified in the following two types

(1) Express consent at the time of formation of contract

(2) Express consent subsequent to formation of contract

Express consent at the time of formation of contract:

The consent of one party to a contract is given to other parties at the time of the formation of the contract.

Example:

"R" sells a computer to "M" on approval with the condition that if the computer does not work efficiently M may return it. Consent to return the computer is given to M at the time of the formation of the contract.

***Express consent subsequent to formation of contract*:**

According to see 62 if the parties to a contract agree to substitute a new contract for it, or rescind or alter it, the original contract need not be performed.

According to see 63 "Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit".

Implied consent

Since contract is created by means of an agreement, it may also be discharged by another agreement between the same parties. Implied consent means the parties to contract enter into a fresh contract in place of original contract. The following are the important methods for the discharge of a contract by a new contract.

(1) Novation

(2) Rescission

(3) Alteration

(4) Remission

(5) Waiver

(6) Accord and satisfaction

(7) Merger

1.Novation:

Novation means substitution of a new contract for the existing one. There are two types of novation. a) New contract is substituted for old one with change of parties. b) New contract is substituted for an existing one without change of parties.

a) Novation with change of parties:

In this type, the nature of the obligation remains the same but the parties are changed with the consent of one party of the contract.

Example:

"X" borrowed Rs.1000 from "Y" now x is a debtors and y is a creditor. "Y" borrowed Rs.1000 from "Z" Here, "Y" is a debtor and "Z" is a creditor. By mutual agreement Y's debt to "Z" and Y's loan to "X" are cancelled and "Z" accepts "X" as his debtor. There is novation involving change of parties.

b) Novation without change of parties:

The concerned parties to a contract agree to substitute the existing contract with out change of parties. Here parties are not changed but the nature of the obligation must be altered substantially in the new substituted contract. The original contract is discharged with out performed.

Example:

Sheela owes Bala Rs.5000. sheela enters into an agreement with Bala and gives Bala a mortgage of her estate for Rs.2500 in place of the debt of Rs.5000. This is new contract and extinguishes the old contract.

The following points are also worth noting in connection with Novation:

(1) The new contract must be valid and enforceable.

(2) An agreement to substitute a contract in future will not be Novation.

(3) Novation cannot be compulsory it can only be with the mutual consent of all the parties.

Example:

A owes B Rs.5,000 under a contract. B owes C Rs.5,000. B orders A to credit C with Rs.5,000 in his books, but C does not assent to the agreement. B still owes C Rs.5,000 and no new contract has been entered into.

2. Rescission

Novation means a new contract in place of the old one. Rescission means cancellation of the contract. A contract may be discharged, before the date of performance, by agreement between the parties to the effect that it shall no longer bind them. Such an agreement amounts to rescission or cancellation of the contract, the consideration for mutual promises being the abandonment by the respective parties of their rights under the contract. Rescission of a contract takes place by mutual consent of the parties or where one party fails in the performances of his obligation. In such a case, the other parties may rescind the contract without prejudice to his right to claim compensation for the breach of contract.

Example:

1) 'A' promises to deliver certain goods to 'B' on a certain date. Before the date of performance, A and B mutually agree that the contract will not be performed. The contract stands discharged by rescission.

2) "Anbu" promises to supply certain good to "Babu" six months after date. By that time, the goods go out of fashion. Anbu and Balu may rescind the contract.

3.Alteration

Alteration of a contract means change in one or more of the material terms of a contract. It a material alteration in a written contract is done by mutual consent, the original contract is discharges by alteration and the new contract in its altered form takes its place. The alteration is valid when it is made with the consent of all the parties. An alternation may cither be material or immaterial.

i) Material alteration

A material alteration is one which alters the legal effect of the contract.

Example:

A charge in the amount of money to be paid, the rate of interest or the names of the parties.

ii) Immaterial alteration

Immaterial alteration has no effect on the validity of the contract and does not amount to alteration in the technical senses.

Example:

Correcting a clerical error in figure or the spelling of a name. If the parties mutually agree to change certain terms of the contract, it has the effect to terminating the original contract.

It is relevant to state that a material alteration make in a written contract by one party without the consent of the other, will, make the whole contract void and no person can maintain an action upon it.

The difference between "novation" and "alteration" may be noted. In case of novation. There may be a change of parties also while in case of alteration parties remain the same, only the ferns of a contract are altered.

Example:

"Arasu" enters into a contract with "Bala" for the supply of a material at his warehouse on 1st February. Later both Arasu and Bala agree to post pone the date of delivery to 1st march. This change amounts to alteration of the contract.

4.Remission:

A contract may be discharge by remission of performances. Remission means acceptance of a lesser fulfillment of the promise made. Remission may be

defined “as the acceptance of a lesser sum than what was contracted for or a lesser fulfillment of the promise made”.

According to section 63, “Every promise may dispense with or remit, wholly or in part, the performance of the promise make to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit”. It is not necessary that there must be some consideration for the remissions of the part of the debt.

It is a unilateral act of the promises discharging the obligation of the other party, either partly or wholly.

Example:

A owes B Rs.10, 000. A pays to B who accepts in satisfaction of the whole debt Rs.7, 000 paid at the time and place at which the Rs.10, 000 were payable. The whole debt is discharged.

5. Waiver

Waiver is nothing but foregoing one’s own right, authorized under law, whereupon the other party to the contract is released form his obligation. There is no need of an agreement for a waiver and consideration is not necessary for it.

Example:

A promises to tailor a shirt for B if he will sing a song at his birthday party and accordingly B sang the sons but offer wards B forbids A to tailor the shirt to which A consents, the contract is terminated by waiver.

6. Accord and satisfaction

The term “accord” may be defined as the promise to accept lesser amount than what is due under the contract. Satisfaction means the payment or fulfillment of the lesser obligation. An accord accompanied by satisfaction is valid and there by discharges the obligation under the old contract. The old contract is discharged only when the lesser sum is actually paid and accepted by the promisee, i.e., there must be actual performance of the new promise and its acceptance by the other party.

7. Meger

Where an inferior right Contract merges into a Superior right Contract, the former Stands discharged automatically. Merger the inferior rights vanish and one not required to be enforced.

Example:

‘A’ Purchase a house, which he was having on lease. His right as a lessee will merge into his right as on owner, as right of a lessee is Inferior to the right of an owner.

Check your progress 1

List out essentials of a valid tender

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

2.2.3 Discharge by impossibility of performance

A contract is discharged if its performance becomes impossible. In other words, there is no question of discharged of a contract which is entered into to perform something that is obviously impossible, e.g. an agreement to discover treasure by magic, because, in such a case there is no contract to terminate, it being an agreement void ab-initio by virtue.

According to sec.56, Impossibility of performance may fall into either of the following categories:

1. Initial impossibility
2. Subsequent impossibility

1. Initial impossibility

This is known as pre-contractual or impossibility existing at the time of agreement. If an agreement contemplates doing something which is absolutely impossible, the same becomes void ab -initio. The rule is based on the following two maxims:

a) Lex- non -cogit ad impossiblia est i.e., the law does not recognize what is impossible; and

b) Impossibilium nulla obligatio est, i.e., what is impossible does not create an obligation.

Section 56, pare 1 which provides: “an agreement to do an act impossible in itself is void”. It is notice that something which is impossible inherently or by its very nature and which may or may not be known to both the parties at the time, when the contract is made.

The impossibility may be;

(a) Known to the parties

(b) Unknown to the parties.

(a) Known to the parties

This is known as absolute impossibility. In case of absolute impossibility the agreement is void ab- inito.

For example:

When A agrees with B to discover treasure by magic, or undertakes to put life into the wife of B, the agreement is void.

(b) Unknown to the parties

Where at the time of making the contract both the parties are ignorant of the impossibility, as in the case of destruction of subject-matter to the ignorance of both the parties, the contract is void on the ground of mutual mistake. It, however, the promisor alone knows of the impossibility of performance at the time of making the contract, he shall have to compensate the promise for any loss which such promise sustains through the non-performance of the promise.

Examples:

(a) X sold to Y certain goods supposed to be on a voyage. The goods had ceased to exist due to the periles of the sea held, the contract was void.

(b) ‘A’ contracts to marr ‘B’, being already married to ‘C’, and being forbidden by the law to which he is subject to practise polygamy. ‘A’ must make compensation to ‘B’ for the can caused to her by the non performance of his promise.

2. Subsequent impossibility

Impossibility which arises subsequent to the formation of a contract is called post-contractual or supervening impossibility. In such a case, the contract becomes void when the act becomes impossible or unlawful.

Section 56 para 2 declares**,** “A contract to do an act which, after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful”.

In order that the section would apply the following conditions must be fulfilled.

1. that the act should have become impossible.
2. that impossibility should be by reason of some event which the promisor could not prevent.
3. that the impossibility should not be self-induced by the promisor or due to his negligence.

The word “impossible” should be construed here in its practical sense and not only in a physical or literal sense. Impossibility of performance of a contract, as a general rule, is no excuse for the non performance of the contract; but where this impossibility is caused by the circumstances beyond the control of the parties, the parties are discharged from further performance of the obligation under the contract.

Example:

A contract to take in cargo for B at a foreign port, A’s Government afterwards war against the country in which the port is situated. The contract becomes void when war is declared.

Supervening impossibility may occur in ways, some of which are explained below:

1. **Destruction of subject-matter of contract**: when the subject matter of a contract, subsequent to its formation, is destroyed without any fault of the parties to the contract, the contract is discharged.

Taylor V.S. Caldwell (1863) Back burn observed as follows: “In contracts in which the performance depends on the continued existence of a given person of thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance”.

Example:

A music hall was let for a series of concerts of certain days. The hall was burnt down before the date of the first concert. The contact becomes void.

2.Death or personal incapacity:

A promise may become physically incapable or performance by reason of the death or incapacity or some person whose continues life and health are necessary for the performance of the contract. Such impossibility discharges the promisor from liability.

Example:

A and B contract to marry each other, before the time fused for the marriage, a goes mad. The contract becomes void.

3. Failure of ultimate purpose:

Where the ultimate purpose for which the contract was entered into fails, the contract is discharged, although there is no destruction of any property affected by the contract and the performance of the contract remains possible in literal sense.

4. Change of law

A contract is discharged by impossibility of performance by the subsequent change in the law. He law may actually forbid the doing of some act undertaken in the contract, or it may take from the control of the promisor something in respect of which he has contracted to act or not to act in a certain way. Impossibility created by law is a valid excuse for non-performance.

Example:

A sold to B 100 bags of wheat as Rs.700 per bad. But before delivery the Government rendered the sale and purchase of wheat by private traders illegal under the defence of India rules. The contract was discharged by impossibility created by subsequent change in law.

5.Declaration of war

Contracts entered into before the outbreak of war are suspended during the war and may be revived after the war is over provided they have not already become time-barred. It may be noted that if war is declared between the countries of the contracting parties than only the contract is suspended during war. If war is declared between the country of one of third country, contract remains binding, and if the party of the country now at war could not perform the contract because of dislocation of transport etc., It will be treated as “difficulty in performance” only and does not discharge the contract.

Example:

A contract to take in cargo for B at a foreign port. A’s Government after wards declares war against the country in which the port is situated. The contract becomes void when he war is declared.

6. Failure of pre-condition:

When certain things necessary for performance cease to exist the contract becomes void on the ground of impossibility. If a contract depends on the occurrence of an event, which does not in fact happen, the contract is discharged.

Example:

“A” person “B” got a lease of land from “P” on a rental basis, then a German prince seized the land and it was not possible for B to use it. The landlord “P” sued for rent. The court held that B must carry out all the terms on the contract including the payment of rent.

Cases not covered by supervening impossibility:

Impossibility of performance is, as a rule, not an excuse for non performance, “He that agree to do an act must do it or pay damages for not doing it” is the general rule of the law of contract. When a person undertakes to do something, he must do it unless its performance becomes absolutely impossible, a person is

bound to perform cannot claim to be excused by the mere fact that performance has subsequently become unexpectedly burden some, more difficult or expensive.

In the following cause, a contract is not discharged on the ground of supervening impossibility:

1. Difficultly of performance:

A contract is not discharged by the more fact that it has become more difficult of performance due some uncontemplated events or delays.

Example:

"X" contracted with "Y" to send certain goods from Bombay to Delhi in September. In August transport companies went on strike and transport was available at very high rates. Held, the increase in freight rate did not excuse performance.

2.Commercial impossibility:

When in a transaction profits dwindle to a very low level or actual low becomes certain, it is said that the performance or the contract has become commercially impossible. Such a situation may arise on account of higher price of the raw material or increase in the wage bill etc. commercial impossibility also does not discharge a contract.

Example:

'A' promised to send certain goods from Bombay to Antwerp in September. Before the goods were sent, war broke out and there was sharp increase in shipping rates. Held, the contract was not discharged.

3. Impossibility due to failure of a third person

Where a contract could not be performance because of the default by a third person on whose work the promisor relied, it is not discharged.

Example:

"K" a wholesaler, enters into a contract with "B" for the sale of certain goods 'to be produced by "Z" a manufacturer of those goods. "Z" does not manufacturer those goods. "K" is liable to " B" for damages.

4. Strikes and lock-outs:

A strike by the workmen or a lock-out by the employer also does not excuse performance because the former is manageable and the letter is self induced. Events such as these do not discharge a contract unless the partics have specifically agreed in this regard at the time of formation of the contract.

Example:

The unloading of a ship was delayed beyond the date agreed with the ship owners owing to a strike of dock workers. Held, the ship owners were entitled to damages, the impossibility of performance being no excuse.

5. Failure of one of the objects

When a contract is entered into for several objects, the failure of one of them does not discharge the contract.

Example:

A company agreed to let out a boat to H, (a) for viewing a naval review on the occasion of the coronation of king Edward VII, and (b) to sail round the fleet. Due to illness of the king, the naval review was later cancelled but the fleet was assembled. Held, the contract was not discharged because the holding of the review was not the sole basis of the contract. To sail round the fleet, which formed an equally basic object of the contract was still capable of attainment.

Check your progress 2

What do you mean by Doctrine of frustration?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

2.2.4 Discharge by lapse of time:

A contact is discharged by lapse of time. A contract should be performed with a specified period, called period of limitation. The period of limitation for simple contract is three years. If the three years expire and creditors fails to file a suit to recover his amount, the debtor, is discharged from his liability.

Example:

The price of goods sold without any stipulation as to credit should be paid within three years of the delivery of the goods. Where goods are sold on credit to be paid for after the expiry of a fixed period of credit, the price should be paid with in three years of the expiry of period of credit. If the price is not paid and creditors does not file a suit against the buyer for the recovery of price within three year the debt becomes time barred and hence irrecoverable.

2.2.5 Discharge by operation of law

A contract terminates by operation of law in the following cases:

(a) Death

In contracts involving personal skill or ability. Death of the promisor results in termination of the contract. The rights and liabilities of the deceased person pass on to the legal represent actives.

(b) Merger

Where an inferior right contract mergers into a superior right contract, the former stands discharged automatically.

(c) Insolvency

A contract is discharged by insolvency of one of the parties to it an insolvency court passes an "order of discharge" exonerating the insolvent from liabilities on debts incurred prior to his adjudication.

(d) Unauthorized material alteration:

A material alteration made in a writer document or contact by one party without the consent of the other, will, make the whole contract void. A material alteration is one which changes, in a significant manner, the legal identify or character of the contract or the right and liability of the parties to the contract. The effect of making such an alteration is exactly the same as that of concelling the contract. Both parties will be discharged from their respective obligations.

2.2.6 Discharge by breach of contract:

The "breach of contract" means the failure of a party to perform his obligations. The party, who fails to perform his obligations, is said to have committed a breach of contract. A breach of a contract discharged the aggrieved party from performing his obligations of course the aggrieved party i.e., the party not a fault can sue for damages for breach of contract as par law; but the contract as such stands terminated.

Breach of contract may be of two kinds

1. Anticipatory breach
2. Actual breach

1. Anticipatory breach

An anticipatory breach of contract is a breach of contract. It occurs when a party to executory contract declarers his intention of not performing the contract before the performance is due. In other words, a refusal by the promisor to perform his part of the contract, before the due date of performance is known as the anticipatory breach of contract.

Anticipatory breach may take place in two ways:

(a) Expressly by words spoken or written:

Here a party to the contract communicates to the other parity, before the due date of performance his intention not to perform it.

Example:

A contracts with B to supply 5000 bags of wheat for is Rs.6,00,000 on 1st June on 15 March A inform B that he will not be able to supply the wheat. There is express rejection of the contract.

(b) Impliedly by the conduct of one of the parties:

Here a party by his own voluntary act disables himself from performing the contract.

Example:

Ramu contracts to sell a particular horse to somu on 1st of July and before that date he sells the horse to somebody else. Section 39 of India contract act lags down "when a party to the contract

(i) has refused to perform or

(ii) disables him self from performing the contract,

(iii) in its entirety, the promise may put and end to the contract

(iv) unless he had signified by words or conduct, his acquiescence in its continuance".

Effect of an anticipatory breach:

When anticipatory breach occurs, the aggrieved party can take the following steps:

(1) He can treat the contract as discharged, so that the is no longer bound by any obligations under the contract and

(2) He can immediately adopt the legal remedies available to him for breach of contract viz., tile a suit fro damages or specific performance or injunction.

2. Actual breach

Actual breach may also discharge a contract. It occurs when a party fails to perform his obligation upon the date fixed for performance by the contract. Actual breach entitles the part not in default to elect to treat the contracts s discharged and to she the part at fault for damages for breach of contract.

Example:

On the appointed day the seller does not deliver the goods or the buyer refuses to accept the delivery actual breach of contract may take place. (i) at the time when the performance is due and (ii) during the performance of the contract.

2.3 LET US SUM UP

In this lesson, we have briefly touched upon the following points. A contract is said to be discharged when the obligations created by it comes to an end. The various modes of discharge of a contract are as follows 1.Discharge by performance: The parties to the contract fulfil their obligations arising under the contract with in the time and the manner prescribed.2 Discharge by agreement: A contract rests on the agreement of the parties. As it is agreement which binds them, so by their agreement or consent they may be discharged. 3. Contract may be discharged by impossibility of performance.4. Discharged by lapse of time; if a contract is not performed within the period of limitation and if no action is taken by the promise in a law court, the contract is discharged. 5. Discharged by law; It includes discharge by death, merger, insolvency and unauthorized alteration of the terms of the written agreement. 6. Discharge by breach of contract; If a party breaks his obligation which the contract imposes, there takes place breach of contract.

2.4 QUESTIONS FOR DISCUSSION

1. Write a note on 'discharge of contract by consent'
2. Discuss fully the "doctrine of supervening impossibility"
3. State briefly the various modes in which a contract may be discharged.
4. What do you understand by anticipatory breach of contract?
5. Discuss fully the law relating to Novation of contract

2.5 MODEL ANSWER TO CHECK YOUR PROGRESS

Check -1 List out essentials of a valid tender

1. It must be unconditional
2. It must be made at proper time and place
3. It must be of the whole obligation contracted for and not only of the part
4. It must be made a proper person

Check – 2 what do you mean by Doctrine of frustration?

It is the parallel concept of 'supervening impossibility'. It come into play when 'the common object of a contract can no longer be achieved or when the contract , after it is made , becomes impossible of performance due to circumstances beyond the control or contemplation of the parties.

2.6 REFERENCES

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LESSON-3

REMEDIES FOR BREACH OF CONTRACT

CONTENTS

3.0 Aims and objectives

3.1 Introduction

3.2 Various remedies for breach of contract

3.2.1 Suit for rescission

3.2.2 Suit for damages

3.2.3 Suit upon quantum meruit

3.2.4 Suit for specific performance

3.2.5 Suit for an injunction

3.3 Let us sum up

3.4 Questions for discussion

3.5 Model answer to check your progress

3.6 References

3.0 AIMS AND OBJECTIVES

In the second lesson, we discussed the meaning of discharge of contract and different ways of discharge of contract. In this lesson we discuss the meaning of remedies and different types of remedies against the guilty party. After going through this lesson, you will able to

1. know the meaning of remedy
2. understand various remedies against the guilty party
3. know rules regarding damages

3.1 INTRODUCTION

Where there is a right, there must be a remedy. A contract gives rise to correlative rights and obligations. In this section we discuss the meaning and definition of remedy for breach of contract.

3.1.1 Meaning

Remedies means the rights of the aggrieved parties of seed redress by way or restoration or claim compensation from the parties who was responsible for causing the cuss, occasioned to them. Parties to a contract are expected to perform their respective promises. If a party fails, neglects, or omits to perform his promise, the other, must be entitled to enforce his right. In breach of contract the injured or the aggrieved part is entitled to bring an action for damages.

3.1.2 Definition

Remedies can be define as “A remedy is the means given by law for the enforcement of a right”.

3.2 VARIOUS REMEDIES FOR BREACH OF CONTRACT

Whenever there is breach of contract, the injured or aggrieved party is entitled to bring an action for damage. In this section, we discuss the various remedy for breach of contract. The aggrieved or injured part becomes entitled to any one or more of the following remedies against the guilty party:

1. Suit for rescission
2. Suit for damages
3. Suit upon quantum meruit
4. Suit for specific performance
5. Suit for an injunction.

As regards the last two remedies stated above, the law is regulated by the specific relief Act, 1963.

3.2.1 Suit for rescission:

Rescission means cancellation. Ever for canceling a contract, it must be done according to the norms laid down under law. When a contract is broken by one party, the other party may sue to treat the contract as rescinded and retuse to perform his part of performance on the rescission of he contract, the aggrieved or injured part is discharged from all the obligations under the contract.

Example:

Bharathi promises Narayanasamy to sell her building for Rs.7,00,000 on certain date. Narayanasamy agreed to pay the price on receipt of the building. Bharathi refuses to sell her building to Narayanasamy. Narayanasamy may cancel the contract and there is no liability on his part to pay price to the Bharathi. Narayanasamy may also file a “Suit for rescission” and claim damages.

Rescission and the consequent payment of damages depend upon facts and circum stances under which contracts are cancelled.

Under section 39, When a party to a contract has refused to perform or disabled himself from performing his promise in its entirely the promise may put an end to contract, unless he has signified, by words or conduct, his acquiescence in its continuance.

Under section 65, Obligation of the person who has received advantage under void agreement or contract that becomes void. “When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreements or contracts is bound to restore it, or to make compensation for its, to the person from whom he received it”.

Under section 75“A person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfillment of the contract”.

Power of the

Court has power to grant or refuse to rescission.

The court may grant rescission of the contract.

(1) Where the contract is avoidable by the plaintiff.

(2) Where the contract is unlawful for causes not apparent on its face and the defendant is more to blame than the plaintiff.

The court may refuse to grant rescission of the contract:

(1) Where the plaintiff has expressly or impliedly ratified the contract; or

(2) Where owing to the change of circumstances, the parties cannot be restore to their original positions; or

(3) Where third parties have, during the subsistence of the contract acquired rights in good faith and for value; or

(4) Where only a part of the contract is sought to be rescinded and such part is not severable from the rest of the contract.

Applying to the count for “rescission of the contract” is necessary for claiming damages for breach or for availing any other remedy. In practice a “suit for rescission” is accompanied by a suit for damages, etc., in the same plant.

Check your progress - 1

What do you mean by cost of decree?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

3.2.2 Suit for damages

Damage means injury. Damages signify the method of making good the loss. Such as indemnification. Damages are a monetary compensation allowed to the injured party for the loss or injury suffered by him as a result or the breach of contract. The fundamental principle underlying damages is not punishment but compensation. In the event of a breach of contract, the other party have certain rights including the right to claim damages of loss arising three from. Damages are to be awarded for comes which naturally arose from the breach.

The law of contract does not seek to punish the quality. The defaulter party is liable to pay damages to the aggrieved party. As a general rule, "compensation must be commensurate with the injury or loss sustained, arising naturally from the breach". "It actual loss is not proved, no damages will be awarded".

According to section 73 insured party is entitled to received from the defaulter party are:

a) Such damages which naturally arose in the usual course of things from such breach no compensation is to be given generally for any remote or indirect loss sustained b reason of the breach.

b) Such damages which the parties knew, when they entered into the contract, as likely to result from the breach.

c) In estimating the loss or damage caused to a party by breach, the means which existed of remedying the inconvenience caused by the breach must also be taken into account.

With a view to making the study of the quantum of damages easily comprehensible, the above rules, as enunciated in section 73 may now be considered in some more details under appropriate heads.

3.2.2. (a) Kinds of damage

Damages may be of four kinds.

1. Ordinary damage
2. Special damage
3. Exemplary damage
4. Nominal damage

We shall now see these kinds one by one.

Ordinary damages

Damages that could be claimed under ordinary circumstances in the regular course of business on account of the default committed by another party to a contract is known as ordinary damages. In other wards damages as may fairly and reasonably be considered as arising naturally and directly in the usual course of things from the breach of contract. It is other wise called as general or compensatory damages. General damages are usually assessed on the basic of actual loss. The measure of ordinary damage is the difference between the contract price and market price at the date of breach.

Example:

Abishnavi contracts to sell and deliver 500 quintals of wheat to Nitailan at Rs.600 par quintal, the price to be paid at the time of delivery. The price of wheat rises to Rs.700 per quintal and Abishnavi refuses to sell the wheat. Nithilan can claim damages at the rate of Rs.100 per quintal.

According to section 73, Compensation is not to be given fro any remote or indirect loss or damage.

Example:

Abishnavi contracts to sell and deliver 1000 backs of cotton to Nithilan on a fixed day. Abishnavi knows nothing of Nithilan's mode of conducting his business. Anishnavi breaks his promise and Nithilan, having no cotton, is obliged to close his mill. Abishnavi is no responsible to Nithilan for the loss caused to Nithilan by the closing of the mill.

2. Special damages:

Special damages are those which arise on account of the special or unusual circumstances affecting the plaintiff. In other words, they one such remote comes which one not the natural and probable consequence of the breach of contract.

Special damages cannot be claimed as matter or right these can be claimed only it the special circumstances which would result in a special loss in case of breach of contract are brought to the notice for the other party. It is important to

note that notice to this special effect must have been given to the other party. It he had no knowledge, he is not answerable. Subsequent knowledge of special circumstances will not create any special liability of guilty party.

Example:

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 first of January, it falls down, and has to be rebuilt by B, who, in consequence loses the rent which he way to have received from C, and is obliged to make compensation for breach of that contract. A must pay to B, by way of compensation, (i) for the cost of rebuilding the house (ii) for the rent lost, and (iii) for the compensation made to C.

3. Exemplary or vindictive damages:

Exemplary damages signify the claims with a view to punishing the guilty party for the breach and not by way of compensation for the loss suffered by the aggrieved party. As observed earlier, the cardinal principle of the law of damages for a breach of contract is to compensate the injured party for the loss suffered and not to punish the guilty party. Hence, obviously, exemplary damages have no place in the law of contract and are not recoverable for a breach of contract. There are two exceptions to this rule.

Breach of a contract to marry:

In this case the amount of the damages will depend upon the extent of injury to the party's feelings, one may be ruined, other may not mind so much. Dishonor of a cheque by a banker when there are sufficient funds to the credit of the customer

In this case the rule of ascertaining damages is "the smaller cheque, the greater the damage", of course, the actual amount of damages will differ according to status of the party.

Nominal damages:

Nominal damages are those which are awarded only for the name sake. In latin, it is known as injury without damage. In this case there may be a breach of contract but no material loss would have been caused. Nominal damages are either awarded by way of compensation to the aggrieved party not by way of punishment to the quality party. These are awarded to establish the right to decree for breach of contract when the injured party has not actually suffered any real damage.

3.2.2.(b)Rules regarding damages

Explanation to Section 73 provides that, "In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by non-performance of the contract must be taken into account" The principles regarding the measure of damages is based on the decision given in Hadley Vs. Baxendale. The rules may now be summarized as follows:

1. General Damages

A party who suffers by breach of a contract is entitled to only such damages which arise naturally in the usual course of things as a result of such breach. Rest of the damages will be deemed to be a remote consequence and are not recoverable

2. Special Damages

Special damages are recoverable only if the special circumstances were brought to the notice of the defaulting party. That is, where a party claims special damage for any loss sustained he must prove that the other party knew at the time of the making of the contract that special loss was likely to result from the breach of the contract.Example: Pinnock Bros. Vs. Lewis & Peat Ltd. (1923)

3. Remote Damages

The second para of Section 73 states that "Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach". The remote or indirect damages are not due to natural and probable consequences of the breach of the contract. In other words, these are the damages which arise indirectly from the breach. The injured party is not entitled to any remote or indirect loss. Example: Hobbs Vs. London A S.W. Railway Co. (1873)

4.Restitution and Compensation

Damages are paid as restitution and compensation and not as punishment. In fact through damages, efforts are made to put the party back into the same position as if the contract had been performed. In other words, "If a contract is broken, law will endeavour, so far as money can do it, to place the injured party in the same position as if the contract had been performed".

5. Mitigation of Loss

The injured party has to take all reasonable steps to minimise the loss caused by the breach. Explanation to Section 73 of the Indian Contract Act reads as under:

"In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account". The loss caused by the breach must be kept to the minimum. The damages which results due to the negligence of the aggrieved party, are not recoverable. Example: Neki Vs. Prabhu

6. Nominal Damages

Nominal damages area small amount awarded by the court when the aggrieved party cannot prove any substantial loss suffered by him. These are neither awarded by way of compensation to the aggrieved party nor by way of punishment to the guilty party. For instance if the contract price is Rs. 10 and after a breach the party obtained the goods from the market also for Rs. 10, he may get only nominal damages for his worries and inconvenience.

7. Actual Loss (Actual Damages)

Ordinarily, the aggrieved party is entitled to recovery by way of compensation, only the actual loss suffered by him. In a breach of contract for the sale of goods, the damages payable would be the difference between the contract price and the market price at the date the breach takes place.

8. Vindictive or Exemplary Damages

Vindictive or exemplary damages are not usually awarded for breach of contract except in case of breach of contract of marriage or wrongful refusal by the bank to honour the customer's cheque. Such damages are awarded by way of lesson to the wrongdoer.

9. Liquidated Damage

When the parties to a contract mutually agree that in the event of a breach the one shall pay to the other a specified sum of money, called liquidated damage. When such an amount has been mentioned in the contract, under Sec. 74 of the Indian Contract Act, the injured party is entitled to get reasonable compensation not exceeding the amount mentioned.

10. Damages in Quasi Contracts

According to Section 73, para 3, "When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract."

Explanation:

"In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account".

11. Difficulty of Assessment

Difficulty in calculating damages is no ground for refusing damages. The court must make an assessment of loss and pass a decree for it. Example: Chaplin Vs. Hicks (1911)

Check your progress 2

Explain English law on Penalty and Liquidated damages?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

3.2.3 Suit upon quantum merit

The next remedy for a breach of contract available to an injured party against the guilt party is to file a suit upon quantum merit. Quantum of work that is done by a person must be rewarded according to the merit of his work. The quantum merit means "as mush as is earned" or "in proportion to the work done". A right to sue on a quantum merit arises where a contract, partly performed by one partly has become discharged by breach of the contract by the other party. This remedy may be availed of either without claiming damages or in addition to claiming damages for breach.

The aggrieved party may file a suit upon quantum merit any may claim payment in proportion to work done or goods supplied in the following cases:

1. Where work has been done in pursuance of a contract, which has been discharged by the default of the defendant.

2. Where work has been done in pursuance of a contract which is "discovered void" or "become void", provide the contract is divisible.

3. When a person enjoys benefit of non-gratuitous act although there exists no express agreement between the parties. One of such cases is provided in section 70 lays down that when services are rendered or goods are supplied by a person (i) without any intention of doing so gratuitously and (ii) the benefit of the same is enjoyed by the other party, the latter must compensate the former or restore the thing so delivered.

4. A party who is guilty of breach of contract may also sue on a quantum merit provided both the following conditions are fulfilled.

a. the contract must be divisible and

b. the other party must have enjoyed the benefit of the part which has been performed, although he had an option of declining it.

3.2.4 Suit for Specific performance

Specific performance means the actual carrying out of the contract as agreed. Under certain circumstances an aggrieved party may tile a suit for specific performance, i.e., for a degree by the court directing the defendant to actually perform the promise that he has made. Specific performance of the contract cannot be claimed as a matter or right rules regarding the granting of this relief are contained in the specific relief and specific performance is usually granted in contracts connected with land, buildings, rare articles and unique goods having some special value to the party suing because of family association. Notice that in all these contracts monetary compensation is not an adequate relief because the injured party will not be able to get an exact substitute in the market.

Some of the cases in which specific performance of a contract may, in the discretion of the court, be enforced are as follows

(a) When the act agreed to be done is such that compensation in money for its non-performance is not an adequate relief.

(b) When there exists no standard for ascertaining the actual damage caused by the non-performance of the act agreed to be done.

(c) When it is probable that the compensation is money cannot be got for the non-performance of the act agreed to be done.

Specific performance is not granted in the following case, when:

(a) Damages are adequate remedy;

(b) The contract is not certain;

(c) The contract is inequitable to either party;

(d) The contract is of revocable nature;

(e) The contract is made by the trustee in breach of trust

(f) The contract is of personal nature

(g) The contract made by a company ultra vires of its memorandum of association; and

(h) The court cannot supervise its carrying act.

3.2.5 Suit for an injunction

"Injunction" is an order of a court restraining a person from doing a particular act. It is a mode of securing the specific performance of the negative terms of the contract. That is, it is order of the court restraining a person from doing something which he promised no to do. This type of order is generally issued in case where the compensation in terms of money is not an adequate relief. Thus injunction is a preventive relief. It is particularly appropriate in cases of "anticipatory breach of contract".

Example:

"Nithilan" agreed to sing at "Abishnavi" theatre for three months from its April and to sing for on one else during that period. Subsequently he contracted to sing at Bharathi's theatre and refused to sing at Abishnavi's theatre. On a suit by Abishnati, the court refused to order specific performance of his positive engagement to sing at the plaintifit's theatre, but granted an injunction restraining Nithilan from singing, else where and awarded damages to B to compensate him for the loss caused by Nithilan's refusal.

3.3 LET US SUM UP

In this lesson, we have briefly touched upon the following points. In case of breach of a contract, the injured party has one or more of the following remedies

1. Rescission: When there is breach of a contract by a party, the injured party may sue to treat the contract as rescinded. He is also absolved of all obligations under the contract

2. Damages: Damages are monetary compensation awarded to the injured party by Court for the loss or injury suffered by him.

3. Quantum meruit: A right to sue on a quantum meruit (as much as earned) arises where a contract, partly performed by one party, has become discharged by the breach of the breach of contract by the other party. This right is founded on an implied promise by the other party arising from the acceptance of a benefit by that/party.

4. Specific performance: In certain cases the Court may direct the party in breach of a contract to actually carry out the promise, exactly according to the terms of the contract. This is called specific performance of the contract

5. Injunction. It is a mode of securing the specific performance of the negative terms of a contract.

3.4 QUESTIONS FOR DISCUSSION

1. What are liquidated damages?
2. What is meant by injunction?
3. When do claims on quantum meruit arise?
4. What are remedies available to an aggrieved party in case of breach of contract?
5. State briefly the principles on which damages are awarded on the breach of a contract

3.5 MODEL ANSWER TO CHECK YOUR PROGRESS

Check - 1 what do you mean by cost of decree?

The aggrieved party is entitled in addition to the damages, to get the cost of getting the decree for damages. However, the cost of suit for damages is at the discretion of the court.

Check – 2 Explain English law on Penalty and Liquidated damages?

In the case of liquidated damages the amount is fixed by the parties at the time of formation of the contract on the basis of reasonable and fair calculation after making a genuine pre-estimation of loss. The amount fixed is considered to be a penalty if it is not based a reasonable calculation of actual loss but is fixed by way of punishment and as a threat.

3.6 REFERENCES

1. M.C. Kuchhal - Mercantile Law
2. R.S.N Pillai & Bagavathi - Business Law
3. N.D. Kapoor - Elements of Company Law

LESSON-4
OFFER

CONTENTS

4.0 Aims and objectives

4.1 Introduction

4.1.1 Definition of offer

4.1.2 Parties to the offer

4. 1.3 Essentials of an offer

4.1.4 How an offer is made

4.2 Types of offer

4.2.1 Specific offer

4.2.2 General offer

4.2.3 Counter offer

4.2.4 Cross offer

4.2.5 Continuing offer

4.3 Rules relating to offer

4.4 Revocation of an offer

4.5 Let us sum up

4.6 Questions for discussion

4.7 Model answer to check your progress

4.8 References

4.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the remedies of breach of contract. Here we discuss the meaning, definition, legal rules relating to offer and Revocation of offer. After going through this lesson, you will able to

1. know the meaning and definition of offer
2. understand various rules relating to offer
3. know the different types of offer
4. study the revocation of offer

4.1 INTRODUCTION

While discussing the essential elements of a valid contract in the preceding chapter we observed that as a first step in the making of a contract there must be a ‘lawful offer’ by one party and a ‘lawful acceptance’ of the offer by the other party. Offer or Proposal is nothing but conveyance of an idea by one person to another for obtaining the consent of the latter in respect of doing or not doing an act or acts. The words ‘proposal’ and ‘offer’ are synonymous and are used interchangeably. In this section we presented here the definition, essentials of offer and parties involved in offer.

4.1.1 Definition of ‘offer’

Section 2(a) of the Indian Contract Act defines an ‘offer’ as, “when one person signifies to another his willingness to another in respect of doing or to abstaining from doing anything, with a view to obtaining the assent of the other, he is said to make a proposal”.

4.1.2 Parties

There are two persons involve in offer, the person making the ‘proposal’ is called the ‘promisor’ or ‘offeror’. The person to whom the offer is made is called the ‘propose’ or ‘offeree,’ and person accepting the offer is called the ‘promisee’ or ‘acceptor’

4.1.3 Essentials of an offer

The above definition reveals the following three essentials of an offer:

(i) It must be an expression of the willingness to do or to abstain from doing something.

(ii) The expression of willingness to do or to abstain from doing something must be to another person. There can be no 'proposal' by a person to himself.

(iii) The expression of willingness to do or to abstain from doing something must be made with a view to obtaining the assent of the other person to such act or abstinence

4.1.4 How an offer is made

An offer may be made by express words, spoken or written. This is known as an express offer.

Example:

A advertises in a newspaper offering Rs 500 to anyone who returns his lost dog. There is an express offer.

An offer may also be implied from the conduct of the parties or the circumstances of the case. This is known as an implied offer.

Example:

A transport company runs a bus on a particular route; there is an implied offer by the transport company to carry passengers for a certain fare.

4.2 TYPES OF 'OFFER'

An offer that is made by a party to an agreement reveals the intention of such party. Hence, to understand the offeror's intention, offer has to be studied under different headings. In this section we attempt to make a brief explanation about different types of offers.

4.2.1 Specific offer

An offer or proposal that is made by one person exclusively to a specific and identifiable person is known as specific offer.

4.2.2 General offer

When an offer is made not to any specific person but made to the general public, it is known as general offer. Such offer can be accepted by any person from the public.

Example:

Announcement of reward through newspapers for restoration of lost goods to the owner.

4.2.3 Counter offer

When the person to whom the offer is made, instead of accepting the offer modifies the same and sends it to the offeror in a different manner, then such modified offer made by the offeree is known as counter offer.

Example:

Rukmani wants 100% cotton shirt from Sundarm Readymade. But, Sundaram Readymade offers in return 85% cotton mixed with polyester, then the offer in return made by the Suadaram Readymade is known as counter offer.

4.2.4 Cross offer

When two persons make offers against each-other simultaneously with regard to the same subject matter without knowing the intention of the other, then such offers are known as cross offers.

Example:

Rani makes an offer to sell garments to Shyamala. Simultaneously, without knowing the intention of Rani and the offer made by her, Shyamala makes an offer to buy garments from Rani. Both these offers made against each other cross simultaneously. This is known as cross offer which can never be accepted and ripen into a promise.

4.2.5 Continuing offer

A continuing offer is one that holds good for a span of period (for a specific duration). In other words, it is a series of offer, which is made from time to time for duration of time.

Example:

Tender is a continuing offer. Ram agrees to supply 100 litres of oil every month commencing from January to December which has been accepted by Krishna Hotels. The offer made by Ram is a continuing offer.

Check your progress 1

What constitutes an offer?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

4.3 RULES RELATING TO OFFER

There are certain rules under contract Act for making a valid offer. In this section we pointed out some of the rules that are to be observed, adhered to, and acted upon in order to form a valid contract.

1. The offer must be communicated to the other party
2. The terms of the offer must be definite and clear
3. The offer must be capable of creating legal relationship
4. The offer must be made with a view to obtain acceptance
5. An offer may be positive or negative
6. The offer should not contain any term the non-compliance of which amounts to acceptance
7. Special terms and conditions of the offer be communicated
8. Two identical cross-offers do not result in a contract

4. 3. 1. The offer must be communicated to the other party

According to Sec. 4 of the Act, "The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made".An offer is effective only when it is communicated to the offeree. A person cannot accept an offer unless he knows of the existence of the offer. Until the offer is made known to the offeree, there can be no acceptance and no contract. An offer is completed only when it has been communicated to the offeree. An offer accepted without its knowledge, does not confer any legal rights on the acceptor.

Example:

Lalman Shukla Vs. Gauri Dutt (1913).

The defendant sent the plaintiff who was in his service in search of his missing nephew. Later on the defendant announced that anybody, who discovered the missing boy would be given a reward of Rs. 501. The plaintiff discovered the boy without knowing the reward. When the plaintiff came to know about the reward, he brought an action against the defendant to recover the same. His suit was dismissed on the ground that he could not accept the offer, unless he had knowledge of it.

4.3.2. The Terms of the Offer must be definite and clear

The terms of an offer should be definite and certain and not vague or ambiguous. Anson says "The law requires the parties to make their own contract: it will not make a contract for them out of terms which are indefinite or illusory". Further Sec. 29 of the Act lays down "Agreements, the meaning of which is not certain, or capable of being made certain, are void" The offer must be reasonably definite and requires nothing to complete it except acceptance.

Examples:

(1) Montreal Gas Co. Vs. Vasey (1900).

The plaintiff relied on a clause that if the company were satisfied with him as a customer the company would "favorably consider an application for renewal of the contract". The court held that there was nothing in these words to create legal obligation

2) Taylor Vs. Portington (1855)

'X' purchased a horse from 'Y' and promised to buy another, if the first one proves lucky. 'X' refused to buy the second horse. 'Y' could not enforce the agreement it being loose and vague.

(3) "A" offered to sell his car to "B" for Rs. 40,000 or Rs. 45,000. There is nothing to show which of the two prices was to be given. This offer cannot be accepted as it is not clear. Thus, no contract will result from this offer.

4.3.3. The Offer must be Capable of Creating Legal Relationship

If the offer does not intend to give rise to legal consequences, it is not a valid offer in the eye of law. An offer must be such that when accepted it will result in a valid contract. The offer must be one which is capable of creating a legal relationship. A social party or an invitation to play cards is not a legal relationship. Generally speaking, in the case of agreements regulating social relations, it is natural inference that the parties do not intend to create legal relations, while in the case of agreements, regulating business relations, the inference is that the parties intend to create legal relations.

Examples:

(1) Balfour Vs. Balfour (1919) (See Chapter II)

The agreement was only an arrangement between husband and wife, and the parties never intended to make a bargain.

(2) Rose and Frank Co. Vs. Crompton & Bros Ltd. (1925)

Sometimes the parties to a business transaction may deliberately state that they do not intend to enter into any legal relationship. The plaintiffs, an American firm, were the constituted selling agents in North America for the defendent, English Company under a written agreement. It contained the following clause "This arrangement is not entered into nor is this memorandum written, as a formal or legal agreement, and shall not be subject to legal jurisdiction in the Law Courts", it was held that the agreement was not legally binding contract. The intention of the parties as expressed in the written document was respected by the court.

4.3.4. The Offer must be made with a View to Obtain Acceptance

When a person is making an offer it means that he is making it with a view to obtain the consent of the offeree. Sec. 2 (a) of the Act lays down "When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal." The terms of an offer should be clear so that there is no confusion whether it is a valid offer or a mere statement of intention. A declaration by a person that he intends to do something gives no right of action to another.

An offer must be distinguished from an 'invitation to receive offer' or as it is sometimes expressed in judicial language an 'invitation to treat.' In the case of an 'invitation to receive offer' the person sending out the invitation does not make an offer but only invites the other party to make an offer. His object is merely to circulate information that he is willing to deal with anybody who, on such information, is willing to open negotiations with him. Such invitations for offers are therefore not offers in the eye of law and do not become agreements by their acceptance. We may give some examples of them here:

An advertisement for sale of goods by auction does not amount to an offer to hold such sale. It merely invites offers. Actual bids made at the auction are 'offers', each higher bid superseding the previous one, and when the hammer falls on the highest bid, there is an acceptance and the contract becomes complete. Newspaper advertisements inviting applications for a job or inviting tenders for some work is not an offer. It is only an invitation to make offers. Applicants who reply to the advertisement are the offerors.

Following are other example of invitation to make an offer:

(1) Goods exhibited with price on a label stuck to them in showcase.

(2) Menu card in a restaurant.

(3) Prospectus of a company inviting public to subscribe for shares or debentures.

(4) An advertisement inviting applications for situation or a post.

(5) An advertisement for sale of goods by auction.

An advertisement for an auction sale does not even bindthe auctioneer to hold the auction and the prospective bidders have no legal right to complaint if they have wasted their time and money in coming to the advertised place of the auction sale (*Harris* vs *Nickersorf*)Quotations, catalogues of prices or display of goods with prices marked thereon do not constitute an offer. They are instead an invitation for offer and hence if a customer asks for goods or makes an offer, the shop keeper is free to accept the offer or not. While explaining the logic behind the aforesaid rule, Lord Herschell has made an interesting observation in *Grainger & Son* vs *Gough"*

The transmission of such a price-list does not amount to an offer to supply an unlimited quantity of the wine described at the price named, so that as soon as an order is given there is a binding contract to supply that quantity. If it were so, the merchant might find himself involved in any number of contractual obligations to supply wine of a particular description which he would be quite unable to carry out, his stock of wine of that description being necessarily limited."

Example:

There is a 'self service system' in a shop. A customer selects the goods and takes them to the cashier for payment of the price. The cashier totals the price and accepts the amount. The contract, in this case is made, not when the customer selects the goods, but when the cashier accepts the offer by accepting the payment. The selection of goods by the customer constitutes an implied offer' to buy goods and the acceptance of payment by the cashier constitutes.

4.3.5. An Offer may be Positive or Negative

Sec. 2 (a) reads as under:" When one person signifies his willingness to do or abstain from doing something..." Thus, an offer may be to do something or not to do something. An offer to do something is a positive offer. And an offer not to do something is negative offer.

4.3.6. The offer should not contain any term the Non-compliance of which Amounts to Acceptance

Thus an offeror cannot say that if acceptance is not communicated upto a certain date, the offer would be presumed to have been accepted. If the offeree does not reply, there is no contract, because no obligation to reply can be imposed on him, on the grounds of justice.

4.3.7. Special terms and conditions of the offer be communicated

Regarding the communication of the special terms of the contract as contained in a ticket, receipt, or 'standard form documents', the more important rules adopted by the courts are as follows:

(i) If the acceptor or the promisee had no knowledge of special terms, before or at the time of the contract, they are not binding upon the acceptor. Example In Handerson vs Stevenson

The plaintiff bought a steamer ticket which bore on its face the words 'Dublin to Whitehaven.' On the back of the ticket certain special terms were printed one of which excluded the liability of the company for loss, injury or delay to the passenger or his luggage. The plaintiff never looked at the back of the ticket and no one told him to do so, and the front of the ticket bore no reference to the back. The plaintiffs luggage was lost in the shipwreck caused by the fault of the company's servants. He claimed damages for its loss. It was held that the plaintiff was entitled to recover his loss from the company as there was not

sufficient communication of the terms and conditions contained on the back of the ticket.

(ii) If the acceptor or the promisee had the knowledge or may be presumed to have the knowledge; because a reasonably sufficient notice has been given to him by suitable words on the document; of special terms, before or at the time of the contract, the terms are binding upon the acceptor whether he has read them or not is immaterial. The leading case on the point is *Parker* vs *South Eastern Railway Co.*

Example:

In the above case ".deposited his bag at the cloak-room at a railway station and received a ticket containing on its face the words, '*see bac'.* On the back of the ticket there was a condition that, 'the company will not be responsible for any package exceeding the value of £ 10 unless extra charge was paid'. A notice to the same effect was hung up in the cloak-room. P's bag was lost and the claimed the actual value of the lost bag, £ 24 Sh. 10. *P,* admitted knowledge of the printed matter on the ticket, but denied having read it. It was held that, even though he had not read the exemption clause, he was bound by it, as the defendants had done what was reasonably sufficient to give him notice of its existence, and therefore *P* was entitled to recover only £ 10.

Again, where the terms are printed in a language which the acceptor does not understand, he cannot set up this fact as a reason for not being bound by the terms, provided his attention is drawn to them by suitable words on the document. It is the acceptor's duty to ask for a translation of the terms before he actually accepts the offer and if he did not ask, he must suffer for his ignorance (MacKillican vs The Compagnie Marikcmas de France).

Similarly, the acceptor cannot plead that he was illiterate or blind, provided the notice is reasonably sufficient for the class of persons to which he belongs (Thompson vs L.M. & S. Railway Co.) .It is important to note that the special terms and conditions become binding as part of the contract only if they are brought to the notice of the acceptor *before or at the time of contract.* A subsequent communication will not bind the contracting party unless he has assented thereto.

4.3.8. Two Identical Cross-Offers do not Result in a Contract

When the parties make identical offers to each other, in ignorance of each other's offer, the offers are cross-offers. Cross-offers do not constitute acceptance of one's offer by the other and as such there is no completed agreement. Example : Tim Vs. Hoffmann (1873).

The defendant wrote to the plaintiff offering to sell a certain quantity of iron at a particular price. The same day the plaintiff wrote to the defendant offering to buy the same quantity of iron at the same price. Unknown to each other the letters crossed in post, the plaintiff claimed that there was a contract. It was held that mere cross-offers made in ignorance of each other would not create a contract.

4.4 REVOCATION OF AN OFFER

An offer may come to an end by revocation or lapse, or rejection. Section 6 has described the modes in which an offer lapses. In this section we pointed out some circumstances for an offer comes to an end.

1.By Notice

An offer may be revoked any time before acceptance but not afterwards. An offer lapses when a notice of revocation has been given any time before its acceptance is complete as against the offeror.

2. By lapse of time

An offer lapses if acceptance is not communicated within the time prescribed in the offer, or if no time is prescribed, within a reasonable time For example, an offer made by telegram suggests that a reply is required urgently and if the offeree delays the communication of his acceptance even by a day or two, the offer will be considered to have lapsed.

3. After expiry of reasonable time

If there is no time has been prescribed, the proposal lapses after the expiry of a reasonable time. What is reasonable time will depend on the circumstances of the case.

4. By Death or Insanity

The offer lapses by death or insanity of the offeror provided that the offeree comes to know about it before acceptance.

5.By non-fulfilment of condition

If the offeree fails to fulfill a condition precedent to acceptance, the offer lapses.

6..By Counter-offer

An offer lapses if it has been rejected by the offeree. The rejection may be express i.e., by words spoken or written or implied. Implied rejection is one: (a) where either the offeree makes a counter offer, or (b) where the offeree gives a conditional acceptance.

7.If the law is changed

An offer comes to an end if the law is changed so as to make the contract contemplated by the offer illegal or incapable of performance

Check your progress 2

Explain different types of rejection of offer?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

4.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points. An offer is an undertaking by the offeror to be contractually bound in the event of a proper acceptance of the offer by the offeree. It may be made by express or implied. Offer may be specific offer, general offer, counter offer, cross offer and continuing offer. The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made. An offer lapses or comes to an end by different reasons.

4.6 QUESTIONS FOR DISCUSSION

1. What is an offer ?
2. Discuss briefly the law relating to offer.
3. How can an offer be accepted?
4. Discuss the circumstances under which an offer lapses.
5. “An invitation to offer is not an offer”. Elucidate the statement.

4.7 MODEL ANSWER TO CHECK YOUR PROGRESS

Chcek- 1 What constitutes an offer?

Not every proposal made by an offerer is legally regarded as an offer.The tests to determine whether or not an offer has actually been made are as follows: The offer must show an obvious intention on the part of the offerer to be bound by it.The offerer must make the offer with a view to obtaining the assent of the offerer to such act. The offer must be definite and it must be communicated to the offerer.

Chcek – 2 Explain different types of rejection of offer?

An offeree may reject the offer. Rejection of the offer may be express or implied. The offeree may reject the offer expressly by words, written or spoken. Rejection of the offer is implied by law. Where the offeree makes a counter offer or gives a conditional acceptance.

4.8 REFERENCES

1. M.C. Kuchhal - Mercantile Law
2. R.S.N Pillai & Bagavathi - Business Law
3. N.D. Kapoor - Elements of Company Law

LESSON-5
ACCEPTANCE

CONTENTS

5.0 Aims and objectives

5.1 Introduction

5.1.1 Definition of acceptance

5.1.2 Acceptance may be express or implied

5. 1.3 Who can accept the an offer

5.2 Types of acceptance

5.2.1 Absolute acceptance

5.2.2 Tentative acceptance

5.2.3 Grumbling acceptance

5.2.4 Express acceptance

5.2.5 Implied acceptance

5.2.6 Conditional Acceptance

5.3 Rules relating to Acceptance

5.4 Revocation of an Acceptance

5.5 Let us sum up

5.6 Questions for discussion

5.7 Model answer to check your progress

5.8 References

5.0 AIMS AND OBJECTIVES

In the previous lesson we discussed the meaning, definition, legal rules relating to offer and revocation of offer. Here we discuss meaning, definition, legal rules relating to acceptance and revocation of acceptance. After going through this lesson, you will able to

1. know the meaning and definition of acceptance
2. know the different types of acceptance
3. understand various rules relating to acceptance
4. study the revocation of acceptance

5.1 INTRODUCTION

A contract, as already observed, emerges from the acceptance of an offer. Acceptance is the act of assenting by the offeree to an offer. An offer without acceptance will not give room for formation of a contract. In other words, an acceptance is the concurrence by the offeree to act according to the terms of the offer. Unless acceptance is communicated, there is no valid acceptance. In this section, we attempt to make a brief explain of the definition and mode of communication of acceptance.

5.1.1 Definition

2(b) defines 'acceptance' as "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted." And states that "A proposal when accepted becomes a promise"

5.1.2 Acceptance may be express or implied

When acceptance is communicated by words, spoken or written or by doing some required act is known as express acceptance. If acceptance is to be gathered from the surrounding circumstances or the conduct of the parties is known as implied acceptance.

5.1.3 Who can accept the an offer

An offer can be accepted only by the person or persons for whom the offer is intended. An offer made to a particular person can only be accepted by him because he is the only person intended to accept. But, an offer made to the world at large can be accepted by any person whatsoever. To constitute a valid acceptance the assent must be communicated to the offeror.

Check your progress 1

Explain the effect of silence on acceptance

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

5.2 TYPES OF ACCEPTANCE

When an offer is made to the offeree or acceptor the acceptor sometimes, instead of accepting the offer as such, may impose certain conditions while conveying his acceptance. He may also accept the offer on some other occasion subject to the happening of an event which may be certain or uncertain. In all .lie above cases, the acceptance is not said to have been made absolutely, but subject to fulfilment of certain conditions. Such types of acceptance are discussed below

5.2.1 Absolute acceptance

When an acceptance is made by the acceptor as per terms contained in the offer without making any change absolutely, such acceptance is said to be absolute acceptance.

5.2.2 Tentative acceptance

A tentative acceptance is not an acceptance at all, for the reason such acceptance is made for the time being subject to final approval or decision. In other words, such acceptance is subject to another acceptance. There cannot be an agreement for entering into another agreement (Section 29).

5.2.3 Grumbling acceptance

An acceptance made by the offeree with a grumble is still held to be a valid acceptance, unless it is challenged in a court of law on the ground of coercion, etc. Acceptance under protest is not a valid acceptance but a qualified one.

5.2.4 Express acceptance:

An acceptance is said to be expressed when (a) it is conveyed by words spoken (orally) (b) or by writing.

5.2.5 Implied acceptance

An acceptance is said to be implied when it is inferred from the conduct of the parties.

Example:

The conductor issuing the ticket to the passenger who has boarded the bus signifies the implied acceptance of the conductor by his conduct.

5.2.6 Conditional Acceptance

When an offer is accepted by the offeree, subject to fulfillment of conditions, then it is said to be a conditional or qualified acceptance. Such conditional acceptance may be classified as condition precedent and condition subsequent.

Condition precedent: Condition precedent imposes fulfilment of certain obligations of the offerer by the acceptor before acceptance of the offer.

Examples:

Condition precedent - X the daughter of Y offers to marry Z chosen by Y provided, Z learns cooking within a month before marriage. This is condition precedent, which is enforceable under law.

Condition subsequent: Condition subsequent imposes fulfilment of certain obligations of the offerer by the acceptor after acceptance of the offer.

Example 1:

X the daughter of Y offers to marry Z chosen by Y provided Z learns cooking within a month after marriage.

Example 2:

A having offered to marry B's daughter imposes a condition that within 2 years subsequent to his marriage with B's daughter, he should become a father of a child. These two examples signify condition subsequent, which cannot be enforced by law.

5.3 RULES RELATING TO ACCEPTANCE

The law of contract prescribes certain fixed rules that are to be followed for effective and valid communication of acceptance by party who has agreed to act upon the proposals conveyed by the offeror .In this section we attempt make a brief explain about rules relating to acceptance. A valid acceptance must be in conformity with the following rules

5.3.1. Acceptance must be given only by the person to whom the offer is made.

An offer can be accepted only by the person or persons to whom it is made and with whom it imports an intention to contract; it cannot be accepted by another person without the consent of the offeror. The rule of law is clear that "if you propose to make a contract with A, then B can't substitute himself for A without your consent." An offer made to a particular Person can be validly accepted by him alone. Similarly an offer made to a class of persons (i.e., teachers) can be accepted by any member of that class. An offer made to the world at large can be accepted by any person who has knowledge of the existence of the offer.

Example:

A sold his business to his manager B without disclosing the fact to his customers. C a customer, who had a running account with A. sent an order for the supply of goods to A by name. B received the order and executed the same C refused to pay the price. It was held that there was no contract between B and C because C never made any offer to B and as such C was not liable to pay the Price to B (Boulton vs Jones).

5.3.2. **Acceptance must be absolute and unqualified** [Sec. 7 (1)].

In order to be legally effective it must be an absolute and unqualified acceptance of all the terms of the offer. Even the slightest deviation from the terms of the offer makes the acceptance invalid. In effect a deviated acceptance is regarded as a counter offer in law.

Example:

L offered to M his scooter for Rs 4.000. M accepted the offer and tendered Rs 3.900 cash down, promising to pay the balance of Rs 100 by the evening. There is no contract, as the acceptance was not absolute and unqualified.

5.3.3. Acceptance must be expressed in some usual and reasonable manner, unless the proposal prescribes the manner in which it is to be accepted [Sec. 7 (2)].

If the offeror prescribes no mode of acceptance, the acceptance must be communicated according to some usual and reasonable mode. The usual modes of communication are by word of mouth, by post and by conduct. When acceptance is given by words spoken or written or by post or telegram, it is called an express acceptance. When acceptance is given by conduct, it is called an implied acceptance. Implied acceptance may be given either by doing some required act, for example, tracing the lost goods for the announced reward, or by accepting some benefit or service, for example, stepping in a public bus by a passenger. Acceptance must be communicated to the offeror, otherwise it has no effect.

If the offeror prescribes a mode of acceptance, the acceptance given accordingly will no doubt be a valid acceptance, even if the prescribed mode is funny. Thus, if an offeror prescribes lighting a match as a mode of acceptance and the offeree accordingly lights the match, the acceptance is effective and complete. But what happens if the offeree deviates from the prescribed mode? The answer to this query is given in Section 7(2) itself which states that in cases of deviated acceptances "the proposer may, within a reasonable time after the acceptance is communicated to him, insist that his proposal shall be accepted in the prescribed manner, and not otherwise; but, if he fails to do so, he accepts the (deviated) acceptance."

Example:

If the offeror prescribes "acceptance by telegram" and the offeree sends acceptance through a messenger, there is no acceptance of the offer, if the offeror informs the offeree that the acceptance is not according to the mode prescribed. But if the offeror fails to do so. it will be presumed that he has accepted the acceptance and a valid contract will arise.

It should be noted that law does not allow an offeror to prescribe 'silence' as the mode of acceptance. Thus, a person cannot say that if within a certain time

acceptance is not communicated the offer would be considered as accepted. Similarly, a trader who, of his own without receiving any order, sends goods to some person with a letter saying. If I do not hear from you by the next Monday, I shall presume that you have bought the goods," cannot impose a contract on the unwilling recipient. It is so because in the absence of such a rule the offerees will be at the mercy of offerers, unless they reply all such offers in negative which will certainly be causing a lot of inconvenience and financial burden to them.

5.3.4. Acceptance must be given within a reasonable time and before the offer lapses and or is revoked.

To be legally effective acceptance must be given within the specified time limit, if any, and if no time is stipulated, acceptance must be given within a reasonable time because an offer cannot be kept open indefinitely (Shree Jaya Mahal Cooperative Housing Society vs Zenith Chemical Works Pvt. Ltd.). Where M applied for certain shares in a company in June but the allotment was made in November and he refused to accept the allotted shares, it was held that the offeror M could refuse to take shares as the offer stood withdrawn and could not be accepted because the reasonable period during which the offer could be accepted had elapsed (Ramsgate Victoria Hotel Co. vs Montefiore). Again, the acceptance must be given before the offer is revoked or lapses by reason of offeree's knowledge of the death or insanity of the offeror.

5.3.5 Acceptance must succeed the offer.

Acceptance must be given after receiving the offer. It should not precede the offer. In a company shares were allotted to a person who had not applied for them. Subsequently he applied for shares being unaware of the previous allotment. It was held that the allotment of shares previous to the application was invalid.

5.3.6. Rejected offers can be accepted only, if renewed.

Offer once rejected cannot be accepted again unless a fresh offer is made.

Check your progress 2

Write short note on “Acceptance through telex”

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

5.4 REVOCATION OF AN ACCEPTANCE

An acceptance may be revoked at any time before the communication of its acceptance is complete as against the accepter, but not afterwards. According to section 5 “An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor but not afterwards”. In fact, revocation of acceptance amounts to withdrawal of the acceptance to a proposal by the offeree himself.

Example:

A proposes, by a letter sent by post, to sell his house to B. B accepts the proposal by a letter sent by post. B may revoke his acceptance any time before the letter communicating it reaches A but not afterwards.

According to English law, an acceptance once complete, cannot be revoked. Acceptance is necessarily irrevocable for it is acceptance that binds both the parties. Anson has said, "Acceptance is to offer what a lighted match is to a train of gunpower. It produces something which cannot be recalled or undone". Therefore, when the acceptance is effected properly the offer ceases to be an offer and it becomes an enforceable contract.

5.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points.Acceptance is an assent or approval which may be either expressed or implied to carry out an act. Acceptance must be absolute and unqualified. It must be communicated to the offeror. An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor but not afterwards.

5.6 QUESTIONS FOR DISCUSSION

1. What is meant by waiver of acceptance?
2. Acceptance must be before the offer lapses – Discuss.
3. State rules regarding valid acceptance.
4. State rules regarding revocation of acceptance.
5. An acceptance to an offer like a lighted match to a train of gun powder- Discuss

5.7 MODEL ANSWER TO CHECK YOUR PROGRESS

Check -1 Explain the effect of silence on acceptance

The acceptance of an offer cannot be implied from the silence of the offeree unless the offeree has by his previous conduct indicated that his silence means that he accepts.

Check – 2 Write short note on "Acceptance through telex"

In the case of contracts over the telephone, each contracting party is able to hear the voice of the other. There is instantaneous communication of offer and acceptance, rejection and counter offer. And therefore, the rule which applies to contracts negotiated orally by the parties in the physical presence of each other *i.e.,* the contract is complete only when the acceptance is received by the offeror also applies to contracts made over the telephone. If the acceptance is not in fact communicated to the offeror because the telephone suddenly goes"dead," there will be no contract. The offeree, therefore, must make sure that his acceptance is received (heard and understood) by the offeror, otherwise there is no binding contract.

5.8 REFERENCES

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2. R.S.N Pillai & Bagavathi - Business Law
3. N.D. Kapoor - Elements of Company Law

LESSON-6
BAILMENT

CONTENTS

6.0 Aims and objectives
6.1 Introduction
 6.1.1 Meaning
 6.1.2 Definition
 6.1.3 Persons involved in Bailment
 6.1.4 Examples for Bailment
6.2 Essential of Bailment
 6.2.1 . Contract
 6.2.2. Delivery of possession
 6.2.3 Specific Purpose
 6.2.4 Return of specific goods
 6.2.5 Movable goods
6.3 Kinds of Bailment
 6.3.1 Kinds on the Basis of Reward
  (i) Gratuitous Bailment
  (ii) Non-gratuitous Bailment
 6.3.2 Kinds on the Basis of Benefit
  (i) Bailment for the Exclusive Benefit of Bailor
  (ii) Bailment for the Exclusive Benefit of Bailee
  (iii) Bailment for mutual benefit
6.4 Difference between Sale and Bailment.
6.5 Difference between 'Bailment' and 'License'
6.6 Rights of Bailor
6.7 Duties of Bailor
6.8 Rights of Bailee
6.9 Duties of Bailee

6.10 Termination of Bailment

6.11 Let us sum up

6.12 Questions for discussion

6.13 Model answer to check your progress

6.14 References

6.0 AIMS AND OBJECTIVES

In the fifth lesson, we discussed the meaning of acceptance, legal rules relating to acceptance and revocation of acceptance. In this lesson we discuss the meaning of Bailment, essentials of bailment and Rights and Duties of Bailor and Bailee. After going through this lesson, you will able to

1. know the meaning of Bailment
2. understand various essentials of bailment
3. study the Rights and Duties of Bailor
4. study the Rights and Duties of Bailee

6.1 INTRODUCTION

Transfer of goods from one person to another for some purpose is quite nature in the business. In this section we discuss the meaning and definition of Bailment, and Persons involved in Bailment.

6.1.1 Meaning

Bailment plays a popular role in day-to-day life. Bailment means any kind of 'handing over'. In legal sense, it involves change of possession of goods from one person to another for some specific purpose. The word 'bailment' is derived from the French word 'ballier' with means 'to deliver'.

6.1.2 Definition

According to Section 148 of the Contract Act — "A Bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, by returned or otherwise disposed of according to the directions of the person delivering them."

6.1.3 Persons involved in Bailment

The person delivering the goods is called the 'bailor.' The person to whom they are delivered is called the 'bailee.' and the transaction is called the 'bailment.'

Examples:

(a) A delivers a piece of cloth to B, a tailor, to be stitched into a suit. There is a contract of bailment between A and B.

(b) A lends a book to B to be returned after the examination. There is a contract of bailment between A and B.

(c) A sells certain goods to B who leaves them in the possession of A. The relationship between B and A is that of bailor and bailee.

6.1.4 Examples for Bailment

Delivering garments for dry cleaning, hiring a cycle, handing over old jewels for remaking them as new jewels to the goldsmith, depositing luggage in the cloak room, borrowing books from library are examples for bailment. Sometimes there may be bailment even without a contract. For example, when a person finds goods belonging to another, a relationship of bailee and bailor is automatically created between the finder and the owner. Example. E's ornaments having been stolen and recovered by the police disappeared from police custody. Held, the State was liable, the contract of bailment having been implied.

6.2 ESSENTIAL OF BAILMENT

Section 148 of the contract Act explains the characteristics of bailment. In this section, we shall see the law relating to bailment from Sections 148.

6.2.1. Contract

A bailment is usually created by agreement between the bailor and the bailee. The agreement is that the goods are to be returned when the purpose is fulfilled. The condition is that the goods should be returned either in their original form or in altered form. The agreement may be express or implied. In certain exceptional cases, bailment is implied by law as between a finder of goods and the owner.

6.2.2. Delivery of possession.

A bailment necessarily involves delivery of possession of goods by bailor to bailee. The basic features of possession are control and an intention to exclude other. As such, mere custody of goods does not create relationship of bailor and bailee. A servant who receives certain goods from his master to take to a third party has mere custody of the goods; possession remains with the master and the servant does not become a bailee.

Example:

A lay employed a goldsmith for melting her old jewellery and making new one out of it. Every evening she received the unfinished jewellery and put it into a box kept at the goldsmith's premises. She kept the key of that box with herself.

One night the jewellery was stolen from the box. Held, there was no bailment as the goldsmith had re-delivered to the lady (the bailor) the jewellery bailed with him by her

Section 149 explains the mode of delivery to the bailee and states that the delivery of goods may be either 'actual' or 'constructive'. When the bailor hands over to the bailee physical possession of the goods, that is called 'actual delivery.' 'Constructive delivery,' on the other hand, does not involve handing over the physical possession, but something is done which has the effect of putting the goods in the possession of the bailee. For some purpose. The delivery of goods from bailor to bailee must be for some purpose. If goods are delivered by mistake to a person, there is no bailment.

6.2.3 Specific Purpose

When goods are delivered by mistake without any purpose, there is no bailment within the meaning of Section 148. Delivery of goods must be for some specific purpose.

6.2.4 Return of specific goods

The goods are delivered subject to the condition that when the purpose is accomplished the goods are to be returned in specie or disposed of according to the directions of the bailor, either in their original form or in an altered form.

6.2.5 Movable goods

Bailment is concerned only with goods. Goods, as defined in Sec. 2 (7) of the Sale Goods Act, 1930, mean every kind of movable property other than money and actionable claims. The bailment can be only of movable goods. Money is not included in movable goods. Moreover, in a contract of bailment it is only possession that passes from the bailor to the bailee and not ownership. Thus if the property in goods is transferred for money consideration, it is a sale and not a bailment. Thus a deposit of money with a banker is not a bailment because there is no obligation to return the identical money. But if notes and coins are deposited in a box for safe custody, it is a bailment as they are to be returned in specie.

6.3 KINDS OF BAILMENT

In this section, we discuss the different basis of classified of Bailment

(i) Reward and

(ii) Benefit

6.3.1 Kinds on the Basis of Reward

On the basis of reward, bailment is classified into two types

(i) Gratuitous Bailment.

It is one in which neither the bailor nor the bailee is entitled to any remuneration, for example, A gives his book to B for reading.

Consideration in Relation to Gratuitous Bailments

There arises a necessity of discovering a consideration to support a contract of bailment where it is 'for the exclusive benefit of the bailor' or 'for the exclusive benefit of the bailee,' that is, where it is a gratuitous bailment. Perhaps viewing such a transaction as a whole very carefully shall enable us to see how the doctrine of consideration is satisfied. "The detriment suffered by the bailor in parting with the possession of the goods is sufficient consideration to support the promise on the part of the bailee to return the goods."

(ii) Non-gratuitous Bailment

It is a bailment for some charges. Either the bailor or the bailee is entitled to remuneration, for example, cycle let out for hire, or cycle given for repairing etc.

6.3.2 Kinds on the Basis of Benefit

On the basis of benefits, bailment may be classified into three types:

(i) Bailment for the Exclusive Benefit of Bailor

It may be in the case of safe custody, where goods are delivered to a neighbour or someone else for safe custody without any charge, while the bailor (owner) goes away.

(ii) Bailment for the Exclusive Benefit of Bailee

It may be in the case of a delivery of a thing to someone else for his use with any charge, for example, delivery of scooter to a friend to go somewhere.

(iii) Bailment for mutual benefit

In this type of bailment delivery of goods is done with some consideration, for example, delivering a scooter to a mechanic for repairs.

Check your progress – 1

How is Delivery Made?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

6.4 DIFFERENCE BETWEEN SALE AND BAILMENT

In this section , we discuss the difference between sale and dailment.

(1) In a sale, the ownership in goods is transferred from seller to buyer , while in bailment, there is transfer of possession only and no ownership is transferred to bailee.

(2) In a sale, there is no return of goods from buyer to seller. But in bailment, the bailee returns the goods to the bailor.

(3) The buyer can use the goods in any way he likes : but in bailment, the bailee can use the goods only according to the directions of the bailor.

(4) In a sale, the consideration for a sale is the price in terms of money. In bailment, the consideration is an understanding to return the goods after the purpose is accomplished.

6.5 DIFFERENCE BETWEEN 'BAILMENT' AND 'LICENSE'

In this section , we discuss the difference between license and bailment.

A contract of 'license' is that under which one party is permitted to place his goods in the premises belonging to the other party.

It is to be noted that in a contract of license, there is no delivery of goods to the licenser. The licenser merely permits the licensee to use the license's place for keeping the licensee's goods. Thus, in a contract of license the goods are not delivered to the license, while in bailment the goods are delivered to the bailee and the bailee is responsible for their safety.

6.6 RIGHTS OF BAILOR

Rights of a bailor are almost the same as the duties of a bailee. In this section, we summarized the rights of bailor

6.6.1. Right to sue

The bailor has a right to sue the bailee for the enforcement of the bailee's duties and liabilities.

6.6.2. Rights to Terminate the Bailment (Sec. 153)

Section 153 states that "A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment."

Example:

A lets to B for hire a horse for his own riding. B drives the horse in his carriage. A can terminate the bailment.

6.6.3. Unauthorised use by the Bailee (Sec. 154)

Section 154 states, "If the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them."

Example:

A lends a horse to B for his own riding only. B allows C, a member of his family to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury does to the horse.

6.6.4. Right against Mixture of Goods Bailed (Section 155, 156 and 157)

If the bailee, with the consent of the barilor, mixes the goods of the bailor with his won goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced

6.6.5. Right to Demand Return of Goods (Sec. 159)

In case of gratuitous bailment the bailor can, at any time, exercise his option to terminate the contract and take back the goods bailed.

6.6.6. He is Entitled to Claim Damages

Bailor can claim damages for loss, destruction or deterioration of the goods bailed, owing to bailee's negligence.

6.6.7. Right to Claim Increase in Value or Profits (Sec. 163)

The bailor is entitled to get any increase or profit from the goods baile.

6.6.8. Suit against Wrongdoer (Sec. 180)

The bailor can sue a third person who wrongfully deprives the bailee of the use of the goods, or does them any injury.

6.6.9. Share in the Compensation Received (Sec. 181)

Under sec. 180, Compensations in any suit, received shall be apportioned between bailor and bailee, in accordance with their respective interest.

6.7 DUTIES OF BAILOR

A bailor is the person who delivers the goods. In this section, we discuss the bailor's duties one by one

6.7.1. Duty to disclose faults in goods bailed.

Section 150 lays down this duty. The Section makes a distinction between a gratuitous bailor and a bailor for reward and provides as follows:

(a) A gratuitous bailor is bound to disclose to the bailee all those faults in the goods bailed, of which he is aware and which materially interfere with the use of them, or expose the bailee to extraordinary risks, and if he fails to do so, he wil be liable to pay such damages to the bailee as may have resulted directly from the faults. A gratuitous bailor will not be liable for damages arising to the bailee from defects of which he was ignorant.

Example: (to Sec. 150).

A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained

(b) A bailor for reward is responsible for all defects in the goods bailed whether he is aware of the defects or not, if he does not disclose them to the bailee. Unlike a gratuitous bailor, ignorance of the defects is no defence for him.

Example (to Sec. 150)

A hires a carriage of B. The carriage is unsafe though B is not aware of it, and A is injured. B is responsible to A for the injury. (If the carriage were lent gratuitously, B would not be liable under the circumstances. Similarly, had B told the fault to A, and then also he would not be liable.)

It may be mentioned that where the goods bailed are of dangerous nature, it is the duty of the bailor to disclose the fact to the bailee otherwise he will be liable for all the resulting damage (Great Northern Rly. Vs L.E.P. transport Ltd[3].).

For example:

A delivers to B, a carrier, some explosives in a case but does not warn B. The case is handled without extra care necessary for such articles and there is an explosion. The carrier is injured and some other goods are damaged. A, the bailor, is liable for all the resulting damage.

6.7. 2. Repay Necessary Expenses (Sec. 158)

According to Section 158, 'Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of bailment." Thus, in the case of gratuitous bailment, the bailor has to repay to the beilee all the necessary expenses incurred by him for the purpose of bailment. In the repay to the bailee, all the necessary expenses incurred by him for the purpose of bailment. In the case of non-gratuitous bailment, the bailor is held responsible to bear only extra-ordinary expenses.

Example:

If a horse is lent for journey, the expenses of feeding the horse would be borne by the bailee (ordinary expense). But if the horse becomes sick and expenses have been incurred for its recovery, the bailor should have to pay it (extraordinary expenses).

6.7. 3. To Indemnify the Bailee (Sec. 159)

If the borrower is compelled to return goods, in the case of gratuitous bailment, before the specified time and suffers loss which exceeds the benefit derived by him, the bailor's duty is to indemnify the borrower for such loss.

6.7 .4. Responsibility for any Loss due to Defect in Title (Sec. 164)

"The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the good, or to give directions, respecting them".

6.7.5. Duty to receive back the goods.

It is the duty of the bailor to receive back the goods when the bailee returns them after the time of bailment has expired or the purpose of bailment has been accomplished. If the bailor refuses to take delivery of goods when it is offered at the proper time, the bailee can claim compensation for all necessary expenses of, and incidental to, the safe custody.

Check your progress – 2

What is consideration?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

6.8 RIGHTS OF BAILEE

The duties of the bailor are the rights of the bailee. However, to recapitulate, the bailee has the following rights against bailor:

1. A bailee is entitled to claim damages for any loss caused to him from the undisclosed faults in the goods bailed. (Sec. 150)
2. In case of gratuitous bailment, bailee is entitled to recover from bailor all necessary expenses incurred by him for bailment (Sec. 158): and of the extraordinary expenses in case of non-gratuitous bailment.

3. Right to indemnify, in case of gratuitous bailment, against premature termination of the contract by the bailor for any loss sustained. (Sec. 159)
4. A bailee is entitled to claim any loss sustained by him because of non-entitlement or defective entitlement of the bailor on goods bailor on goods bailed.
5. If a third person claims the ownership of the goods bailed, the bailee can ask the court to decide the ownership and can withhold the delivery to the bailor.
6. If a third person wrongfully deprives the bailee of the use or possession of the goods bailed to him, he has the right to bring an action against such third party (Sec. 180).
7. According to Section 165, in case of several joint bailors, the bailee can deliver the goods back to one of them without the consent of all.
8. Bailee enjoys the right of lien (Sec. 170 and 171) Bailee's lien, discussed separately, in this chapter.

6.9 DUTIES OF BAILEE

A bailee is the person who receives the goods. In this section, we discuss the bailee's duties one by one

6.9.1. To Take Reasonable Care of the Goods Bailed (Sec. 151)

According to Section 151, "In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary proudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed."

Further Section 152 States, "The bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if be has taken the amount of care of it described in Section 151".

6.9. 2. Not to Make Unauthorised Use of Goods Bailed (Sec.154)

"If the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he us liable to make compensation to the bailor for any damage arising to the goods from or during such use of them".

Example:

(1) A lends a horse to B for his own riding only, B allows C, member of his family, to ride the horse. C rides with care, but the horse accidently falls and is injured. B is liable to make compensation to A for the injury done to the horse.

(2) A hires a hors in Calcutta from B expressly to march to Banaras. A rides with due care, but marches to cuttack instead. The horse accidently falls and is injured. A is liable to make compensation to B for the injury to the horse.

6.9 .3. Not to Mix the Goods Bailed with his Own Goods (Secs. 155, 156 and 157)

The bailee should not mix the goods bailed with his own goods. If he mixes, the following rules apply:

(a) "If the bailee, with the consent of the barilor, mixes the goods of the bailor with his won goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced" (Sec. 155).

Example:

A bails one bag of sugar to B. B with the consent of A, mixes A's sugar with three bags of his own. Here A and B have interest in the mixture in proportion of 1:3.

(b) "If the bailee, without the consent of the bailor mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively but the bailee is bound to bear the expenses of separation or dividion, and any damage arising from the mixture" (Sec. 156).

Example:

A bails 100 bales of cotton marked with a particular mark to B. B without A's consent mixes the 100 bales with other bales of his own bearing a different mark. A is entitled to have his 100 bales returned and B is bound to bear all the expenses incurred in the separation of the bales and any other incidental damages.

(c) "If the bailee, without the consent of the bailor, mixes the goods of the bailor with his won goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods" (Sec. 157).

Example:

A bails a barrel of cape flour worth Rs.45 to B. B without A's consent mixes the flour with country flour of his own, worth only Rs.25 a barrel. B must compensate A for the loss of his flour.

6.9. 4. To Return the Goods Bailed (Sec.160)

According to Section 160, "It is the duty of the bailee to return, or deliver, according to the bailor's direction, the goods bailed, without demand, as soon as

the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished”. Again according to Section 165, “Where there are several joint bailee may return the goods to any one of the joint owners.

According to Section 161, “If, by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time”.

Example: Shaw & Co. Vs. Symmons & Sons (1917)

A delivered certain books to B to be bound and return and return within reasonable time. B could not complete the job within reasonable time. The books were subsequently burnt in an accidental fire in B’s was held liable in damages for the loss of the books and the plea that the fire was accidental or an act of God was of no avail.

6.9.5. To Return Increase or Profit Accrued

According to Section 163, “In the absence of any contract to contrary, the bailee is bound to deliver to the bailor, or according to his direction, any increase or profit which may have accrued from the goods bailed”.

Example:

A leaves a cow in the custody of B to be taken care of. The cow has a caif. B is bound to deliver the calf as well as the cow to A.

6.9.6. Not to set up an Adverse Title

Under section 117 of the Indian Evidence Act, the bailee holds the goods on behalf of and for the bailor, he cannot deny the title of the bailor. It is the duty of the bailee to return the goods only to the bailor even though any third person is claiming title over them.

6.10 TERMINATION OF BAILMENT

In this section, we discuss various circumstances for a contract of bailment terminates

1. If the bailment is for a ‘specified period’, the bailment terminates as soon as the stipulated period expires.
2. If the bailment is for a ‘specified period’, the bailment terminates as soon as the purpose is fulfilled.
3. If the bailee does any act with regard to the goods bailed, which is inconsistent with the terms of bailment, the bailment may be terminated by the bailor even though the term of bailment has not expired or the purpose of bailment has not been accomplished (Sec. 153).

4. A gratuitous bailment can be terminated by the bailor at any time, even before the specified time or before the purpose is achieved, subject to the limitation that where such termination causes loss in excess of benefit actually derived by the bailee, the bailor must indemnify the bailee for the amount in which the loss occasioned exceeds the benefit derived (Sec. 159).

5. A gratuitous bailment is terminated by the death either of the bailor or of the bailee (Sec. 162)

6.10 LET US SUM UP

In this lesson, we have briefly touched upon the following points.A 'bailment' is the delivery of goods by one person to another for some purpose, upon a contract, that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the 'bailor' and the person to whom they are delivered is called the 'bailee' (Sec. 148).

Requisites of Bailment

1. Contract. 2. Delivery of possession of goods for some purpose. 3. Return of goods when the purpose is accomplished.

Classification of Bailment

Bailment may be for the (1) exclusive benefit of the bailor, or (2) exclusive benefit of the bailee, or (3) mutual benefit of the bailor and the bailee. Bailment may also be classified into (1) gratuitous bailment, and (2) non-gratuitous bailment or bailment-for reward.

Duties of bailee

1. To take care of the goods bailed. 2. Not to make any unauthorised use of the goods. 3. Not to mix the goods balled with his own goods. 4. Not to set up an adverse title. 5. To return any accretion to the goods. 6. To return the goods.

Duties of bailor

1. To disclose known faults. 2. To bear extraordinary expenses of bailment. 3. To receive back the goods. 4. To indemnify bailee.

6.4 QUESTIONS FOR DISCUSSION

1. Define a contract of bailment. What are its essentials?
2. What are the duties of a bailor ?
3. What are the duties of a bailee ?
4. What are the rights of a bailor and bailee ?

6.5 MODEL ANSWER TO CHECK YOUR PROGRESS

Check-1 How is Delivery Made?

The delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorized to hold them on his behalf.

Check – 2 What is consideration?

There arises a necessity of discovering a consideration to support a contract of bailment where it is 'for the exclusive benefit of the bailor' or 'for the exclusive benefit of the bailee,' that is, where it is a gratuitous bailment. Perhaps viewing such a transaction as a whole very carefully shall enable us to see how the doctrine of consideration is satisfied. "The detriment suffered by the bailor in parting with the possession of the goods is sufficient consideration to support the promise on the part of the bailee to return the goods."

6.6 REFERENCES

1. M.C. Kuchhal - Mercantile Law
2. R.S.N Pillai & Bagavathi - Business Law
3. N.D. Kapoor - Elements of Company Law

LESSON-7
PLEDGE

CONTENTS

7.0 . Aims and objectives
7.1. Introduction
7.2 Essentials of Pledge
7.3 Rights of Pawnor
7.4 Duties of Pawnor
7.5 Rights of pawnee
7.6 Duties of Pawnee
7.7 Bailment and Pledge Compared
7.8 Pledge and Bailment distinguished
7.9 Let us sum up
7.10 Questions for discussion
7.11 Model answer to check your progress
7.12 References

7.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning and essential of bailment, rights and duties of bailor and bailee. In this lesson we have briefly touched upon the meaning , Essential of pledge and Rights and Duties of Pawnor and Pawnee. After going through this lesson, you will able to

1. know the meaning of and definition of Pledge
2. understand various essential of pledge
3. know rights and duties of pawnor
4. understand rights and duties of pawnee

7.1 INTRODUCTION

In this section, we have briefly touched upon the meaning, definition and parties to a pledge

7.1.1 Meaning

When goods are delivered as securities by one person to another, for the purpose of loan to be advanced, or already advanced by other, the transaction is known as pledge or pawn. Pledge is also a case of a bailment, but it is a special kind of a bailment.

7.1.2 Definition

According to Section 172 of the Contract Act, "The bailment of goods as security for payment of a debt or for performance of a promise is called pledge. The bailor in this case is called the pawnor. The bailee is called the pawnee".

7.1.3 Parties to a pledge

(i) The person who delivers the goods is known as Pawnor or pledger. (ii) The person to whom the goods are delivered as security is known as Pawnee or Pledgee. Example: Raja borrows Rs. 3,000 from Rukmani and keeps his scooter as security for repayment of the debt. This kind of bailment of property is called a pledge or pawn. Here Raja is the pawnor and Rukmani the pawnee.

7.2 ESSENTIALS OF PLEDGE

In this section, we shall see the essentials of a valid pledge.

1. The goods must be delivered by borrower to the lender as a security for repayment of debt or for performance of a promise.
2. The possession of the goods passes from one person to the other person and not the ownership.
3. Pledge can be of only movable goods - documents of title, shares-, valuables etc. Immovable properties cannot be pledged.
4. The goods, pledged with the pawnee, to be returned on receipt of his full dues.

7.3 RIGHTS OF PAWNOR

In this section, we discuss the rights of Pawnor.

1. The pawnor has the right to take back the goods pledged provided that he has paid the whole of the amount of debt along with any interest or charges thereon, to the pawnee.
2. The duties of the pawnee are the rights of the pawnor. Therefore, the pawnor can enforce by suit all the duties of the pawnee

3. Usually a time may be stipulated for the payment of the debt, or performance of the promise, for which the pledge is made. If the pawnor makes default in payment of the debt or performance of the promise at the stipulated time he may redeem the goods pledged at any subsequent time before the actual sale is made. But on exercising such right of redemption the pawnor must pay any expenses which might have arisen from his default (Sec. 177).

7.4 DUTIES OF PAWNOR

In this section, we discuss the duties of Pawnor.

1. It is the duty of the pawnor to repay the loan taken from the pawnee within the time and in the manner specified in the contract
2. He has to compensate the pawnee for any extraordinary expenses incurred by him.
3. Default or risk, if any, in the goods pledged, should be known to pawnee

Check your progress - 1

How pledge is differ from mortgage?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

7.5 RIGHTS OF PAWNEE

In this section, we discuss the rights of Pawnee

7.5.1. Right of retainer. The pawnee may retain the goods pledged until his dues are paid. He may retain them not only for the payment of the debt or the performance of the promise, but for (a) the interest due on the debt, and (b) all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged (Sec. 173). He can however exercise only a particular lien over the goods.

7.5.2. Right of retainer for subsequent advances. When the pawnee lends money to the same pawnor after the date of the pledge, it is presumed that the right of retainer over the pledged goods extends to subsequent advances also. This presumption can be rebutted only by a contract to the contrary (Sec. 174).

7.5.3.Right to extraordinary expenses. The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged (Sec. 175). For such expenses, he has no right to retain the goods ,he can only sue to recover them.

7.5.4.Right against true owner, when the pawnor's title is defective. When the pawnor has obtained possession of the goods pledged by him under a voidable contract (i.e., by fraud, undue influence, coercion, etc.) but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title (Sec. 178-A).

7.5.5.Pawnee's rights where pawnor makes default (Sec. 176). Where the pawnor fails to redeem his pledge, the pawnee can exercise the following rights:

(1) He may file a suit against the pawnor upon the debt or promise and may retain the goods pledged as a collateral security.

(2) He may sell the goods pledged after giving the pawnor a reasonable notice of the sale. of these two rights, while the right to retain or sell the pawned goods are not concurrent, the right to sue and sell are concurrent rights, i.e., the pawnee may sue and at the same time retain the goods as concurrent security or sell them after giving reasonable notice of the sale to the pawnor

(3) He can recover from the pawnor any deficiency arising on the sale of the goods by him. But he shall have to hand over the surplus, if any, realised on the sale of the goods to the pawnor.

7.6 DUTIES OF PAWNEE

In this section, we discuss the duties of Pawnor.The duties of pawnee are similar to bailee:

1. He has to take reasonable care of the goods pledged.
2. He is not permitted any unauthorised use of the goods pledged.
3. He has to return the pledged goods on the payment of debt.
4. He should not do any act in violation of the terms of the contract.
5. He should not mix the goods pledged with his own goods.
6. Any accruals to the goods pledged belong to the pledgor and should be delivered accordingly.

7.7 BAILMENT AND PLEDGE COMPARED

In this section, we discuss similarities between bailment and pledge

1. In both, delivery of goods is important.
2. In both, possession of goods alone is transferred and the ownership is retained by owner.
3. Both are created by agreement between the parties.
4. In both, moveable goods are the subject matter.
5. In both, the goods are returned on the fulfilment of purpose

7.8 PLEDGE AND BAILMENT DISTINGUISHED

In this section, we discuss similarities between bailment and pledge

1. In pledge, goods are pledged as a security. In bailment goods are bailed for carrying out specific purpose
2. In pledge, In case of default, the pawnee may retain the goods. He can sell the goods.In bailment, the bailee can retain the goods baild but he cannot sell it.
3. In pledge, Pawnee has no right to use the goods. In bailment, Bailee may use the goods bailed as per the terms of the contract.

7.9 LET US SUM UP

In this lesson, we have briefly touched upon the following points. The bailment of goods as security for payment of debt or performance of a promise is called “pledge”. The bailor is, in this case, called the 'pawnor' or “pledger” and the bailee is called the “pawnee” or “pledge”

The essential of pledge is the goods must be delivered by borrower to the lender as a security for repayment of debt or for performance of a promise, and the possession of the goods passes from one person to the other person and not the ownership.

Rights of pawnor: The pawnor has the right to take back the goods pledged provided that he has paid the whole of the amount of debt along with any interest or charges thereon, to the pawnee. The duties of the pawnee are the rights of the pawnor. Therefore, the pawnor can enforce by suit all the duties of the pawnee.

Duties of pawnor: He has to compensate the pawnee for any extraordinary expenses incurred by him. Default or risk, if any, in the goods pledged, should be known to pawnee.

Rights of pawnee. (1) Right to retain goods for debt, interest and expenses, and for subsequent advances. (2) Right to extraordinary expenses. (3) Right against true owner when the pawnor's title is defective. (4) Rights where pawnor makes default (a) Suit against the pawnor. (b) Retention of the goods as a collateral security, (c) Suit for the sale of the goods pledged. (d) Right of sale, (e) Right to recover deficiency on sale.

7.10 QUESTIONS FOR DISCUSSION

1. Define pledge
2. What are the rights and duties of pawnor and pawnee?
3. What are essentials of a valid pledge?
4. Distinguish between pledge and bailment**.**

7.11 MODEL ANSWER TO CHECK YOUR PROGRESS

Check -1 How pledge is differ from mortgage?

1. Only one loan can be taken at a time on the pledge of the same time. On a mortgage of asset more than one loan can be taken.
2. Moveable property is the subject matter in pledge. Immoveable property is the subject matter in mortgage.
3. A pawnee is not allowed to use the goods pledged. Mortgagee has the right to use the property mortgaged.

7.12 REFERENCES

1. M.C. Kuchhal - Mercantile Law
2. R.S.N Pillai & Bagavathi - Business Law
3. N.D. Kapoor - Elements of Company Law

LESSON-8

CONTRACT OF SALE OF GOODS ACT 1930

CONTENTS

8.0 . Aims and objectives

8.1. Introduction

8.1.1 Scope

8.2 Goods

8.3 Classification of Goods

8.4 Contract of Sale

8.5 Sale and an Agreement to sell Distinguished

8.5.1. Nature of contract

8.5.2. Creation of right

8.5.3. Passing of property

8.5.4. Remedies in case of breach of contract

8.5.5. Risk of loss

8.5.6. Insolvency

8.6 Essential of a Contract of Sale

8.6.1 Offer and Acceptance

8.6.2 Two Parties

8.6.3 Goods

8.6.4 Transfer of Property

8.6.5 Price

8.6.6 Contract

8.7 Performance of Contract of sale

8.8 Definitions of Delivery of Goods

8.9 Mode of Delivery

8.10 Rules regarding Delivery of goods

8.11 Let us sum up

8.12 Questions for discussion

8.13 Model answer to check your progress

8.14 References

8.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning, essential of pledge and rights and duties of Pawnor and Pawnee. In this lesson, we discuss in detail about contract of sale of goods Act 1930.After going through this lesson, you will able to

1. know the meaning and definition of a contract of sale
2. understand various essential characteristics of a contract of sale
3. know the different kinds of goods
4. understand rules regarding delivery of goods

8.1 INTRODUCTION

The law as to the sale of goods was originally embodied in section 76 to 123 of the Indian Contract Act 1872. However, as the provisions of the sections76 to 123 were found inadequate to meet the complexities of growing mercantile transaction, the said sections were repealed and the Sale of Goods Act 1930 took its birth. It is well known that our Sale of Goods Act 1930 is largely based of the English Sale of Goods Act 1893. Law relating to the sale of goods is a branch of Contract Law as the general principles of contract are applicable to contracts for sale of goods such as offer and acceptance, capacity of parties, free consent, consideration and legality of the object. Here, we discuss the scope and meaning of goods and its kinds

8.1.1 Scope

The law relating to sale of goods is contained in the Sale of Goods Act 1930, which came into force on 1st July 1930. The sale of Goods Act applies only to movables other than actionable claim and money and not to immovable property is governed by the Transfer of Property Act, 1882. “Actionable claims” and “money” are excluded from “goods”. Actionable claims mean ‘chose in action’ or ‘thing in action’. It means the person has a right to recover a thing by suit but does not have the enjoyment of the thing. Money is excluded from the definition of goods for two reasons (a) that it constitutes the price for exchange of goods sold and (b) that it is governed by a different principles of law due to its being currency. Foreign currency may, however, be bought or sold.

8. 2 GOODS

In this section, we discuss meaning of goods. Goods form die subject matter of contract of sale. According to Sec. 2 (7) “Goods” means (i) every kind of movable property other than actionable claims and money and includes, (ii) stock and (iii) shares, (iv) growing crops, grass and (v) things attached to or forming part of the land which are agreed to be separated before sale or under the contract of sale.

8.3 CLASSIFICATION OF GOODS

In this section, we discuss different types of goods

Goods may be

i) Existing goods

ii) Future goods

iii) Contingent Goods

8.3.1 Existing Goods

According to section 6 (1), Goods owned and possessed by the seller at the time of making the contracts of sale are called existing goods. The existing goods may be of the following types:

(a) Specific Goods: According to sec 2 (14), Goods identified and agreed upon at the time of the making of the contract of sale are called specific goods. [Sec. 2(14)] Where there is a contract for specific goods, the seller would not fulfil his contract by delivering any goods other than those agreed upon. For example, if A who owns a number of horses, promises to sell one of them, the contract is for unspecified goods. But if the horse that is to be sold has been singled out, the contract is for specific goods.

(b) Unasertained Goods: The goods which are not specifically identified at the time of contract of sale are known as unascertained goods. In other words, unascertained goods are indicated by description and not separately identified

Example:

Sale of one kg of oil from 100 kgs of oil with the merchant is a sale of un-ascertained goods. When one kg is separated from 100 kgs of oil the sale is of specific goods.

8.3.2 Future Goods

"Future Goods" means goods to be manufactured or produced or acquired by the seller after making the contract of sale" [Sec. 2(6)].)These are the goods which are not in existence at the time of contract of sale. The seller acquires such goods after the making of the contract of sale. But subsequently come into existence.

8.3.3 Contingent Goods

Contingent goods are future goods. According to Sec. 6 (2) "there may be a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen."

Example:

A agrees to sell B a certain paintings provided he is able to purchase it from its present owner. This is an agreement for the sale of contingent goods.

8.4 CONTRACT OF SALE

In this section, we discuss definition of sale and agreement to sell. A contract of sale of goods is a contract where by the seller transfer or agrees to transfer the property in goods to the buyer for a price. Such a contract of sale may be absolute or conditional. Absolute contract is without any conditions. Conditional contract may be a contract with condition precedent or condition subsequent. A contract of sale of goods may be either a 'sale' or an 'agreement to sell.'

Sec. 4 (1) of the Sale of Goods Act defines a contract of sale of goods as "a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price". Here property means the right of ownership.

8.4.1 Sale

Where under a contract of sale the property in the goods is transferred from seller to the buyer, the contract is called a 'sale'. In a sale immediate payment is not necessary. Payment may be done at a future date. But the ownership of goods i.e., the property in the goods must be transferred immediately from the seller to the buyer.

Examples:

A sells his bike for Rs. 10,000 to B. It is a sale, as the ownership of the bike has been transferred to B by A for a price.

8.4.2 Essentials of a Valid Sale

1. **Property**: There must be a transfer of general property in the goods i.e., transfer of ownership in the goods, and not merely special property or special interest, from the seller to the buyer.
2. **Movable goods**: Transfer of goods must be that of movable goods only.
3. **Price**: The price or consideration of goods must be money. Where goods are exchange for goods, it is nor a sale.
4. **Parties**: There must be two parties, i.e., buyer and seller. The parties must be competent to contract as under the Indian Contact Act, 1872. The seller and buyer must be two different persons.
5. **Form**: no particular form is necessary to constitute a contract of sale. A contract of sale may be made in writing or by word of mouth, i.e., may be express or it may be implied from the conduct of the parties, or from the course of dealings between the parties [Sec. 5 (2)]. It may also be made partly in writing or partly by word of mouth. Proposal and acceptance must be made.

Sec. 4 (3) states "where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called "an agreement to sell".

8.4.3 Agreement to Sell

Where the transfer of the property i.e., ownership in the goods is to take place at a future date or subject to some condition to be fulfilled, the contract is called an agreement to sell. Where by a contract of sale the seller purports to effect the present sale of future goods, the agreement operates as an agreement to sell.

Examples:

A agrees with B to sell his bike after two months for Rs. 10,000. It is an agreement to sell as the bike is to be transferred on a future date.

8.4.4 When agreement to sell becomes sale?

An agreement to sell neither does nor involves any immediate transfer of property in the goods. An agreement to sell becomes a sale when the time lapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

8.5 SALE AND AN AGREEMENT TO SELL DISTINGUISHED

In this section, we discuss difference between sale and agreement to sell.

8.5.1. Nature of contract:

Sale is an 'executed contract' while an agreement to sell is an 'executed contract'. In an executed contract, one of the parties has already performed his part of the contract. On the other hand, in an executory contract, both the parties are yet to perform their mutual promises.

An agreement to sell becomes a sale when, (i) agreed time of the fulfillment of the performance of the contract elapses, or (ii) the conditions of the sale are fulfilled. Till then the transaction is an agreement to sell and not a sale. On the other hand in a sale, there is an immediate transfer of ownership in the goods. Sale is a contract plus a conveyance, while an agreement to sell is only a pure contract. A sale is therefore, an executed contract while an agreement to sell is an executory contract.

8.5.2. Creation of right:

Sale creates a 'jus-in-rom' i.e., a right on the goods against the whole world, while an agreement to sell creates a jus-in-personam, i.e., a personal right only against the person for any default in fulfilling his part of the agreement.

8.5.3. Passing of property:

In a sale, the property in the good passes to the buyer with the risk while in an agreement so sell, risk and property does not pass to the buyer immediately.

8.5.4. Remedies in case of breach of contract:

In a sale, the seller is entitled to sue for the price of the goods and also has a right of lien, stoppage in transit and re-sale. In an agreement to sell, the seller has the right only to sue for damages for non-performance of the contract.

8.5.5. Risk of loss:

In case of loss to good, in sale, the loss will be borne by the buyer even if the possession of good is with the seller while in an agreement to sell, the seller will have to pay for the loss since the ownership in the goods has not passed to the buyer.

8.5.6. Insolvency:

(i) Insolvency of buyer: In a sale, the seller must deliver the good to Official Assignee or Receiver and can claim rateable dividend for the goods, while in an agreement to sell, the seller may refuse to deliver the goods unless paid for.

(ii) Insolvency of seller: In a sale, the buyer is entitled to receive the goods from the Official Assignee or Receiver, while in an agreement to sell, the buyer has to prove the amount he has paid to the seller and he can only claim a reteable dividend. He cannot compel the Receiver to sell and deliver the goods.

8.6 ESSENTIAL OF A CONTRACT OF SALE

According to Sec. 4 of the Sale of Goods Act defines "sale" as "a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for price". In this section, we attempt to make a brief study of the essentials of a contract of sale.

Contract of sale how made?

According to Sec. 5 (1). "A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery or payment by instalments, or that the delivery or payment or both shall be postponed"

According to Sec. 5 (2). "Subject to the provisions of any law for the time being in force, a contract of sale may be made in writing or by word of mouth, or partly in writing and partly by word of mouth or may be implied from the conduct of the parties"

The definition reveals the following essentials of a contract of sales of good

8.6.1 Offer and Acceptance:

An offer to buy or sell goods by one party for a price and acceptance of such an offer by another party is necessary

8.6.2 Two Parties

To constitute a contract of sale, there must be a transfer or agreement to transfer the property in goods by the seller to the buyer. That is, there must be two parties in a contract of sale - seller and buyer. Buyer means a person who buys or agrees to buy goods. Similarly seller is a person who sells or agrees to sell his goods. Sec. 2 (1). The seller and the buyer must be two different persons, for a man cannot purchase his own goods.

8.6.3 Goods

The subject matter of the contract of sale must be “goods”. According to Sec. 2(7), “goods means every kind of moveable 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”. Goods which form the subject matter of sale may be either existing goods or future goods. Money, actionable claims and immovable property cannot form the subject matter of sale within the meaning of Sec. 2(7).

8.6.4 Transfer of Property

‘Property’ here means ‘ownership’. In every contract of sale, the ownership of goods must be transferred by the seller to the buyer; where should be an agreement by the seller to transfer the ownership to the buyer. According/to Sec. 2 (11) “Property means the general property in the goods, and not merely a special property.” The property in the goods means the general property i.e., ‘all ownership right of the goods. Though passing of the title in the goods is an ingredient of sale, physical delivery of goods is not essential. The term ‘property’ as used in the Sale of Goods Act means general property in goods as distinguished from special property. For example, if A who owns certain goods pledges them to B, he has general property in the goods, whereas B has special property or interest in the goods to the extent of the amount of advance he has made.

8.6.5 Price

The term ‘price’ is defined in Section 2 (10) as “Price means the money consideration for of goods.” Consideration in a contract of sale has necessarily to be-money i.e., legal tender. If goods ‘are sold or exchanged for other goods, the transaction is barter and not a sale of goods under this Act. As a matter of fact, the requirement is that the goods must be sold for a definite” sum of money and it may be partly in cash and partly in valued op goods. For example, when an old bike is returned to the dealer for a new one and the difference is paid in cash that would also be a sale. (Aldridge Vs. Johnson 1857).

8.6.6 Contract

All the essential elements of a contract must be present in a contract of sale. the word contract means an agreement enforceable at law. If any of the essential elements' of a valid contract is missing, then the contract of sale will not be valid.

It may be noted that no particular form is necessary for the making of a contract of sale. It may be in any form. A contract of sale may be made (a) in writing or (b) by words of mouth or (c) partly in writing and partly by words of mouth, or {d) may be implied from the conduct of the parties. However, if any particular mode is prescribed by any law, then the contract of sale must be made in that particular mode. (Sec. 5 (2))

8.7 PERFORMANCE OF CONTRACT OF SALE

In this section, we attempt to make a brief study of the performance of a contract of sale. After the formation of a valid contract of sale, the next stage is its performance. Contract of sale imposes some duties on the seller and the buyer. It also confers some rights to the seller and the buyer. The seller's main duty is to deliver the goods to the buyer. Similarly, the buyer's main duty is to accept the goods and pay the price to the seller as per the terms of the contract. The term "performance of contract of sale" may be defined as the performance of the respective duties of the seller and the buyer as per the terms of the contract. The buyer and the seller are free to provide any terms them like in their contract about the time, place, delivery of goods, payment of the price etc. But when the parties are silent and do not provide any terms and conditions in the contract, then the rules contained in the Sale of Goods Act are applicable.

8.8 DEFINITIONS OF DELIVERY OF GOODS

In this section, we attempt to make a brief study of the definition of delivery of goods

According to Sec. 2(2), "delivery means voluntary transfer of possession from one person to another". Delivery is a bilateral act. It requires two parties to act. If transfer of possession of goods is not voluntary i.e., possession is obtained by theft etc., there is no delivery.

The performance is mutual and is laid down in Sec. 31 of the Act states that, "It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale."

The primary rule to be followed is that the payment of price and the delivery of goods are to be concurrent. Sec. 32 lays down that "Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is

to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods."

8.9 MODE OF DELIVERY

In this section, we attempt to make a brief study of the different mode of delivery.

According to sec. 33 states that "Delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf." Thus delivery need not mean the transfer of physical possession of goods. The essence of delivery is placing the buyer in such a position as to enable him to exercise his rights of ownership over the goods. Therefore, the delivery of goods may be made in any of the following ways:

8.9.1 Actual Delivery (Physical Delivery)

Where the goods are actually handed over by the seller to the buyer or his duly authorised agent, it is called actual delivery. Further Sec. 33 states that, delivery of goods may also be made by doing anything which has the effect of putting the goods in the possession of the buyer

8.9.2.Symbolic Delivery

Where a bulk of goods is sold, it is not possible to give actual delivery of the goods. In such case the control over the goods is transferred by delivery of a symbol For example, the delivery of keys of the godown in which goods are lying, transfer of documents (railway receipt, delivery orders etc.) are the instances of symbolic delivery.

8.9.3 Constructive Delivery

Sec. 36 (3) of the Act states that "Where the goods at the time of sale are in the possession of a third person, there is no delivery by seller to buyer unless and until such third person acknowledges to the buyer that he holds the goods on his behalf." Constructive delivery may be defined as the delivery when a third person, in possession of the goods, acknowledges holding the goods on behalf of the buyers. In such cases, three persons are required - the seller, the person holding the seller's goods and the buyer.

Check your progress - 1

What do you mean by Barter?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

8.10 RULES REGARDING DELIVERY OF GOODS (SEC. 33 TO 39)

In this section, we attempt to make a brief study of the provisions relating to the delivery of goods by the seller to the buyer:

8.10.1. Possession of Goods (Sec. 33)

The delivery of goods should be such which enables the buyer to exercise his control over the goods. Thus the delivery of the goods may be either actual or symbolic or constructive. These terms have been explained under the preceding heading.

8.10.2. Delivery and Payment are concurrent Conditions (Sec. 32)

Sec. 32 lays down that "Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods." The delivery of the goods and the payment of their price are the concurrent conditions, i.e., both these conditions should be performed simultaneously, as in the case of cash sales at the counter.

8.10.3. Demand for Delivery of Goods (Sec. 35)

Sec. 35 lays down that "Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery." When the goods are subsequently acquired by the seller, he should inform this to the buyer and the buyer should then apply for delivery. The buyer will have no cause of action if he fails to apply for delivery.

8.10.4. Time of Delivery [Sec. 36(2)]

Sec. 36 (2) lays down that, "Where under the contract of sale the seller is bound to send the goods to the buyer, but no time for sending them is fixed, the seller is bound to send them within a reasonable time." According to the terms of the

contract, the seller has to deliver the goods to the buyer and where no time for delivery is fixed, and then the delivery of goods must be made within a reasonable time. In commercial dealings, time is the essence of contract. As such it is usual to find a provision in a contract of sale regarding the time of delivery.

8.10.5. Place of Delivery [Sec. 36(1)]

Sec. 3.6 (1) lays down that "whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer is a question depending in each on the contract, express or implied, between the parties. Apart from any such contract:

(a) goods sold are to be delivered at the place at which they are at the time of the sale; and

(b) goods agreed to be sold are to be delivered at the place at which they are at the time of the agreement to sell or

(c) if not then in existence, at the place at which they are manufactured or produced."

8.10.6. Goods in the Possession of Third Person [Sec. 36 (3)]

Sec. 36 (3) lays down, "Where the goods at die time of sale are in the possession of a third person, there is no delivery by seller to buyer unless and until such third person acknowledges to the buyer that he holds the goods on his behalf." The third person must inform the buyer that he holds the goods on his behalf. When the goods have been sold by the transfer of the document of title to goods, for example, railway receipt or Bill of Lading, the buyer is deemed to be in possession of the goods represented by such document and the assent of the third party is not required.

8.10.7. Effect of Part Delivery (Sec. 34)

Sec. 34 states that "A delivery of part of goods, in progress of the delivery of the whole, has the same effect, for the purpose of passing the property in such. Goods, as a delivery of the whole; but a delivery of part of the goods, with an intention of severing it from the whole, do not operate as a delivery of the remainder." Delivery of part of goods sold may amount to delivery of the whole if it is so intended and agreed. But, however where the part is intended to be severed from the whole, part delivery does not amount to be delivery of the whole.

8.10. 8.Expenses of Delivery [Sec. 36 (5)]

Sec. 36 (S) lays down that "Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state shall be borne by the seller."

8.10.9. Instalment Delivery (Sec. 38)

Sec. 38 (1) lays down that "Unless otherwise agreed, the buyer of goods is not bound to accept delivery there of by instalments." Unless there is a term in the contract of sale, the seller is not entitled to deliver the goods in instalments and if he does so, the buyer is not bound to accept them.

8.10.10. Delivery of Wrong Quantity (Sec. 37)

The seller is under a duty to comply with the order of the buyer in quality and quantity. Sometimes, the delivery of goods may be of a quantity less than that contracted for, or a quantity larger than agreed, or may be contract goods mixed with goods of a different description. A defective delivery may be either of the following:

(a) Short Delivery (Sec. 37 (1))

"Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contract rate."

(b) Excess Delivery (Sec. 37 (2))

"Where the seller delivers the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and reject the rest or he may reject the whole. If the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate".

(c) Mixed Delivery [Sec. 37 (3)]

"Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest, or may reject the whole."

8.10.11. Delivery to a Carrier or Wharfinger (Sec. 39)

Where the seller is required, under the terms of the contract to send the goods to the buyer, delivery to a carrier or wharfinger, whether named by the buyer or not, for the purpose of transmission to the buyer is prima facie delivery to the buyer. However, if the goods are lost in transit and the seller has not made any contract with the carrier on behalf of the buyer, the seller shall be required to bear the loss. (Sec. 39).

8.1.0. 12. Delivery at a Distant Place (Sec. 40)

Where the seller agrees to deliver goods at his own risk at a place other than that where they are sold, the buyer shall have risk of any natural deterioration in the goods incidental to the transit, unless otherwise agreed between the parties. (Sec. 40)

Check your progress - 2

What do you mean by Earnest Money?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

8.11 LET US SUM UP

In this lesson, we have briefly touched upon the following points

Contract of sale: A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price (Sec.4).

Sale and agreement to sel1: Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled the contract is called an agreement to sell. An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property In the goods is to be transferred.

Subject-matter of sale: **"**Goods" form the subject of a contract of sale. They mean every kind of movable property other than actionable claims and money, and include 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)1 Goods may be: (1) Existing goods. i.e., goods which are owned and possessed by the seller at the time of sale. These goods may be specific ascertained or unascertained. (2) Future goods, i.e., goods which the seller does not possess at the time of the contract and which will be acquired, manufactured or produced by him at some future date. (3) Contingent goods i.e.,, goods the acquisition of which by the seller depends upon a contingency which may or may not happen.

Delivery of goods: Delivery means voluntary transfer of possession of goods from the seller to the buyer. It may be (t) actual, [i$ symbolic, or (tii) constructive. But it must be according to the rules as given below :

Rules as to delivery**:** 1. Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions. (2) A delivery of part of the goods, in progress, of the delivery of whole, amounts to, for the purpose of

passing the property in such goods, as a delivery of the whole. (3) Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery. (4) The place of delivery is the place at which they are at the time of the sale. (5) If the goods are in possession of a third party, there is no delivery until such third party acknowledges to the buyer that he holds the goods on his behalf. (6) Where the seller is bound to send the goods to the buyer but no time for sending -them is fixed, they must be sent within a reasonable time. (7) Expenses of making delivery are borne by the seller and expenses of obtaining delivery by the buyer. (8 the seller sends to the buyer a larger or a smaller quantity of goods than he ordered, the buyer may (a) reject the whole, or (b) accept the whole, or (c) accept the quantity he ordered and reject the rest. (9) If the seller delivers, with the goods ordered, goods of a wrong description, the buyer may accept the goods ordered and reject the rest or reject the whole. (10) Unless otherwise agreed, the goods are net to be delivered by instalments.

8.12 QUESTIONS FOR DISCUSSION

1. What is the scope of the Sale of Goods Act?
2. Define the term Goods. What are the different types of goods?
3. Distinguish between sale and agreement to sell.
4. “Sale is an executed contract but an agreement to sell is an executory contract”-Discuss
5. Is time with regard to payment of price is the essence of the contract of sale?

8.13 MODEL ANSWER TO CHECK YOUR PROGRESS

Check-1 **what do you mean by Barter?**

Barter is nothing but transfer of goods by one party to the other in consideration for another’s goods and which is not for price or money.

Check-2 **what do you mean by Earnest Money?**

It is a common practice among businessmen to advance a portion out of the purchase price payable to the seller as earnest money in order to show their sincerity and seriousness in performing the contract.

8.14 REFERENCES

1. “ Company law” -- A.K. Bagrial
2. “Principles of modern company law” – L.B. Gower
3. “Business Law” -- M.R. Sreenivasan

LESSON-9

RIGHTS AND DUTIES OF A BUYER AND SELLER

CONTENTS

9.0 Aims and objectives
9.1 Introduction
9.2 Rights of Buyer
9.3 Duties of Buyer
9.4 Rights of Seller
9.5 Duties of Seller
9.6 Let us sum up
9.7 Questions for discussion
9.8 Model answer to check your progress
9.9 References

9.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning of Contract of sale of Goods Act 1930 and rules regarding delivery of goods. Here, we have briefly touched upon the rights and duties of buyer and seller. After going through this lesson, you will able to

1. know the Rights of Buyer
2. understand Duties of Buyer
3. know rights and duties of seller

9.1. INTRODUCTION

The property in the goods is transferred from the seller to the buyer for a price; the contract is called a sale. In sale of goods, there are two parties involved in sale of goods. Both buyer and seller have some rights and duties.

9.2 RIGHTS OF A BUYER

In this section, we attempt to make a brief study of the rights of a buyer of goods.

9.2.1. Right to have Delivery of Goods (Sec. 32)

The buyer has the right to take delivery of the goods on payment of price when delivery of goods and payment of price are concurrent conditions in the contract of sale.

9.2.2. Right to Reject the Goods (Sec. 37)

The buyer is entitled to reject the goods in the following cases :

(a) Where the seller delivers lesser quantity than that contracted for

(b) Where the seller delivers larger quantity than that contracted for

(c) Where the seller mixes the contracted goods with goods of a different description.

9.2.3.Right not to Accept instalments (Sec. 38)

Subject to contract, the buyer is under no obligation to accept delivery of the goods by instalments. He can repudiate the contract in such circumstance. [Sec. 38 (1)]

9.2.4.Right to Examine the Goods (Sec. 41)

The buyer is not deemed to have accepted the goods unless and until:

(i) he has reasonable opportunity to examine the goods;

(ii) he is afforded a reasonable opportunity of examining the goods to see whether the goods are in conformity with the contract.

9.2.5. Right not to return the Rejected Goods (Sec. 43)

Subject to agreement, the buyer is not liable to return the goods rejected by him rightfully. It is sufficient if he intimates the seller that he refused to accept the goods.

9.2.6. Right to the Notice of Insurance [Sec. 39 (3)]

It is the duty of the seller to give notice to die buyer to enable him to insure the goods during the sea transit. If he fails to do so, the buyer is not liable for destruction of goods in transit.

Right against the Seller for Breach of Contract

9.2.7.Suit the Seller for non-delivery (Sec. 57)

Sec. 57 lays down that, “Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.”

9.2.8. Suit for Specific Performance (Sec. 58)

The buyer may sue the seller for specific performance of the contract of sale. If the goods are specific or ascertained, the court may order for the specific performance of the contract.

9.2.9.Suit for Breach of Warranty (Sec. 59)

Section 59 lays down that, "Where there is a breach of warranty, by the seller, or where the buyer elects or is compelled to treat the breach of condition by the seller as a breach of warranty, the buyer may:

(a) set up against the seller the breach of warranty in dimunition or extinction of the price; or

(b) sue the seller for damages for the breach of warranty.

9.2.10. Repudiation of the Contract before due Date (Sec. 60)

In such a case the buyer has the right for anticipatory breach of contract. Sec. 60 states that where the seller repudiates the contract before the date of delivery, the buyer may either treat the contract as subsisting and wait till the date of delivery or treat the contract as rescinded and sue for damages for breach of contract

9.2.11. Suit for Interest (Sec. 61 (2) (b))

Where there is a breach of contract on the put of the seller and as a result the price is to be refunded to the buyer, the buyer has a right to claim interest on the amount of price.

9.3 DUTIES OF THE BUYER

The buyer, in respect to the contract of sale, has to perform some duties. Here, we shall see, the duties perform by a buyer one by one.

9.3.1. Duty to Pay Price and Accept the goods (Sec. 31)

It is the duty of the buyer to take the delivery of the goods and pay for them in accordance with the terms of the contract.

9.3.2. Duty to Apply for delivery (Sec. 35)

The seller is not bound to deliver the goods to the buyer until the buyer applies for delivery, in the absence of any contract to the contrary.

9.3.3. Duty to Demand Delivery at a Reasonable Hour [Sec. 36 (4)]

As per Sec. 36 (4), "Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact."

9.3.4. Duty to Accept Instalment Delivery and Pay far It [Sec. 38 (2)]

Where there is a contract for the sale of goods to be delivered by stated instalments which are to be separately paid for, it is the duty of the buyer to accept the instalment delivery and pay for it.

9.3.5. Duty against Deterioration (Sec. 40)

Unless otherwise agreed, the buyer has to take the risk of deterioration of the goods incidental to the course of transit.

9.3.6. Duty to Intimate the Seller when Reject the Goods (Sec, 43)

Unless otherwise agreed, it is the duty of the buyer to inform the seller in case he refuses to accept the goods.

9.3.7.Duty to take delivery (Sec. 44)

It is the duty of the buyer to take delivery of the goods within a reasonable time after the tender of delivery. He will be becomes liable to the seller for any loss occasioned by hi» neglect or refusal to take delivery. .

9.3.8.Duty to Pay Price (Sec. 55)

Sec. 55 (1) lays down that "Where under a contract of sale the property in the goods has passed to the buyer and die buyer wrongfully neglects or refuses to pay the goods according to the terms of the contract, die seller may sue him for the price of the goods."

9.3.9.Duty to Pay Damages for Non-acceptance (Sec. 56)

Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance.

9.3.10. Duty to Pay Increased Hut (Sec. 64 A)

The buyer is liable to pay so much as will be equivalent to the amount paid or payable in respect of such tax imposed or increase of tax which may be chargeable at die time of sale, in die absence of any contract to contrary

9.4 RIGHTS OF A SELLER

In this section, the rights of seller may be discussed as under:

9.4.1. Right to Claim Compensation (Sec 44)

If is the right of the seller to claim compensation for the loss occasioned by the buyer's neglect or refusal to take delivery and also reasonable charges for the care and custody of the goods.

9.4.2. Might to Sue for Price [Sec. 55 (1)]

Sec 55 (1) lays down that "Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods."

9.4.3. Right to Sue for Price against Contract [Sec. 55 (2)]

Sec. 55 (2) lays down that, "Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract."

9.4.4. Right to sue for Damages (Sec. 56)

Sec. 56 lays down that, "Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance."

9.4.5. Right to Treat the Contract as Subsisting (Sec. 60)

Sec. 60 states, "Where the buyer repudiates the contract before the date of delivery of goods, seller may either treat the contract as subsisting or wait till the date of delivery, or he may treat the contract as repudiated and sue for damages for the breach."

9.4.6. Right to Interest by Way of Damages [Sec. 61 (1)]

It is the right of the seller to recover interest or special damages in any case where by law interest or special damages may be recoverable.

9.4.7. Rights of an Unpaid Seller

(a) Right against the goods

(b) Right against the buyer personally

9.5 DUTIES OF A SELLER

In this section, the duties of the seller may be discussed as follows:

9.5.1. Duty to Deliver the Goods (Sec. 31)

It is the duty of the seller to deliver the buyer goods in accordance with the terms of the contract.

9.5.2. Duty to Deliver the Goods at the Agreed Place (Sec. 36 (1))

It is the duty of the seller to send the goods to the buyer at the place at which they are contracted to be delivered.

9.5.3. Duty to Supply the Goods within Specified time [Sec. 36 (2)]

It is the duty of the seller to send the goods to the buyer within die fixed time or within reasonable time when no time for sending the goods is fixed.

9.5. 4. Duty to Send the Goods at Reasonable Hour [Sec. 36 (4)]

Tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is reasonable hour is a question of fact.

9.5.5. Duty to Bear the Expenses of Putting the Goods in Deliverable State [Sec. 36]

It is the liability of the seller to bear the expenses of and incidental to putting the goods into a deliverable state.

9.5.6.Duty to make Contract with Carrier and Wharfinger [Sec. 39 (2)]

It is the duty of the seller to make such contract with the carrier or wharfinger on behalf of the buyer as may be reasonable, having regard to the nature of the goods. If he fails to do so he is liable to bear loss if any, incurred in course of transit of the goods.

9.5.7. Duty to Give Notice to the Buyer [Sec. 39 (3)]

Subject to the agreement, it is the duty of the seller to give notice to the buyer to get the goods insured while the goods are sent by a route involving sea transit. If he fails to do so, goods shall be deemed to be at seller's risk during such sea transit.

9.5.8. Duty to Give Reasonable Opportunity to Examine the Goods (Sec. 41)

It is the duty of the seller to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.

Check your progress – 1

When can stoppage of goods in transit right be exercised ?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

9.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points

Rights of Buyer:Right to have Delivery of Goods, Right to Reject the Goods, Right not to Accept instalments, Right to Examine the Goods, Right not to return the Rejected Goods, Right to the Notice of Insurance, Right against the Seller for Breach of Contract, Suit the Seller for non-delivery, Suit for Specific Performance , Suit for Breach of Warranty , Repudiation of the Contract before due Date .

Duties of the Buyer:Duty to Pay Price and Accept the goods, Duty to Apply for delivery, Duty to Demand Delivery at a Reasonable Hour, Duty to Accept Instalment Delivery and Pay far It, Duty against Deterioration, Duty to Intimate the Seller when Reject the Goods, Duty to take delivery, Duty to Pay Damages for Non-acceptance, Duty to Pay Increased Hut.

Rights of a Seller: Right to Claim Compensation, Might to Sue for Price, Right to Sue for Price against Contract, Right to sue for Damages, Right to Treat the Contract as Subsisting, Right to Interest by Way of Damages ,Rights of an Unpaid Seller

Duties of a Seller: Duty to Deliver the Goods, Duty to Deliver the Goods at the Agreed Place, Duty to Supply the Goods within Specified time ,Duty to Send the Goods at Reasonable Hour, Duty to Bear the Expenses of Putting the Goods in Deliverable State , Duty to make Contract with Carrier and Wharfinger ,Duty to Give Notice to the Buyer.

9.7 QUESTIONS FOR DISCUSSION

1. Discuss the rights and duties of buyer.
2. Explain the rights and duties of seller**.**

9.8 MODEL ANSWER TO CHECK YOUR PROGRESS

The right of stoppage in transit means the right of stopping further transit of the goods while they are with a carrier for the purpose of transmission to the buyer, resuming possession of them and retaining possession until payment or tender of the price.

9.9 REFERENCES

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3. N.D. Kapoor - Elements of Company Law

LESSON-10

COMPANY FORM OF BUSINESS – ON OVER VIEW

CONTENTS

10.0 Aims and objectives

10.1 Introduction

10.1.1 Companies Act 1956

10.1.2 Meaning

10.1.3 Definition of Company

10.2 Characteristics or Essential Features of a Company

10.3 Kinds of Company

10.3.1 Basis of Classification

10.3.2 Distinction between a public company and a private company

10.4 Special Privileges of a Private Company Over Public Company

10.5 Let us sum up

10.6 Questions for discussion

10.7 Model answer to check your progress

10.8 References

10.0 AIMS AND OBJECTIVES

In the ninth lesson, we discussed the rights and duties of buyer and seller .In this lesson we discuss the meaning, definition and characteristics of company, different types of companies and privileges of private company. After going through this lesson, you will able to

1. know the meaning and definition of company
2. understand various kinds of the companies
3. know privileges of private company

10.1 INTRODUCTION

Nowadays, to start or carry on a business requires huge investments. It may not be possible for a single person to fulfill all his financial requirements. Thus, the persons are generally desirous of carrying on joint business enterprises. To

such persons, the law offers a choice between a partnership and a company. The partnership is suitable for small-scale business, in which the partners take personal interest and work together with mutual trust and confidence. But sometimes, the persons like to start business on large scale requiring huge investments which cannot be financed by the resources of a few persons. In such cases, the formation of a company is the only choice. It may, however, be noted that even for a small-scale business, a company offers certain privileges as compared to partnership, such as the limited personal liability of the members. A company means a group of persons associated together to achieve some common objective. In this section, we discuss the companies Act 1956, meaning and definition of company.

10.1.1 Companies Act 1956

The law relating to companies is contained in The Companies Act, 1956. It came into force on 1st April, 1956, and it applies to the whole of India. It is amended up-to-date. The last amendment to the Act has been made in 1999 by the companies (Amendment) Act 1999.

10.1.2 Meaning

A company is a voluntary association of persons formed to achieve some common objectives, having a separate form its members, with a perpetual succession and a common seal, and with capital divisible into transferable shares.

10.1.3 Definition of Company

The term ‘company’ may be defined as a group of persons associated together to achieve some common objective. This, how, ever, is not the legal definition. The legal definition of a company is given in Section 3 (1) (i) of the Companies Act, which reads as under: “Company means a company formed and registered under this Act or an existing company”.

L.J. Lindley’s defines a company as “an association of many persons who contribute money or money’s worth to a common stock, and employ it in some common trade or business and who share the profit or loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The person who contribute it , or whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted.”

10.2 CHARACTERISTICS OR ESSENTIAL FEATURES OF A COMPANY

The meaning and nature of the company becomes clear after looking into its characteristics. The legal meaning of the term ‘company’, as revealed by these characteristics, may be summed up as under

10.2.1 Registration

A company is to be compulsorily registered under the Companies Act.

10.2.2 Distinct person-Separate legal entity

A company is a distinct person possessing its own identity. It is altogether a separate legal entity, independent from its members, though controlled by the Board of Directors.

10.2.3 Perpetual succession

A company incorporated never dies. It has a perpetual succession. Its members may come and go but the company can go on for ever and remain the same entity. The death or insolvency of the members does not affect the corporate existence of the company. It may be wound up. On winding up it ceases to exist.

Prof. Grover in his book on Modern Company Law says that "A company continues to exist even if all the members are dead. During the war all the members of one private company while in general meeting were killed by a bomb. But the company survived. Not even a hydrogen bomb could destroy it."

10.2.4 Artificial person but not a citizen

The Company is an artificial person. It functions through its Board of Directors. However, it is not a citizen as it cannot enjoy the rights under the Constitution of India or Citizenship Act. In State Trading Corporation of India V. C. T. O. (1963 S. C. J. 705), it was held that neither the provisions of the Constitution nor the Citizenship Act apply to it. It may have a domicile. It should be noted that though a company does not possesses fundamental rights, yet it is a person in the eyes of law. It can enter into contracts with its Directors, its members and outsiders.

10.2.5 Transferable Shares

A company has the greatest advantage of its shares being easily transferable. Unlike a partnership concern, where against the will of the partners, the transferee does not become a partner, the members in an incorporated company can easily transfer their shares. Section 82 of the Companies Act provided for in the articles of the company. However, in a private limited company, there are certain restrictions on the transferability of its shares.

10.2.6 Limited liability

The novel idea of limited liability was for the first time introduced by the Companies Act of 1857. Any person can participate in the share capital of an incorporated company and limit his liability to the extent of his participation.

Limited liability in other words means, the members cannot be called upon, in case of liquidation or winding up of the company to contribute more than what has been agreed by them to subscribe, by way of participation in the share

capital of the company. In an incorporated company, the members can call upon to contribute only to the extent of their unpaid up capital on the shares subscribed by them. This secures the members and encourages large scale investments in an incorporated form of organization.

10.2.7 Common Seal

The company has a separate legal existence under its own common seal. It can enter into contracts with outsiders, with its Directors or with its members. The common seal of the company gives it an independent existence.

10.2.8 Separate Property

The company being a distinct and legal personality can won, enjoy and dispose of property in its own name. It is the owner of its capital and assets though contributed by its members. The shareholders are not the owners of the company's property. In Hyderabad (Sind) Electric Supply Co. v. Union of India (A.I.R. 1959 Pinj. 99), it was held that the property of the company is not the property of the shareholders. It is the property of the Company.

10.2.9. Capacity to sue and be sued

A company can sue and be sued in its corporate name.

Check your progress 1

A Company is an artificial person- Explain

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

10.3 KINDS OF COMPANY

Depending upon the capital to be mobilized, and the structure to be organized, and in conformity with the Government policy, companies have to be formed with the following classifications. In this section, we attempt to make a brief study of the kinds of company .The companies may be broadly classified as incorporated Companies and unincorporated Companies

i) Incorporated Companies

An incorporated company is one which is formed for the purpose of carrying on a business and is incorporated under the Companies Act, 1956, or some earlier Companies Acts.

ii) Unincorporated Companies

Unincorporated companies are to all intents and purposes large partnerships. These are not regarded as distinct entities separate form the members constituting them. Their shares may be transferable, but liability of their members is unlimited. These companies continue even after the death or insolvency of a member, and their management is vested in a select body of directors to the exclusion of members generally. Such companies can no longer be formed under the Companies Act, 1956, if the number of their members exceeds 10 in the case of companies carrying on banking business, and 20 in the case of any other business (Sec. 11).

10.3.1 Basis of Classification

Companies may be classified into various kinds on the following basis

I. On the Basis of Incorporation

1. Statutory Companies
2. Registered Companies.

II. On the Basis of Liability

1. Companies which limited liability. These may be
   (a) Companies limited by shares
   (b) Companies limited by guarantee
2. Companies with unlimited liability [Sec. 12(2)]

III. On the Basis of Number of Members

1. Private Company
2. Public Company.

IV. On the Basis of Control

1. Holding Companies
2. Subsidiary Companies (Sec. 4)

V. On the Basis of Ownership

1. Government Companies
2. Non Government Companies

VI Foreign Companies

VII Investment Company

VIII One – Man company

1.On the Basis of Incorporation

1. Statutory Companies

2. Registered Companies

1. Statutory companies. These are the companies which are created by a special Act of the Legislature, e.g., the Reserve Bank of India, the State Bank of India, the Life Insurance Corporation, the Industrial Finance Corporation, and the Unit Trust of India. These are mostly concerned with public utilities, e.g., railways, tramways, gas and electricity companies and enterprises of national importance. The provisions of the Companies Act, 1956 apply to them, if they are not inconsistent with the provisions of the special Acts under which they are formed.

2. Registered companies. These are the companies which are formed and registered under the Companies Act, 1956, or were registered under any of the earlier Companies Acts. These are by far the most commonly found companies.

II. On the basis of liability

On the basis of liability companies may by classified into :

1. Companies which limited liability. These may be
    (a) Companies limited by shares
    (b) Companies limited by guarantee
2. Companies with unlimited liability [Sec. 12(2)]

1. Companies with limited liability

(a) Companies limited by shares.

Companies limited by shares are the most common. Where the liability of members of a company is limited to the amount unpaid on the shares, such a company is known as a company limited by shares. The liability can be enforced during the existence of the company as also during the winding up of the company. If the shares are fully paid, the liability of the members holding such shares is nil. A company limited by shares may be a public company or a private company.

(2) Companies limited by guarantee.

Where the liability of the members of a company is limited to a fixed amount which the members undertake to contribute to the assets of the company in the event of its being wound up, the company is called a company limited by guarantee. It has a legal personality distinct from its members. The liability of its members is limited. .

2. Unlimited Companies

Sec. 12 specifically provides that any 7 or more persons (2 or more in case of a private company) may form an incorporated company, with or without limited liability. A company without limited liability is known as an unlimited company. In case of such a company, every member is liable for the debts of the company, as an ordinary partnership, in proportion to his interest in the company.

An unlimited company may or may not have share capital. If it has a share capital, it may be a public company or a private company. It must have its own Articles of Association. The Articles must state the number of members with which the company is to be registered. It the company has a share capital, the Articles must also state the mount of share capital with which the company is to be registered.

III. On The Basis of Number of Members

From the point of view of the general public and on the basis of number of members, a company may be–

1. Private Company

2. Public Company

1. Private company. A private company is normally what the Americans call a 'close corporation'. According to Sec 3 (1) (iii), a 'private company' means a company which has a minimum paid-up capital of Rs.1,00,000 or such higher paid-up capital as may be prescribed, and by its Articles–

(a) restricts the right to transfer its shares, if any. This restriction is meant to preserve the private character of the company;

(b) limits the number of its members to 50 not including its employee-members (present or past) ;

(c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company.

(d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

2. Public company. A public company means a company which

(a) is not a private company ;

(b) has a minimum paid-up capital of Rs.5,00,000 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. A public limited company may be :

(1) Listed public company

(2) Unlisted public company.

Listed public company means a public company which has any of its securities listed in any recognized stock exchange [Sec. 2(23-A) as inserted by the Companies (Amendment) Act, 2000].

Unlisted public company is one whose securities are not listed in any recognized stock exchange.

IV. On the basis of control, companies may be classified into:

1. Holding companies, and
2. Subsidiary companies.

1. Holding company [Sec. 4 (4)]

When one company controls another company it is called a holding company According to Sec. 4 (4), a company is "deemed to be the holding company of another, if but only if, that other is its subsidiary." One company may control another company in any of the following ways:

(i) when it controls the composition of the Board of Directors of another company;

(ii) where it controls more than half of the total voting power of the other company; or

(iii) where it holds more than half of the nominal value of equity share capital of the other company; or

(iv) where it is a subsidiary of any company which is the subsidiary of some other company.

2. Subsidiary company [Sec. 4(1)]

When one company is dominated over by another (a) by virtue of control over more than half of the nominal equity shares belonging to the former company, the company whose shares are thus controlled is known as subsidiary company. In other words, a company is known as a subsidiary of another company when control is exercised by the latter (called holding company) over the former called a subsidiary company.

V. On the Basis of Ownership

On the basis of ownership, a company may be a

1. Government Company, or
2. Non-Government Company

1. Government Company

A Government company means any company in which not less than 51 percent of the paid- up share capital is held by the Central Government or Sate Governments or both the governments.

2. Non-Government Company

All companies other than government company are known as non- Government companies.

V Foreign Companies

It means any company incorporated outside India which has an established place of business in India [Sec. 591 (1)]. Where, for example, representatives of a foreign company frequently come and stay in a hotel in India for purchasing raw material, machinery, cotton etc., the foreign company has a place of business in India.

VI Investment Company

The company Law under section 372 imposes restrictions on investments made by the public companies in other body corporate, which should not exceed 30 % of the paid up equity capital of the investment company

VII One-Man Company

One-man company is a Company in which the whole share capital is held by a single individual.

10.3.2 Distinction between a public company and a private company

1. Minimum number

The minimum number of persons required to form a public company is 7. It is ‘2 in case of a private company.

2. Maximum number

There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company.

3. Number of directors

A public company must have at least 3 director whereas a private company must have at least 2 directors (Sec. 252).

4. Restriction on appointment of directors

In the case of a public company, the directors must file with the Registrar consent to act as directors or sign an undertaking for their qualification shares. The directors of a private company need not do so (Sec. 266).

5. Restriction on invitation to subscribe for shares

A public company invites the general public to subscribe for the shares in, or the debentures of, the company. A private company by its Articles prohibits any such invitation to the public.

6. Transferability of shares/debentures

In a public company, the shares and debentures are freely transferable (Sec. 82). In a private company the right to transfer shares and debentures is restricted by the Articles.

7. Special privileges

A private company enjoys some special privileges. A public company enjoys no such privileges.

8. Quorum.

It the Articles of a company do not provide for a larger quorum, 5 members personally present in the case of a public company are quorum for a meeting of the company. It is 2 in the case of a private company (Sec. 174).

9. Managerial remuneration.

Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits (Sec. 198). No such restriction applies to a private company.

Check your progress -2

How a Company is defer from partner ship

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

10.4 SPECIAL PRIVILEGES OF A PRIVATE COMPANY

Both private and public companies are regulated by the provisions of the Companies Act, 1956. However, certain provisions of the Act do not apply to private company. These are the privileges which private company enjoys over the public company under the Act. In this section we summarized privileges of private company

1. The minimum number of members in a private company can be two only as against seven in a public company.

2. Provisions regarding minimum subscription before allotment of shares do not apply to a private company.

3. A private company need not file a prospectus or a statement in lieu of prospectus with the Registrar.

4. Further issue of shares need not be offered to the existing members.

5. Private company may issue share capital of such kinds, in such forms and with such voting rights, as it may think fit.

6. Private company can commence business immediately on incorporation.

7. It need not keep an index of members.

8. It need not hold statutory meeting or file statutory report.

9. Provisions as to overall maximum managerial remuneration and remuneration to directors, do not apply to a private company.

10. Minimum number of directors is only two in a private company.

11. Provisions as to proportion of directors liable to retire by rotation do not apply to a private company.

12. Director's consent to act as such is not required.

13. Restrictions on appointment of Directors as regards their consent and holding qualification shares do not apply to a private company.

14. Government approval to appointment or amendment of provisions relating to managing or whole-time or non-rotational directors is not required.

15. Directors' contract to take up qualification shares need not be filed with the Registrar of companies.

16. Provisions regarding loans to directors do not apply.

17. Provisions regarding interested directors not to participate or vote in board's proceedings do not apply.

18. Provisions requiring Government approval for increasing remuneration of a director or managing director do not apply.

19. Prohibition regarding appointment of a managing director for more than give years at a time do not apply.

20. Restrictions on advancing loans to other companies do not apply.

10.5 LET US SUM UP

In this lesson, we have briefly touched upon the following points. A company means a group of persons associated together to achieve some common objective. The law relating to companies is contained in The Companies Act, 1956. The company has a separate legal existence under its own common seal. Companies may be classified into various kinds on the following basis

I. On the Basis of Incorporation:1. Statutory Companies

2. Registered Companies.

II. On the Basis of Liability: 1. Companies which limited liability.(a) Companies limited by shares (b) Companies limited by guarantee. 2. Companies with unlimited liability. III. On the Basis of Number of Members: 1. Private Company 2. Public Company. IV. On the Basis of Control : 1. Holding Companies 2. Subsidiary Companies .V. On the Basis of Ownership:1. Government Companies 2. Non Government Companies. VI Foreign Companies VII Investment Company

VIII One – Man company . These are the privileges which private company enjoys over the public company under the Act

1. The minimum number of members in a private company can be two only as against seven in a public company.
2. Provisions regarding minimum subscription before allotment of shares do not apply to a private company.
3. A private company need not file a prospectus or a statement in lieu of prospectus with the Registrar.
4. Further issue of shares need not be offered to the existing members.
5. Private company may issue share capital of such kinds, in such forms and with such voting rights, as it may think fit.
6. Private company can commence business immediately on incorporation.
7. It need not keep an index of members.

10.6 QUESTIONS FOR DISCUSSION

1. Define a company. State the characteristic features of a company.
2. Distinguish between private company and public company
3. Explain what is meant by a 'holding company' and a 'subsidiary company'
4. What is a government company?
5. Explain the various privileges of private company.
6. Write notes on: Foreign Company

10.7 MODEL ANSWER TO CHECK YOUR PROGRESS

Check -1 A Company is an artificial person- Explain

A company is an artificial person in the sense that it is constituted by a group of peoples associating themselves to form such company. A company does not possess the attributes of a natural person. A company cannot enjoy certain rights there are exercised by a natural citizen It has to exercise its rights only through and in compliance with the procedures prescribed under company Law.

Check – 2 How the Company is defer from partner ship

A company has separate existence apart from the members constituting it. In case of Partnership firm it has no separate existence apart from the members constituting it. In the case of a public Ltd., co., liability of the members is limited to the extent of the face value of the shares. In case of Partnership, every partner is jointly and severally liable for the debt of the firm.

10.8 REFERENCES

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LESSON-11

FORMATION OF A COMPANY

CONTENTS

11.0 Aims and Objectives
11.1 Introduction
11.2 Definition of Formation of a Company
11.3 Stages in Formation of a Company
11.3.1 Promotion of a Company
11.3.2 Registration and Incorporation of a Company
11.3.3 Certificate of Incorporation
11.3.4 Commencement of Business
11.3.5 Companies Amendment Act, 1965
11.4 Procedure for Incorporation of Company
11.5 Advantages of Incorporation
11.6 Disadvantages of Non-Registered Company
11.7 Let us sum up
11.8 Questions for discussion
11.9 Model answer to check your progress
11.10 References

11.0 AIMS AND OBJECTIVES

In the 10th lesson, we discussed the meaning, definition and characteristics of company, different types of companies and privileges of private company. In this lesson we discuss the meaning, definition of formation of a Company and Stages in formation of a Company, Certificate of Incorporation, Commencement of Business, Procedure for registration or incorporation of company and Effect of Registration. After going through this lesson, you will able to

1. know the meaning and definition of formation of a company
2. understand various stages in formation of a Companies
3. identify various documents required by The Registrar of Companies.
4. understand the Procedure for registration of a company
5 learn the advantages of registration of a company
6. known the disadvantages of registration of a company

11.1 INTRODUCTION

We know that a company is separate legal entity which is formed and registered under the Companies Act. It may be noted that before a company is actually formed (i.e. formed and registered under the Companies Act), certain persons, who wish to form a company, come together with a view to carry on some business for the purpose of earning profits. Such persons have to decide various questions such as (a) which business they should start (b) whether they should form a new company or take over the business of some existing company, (c) if new company is to be started, whether they should start a private company or public company, (d) what should be the capital of the company etc. After deciding about the formation of the company, the desirous persons take necessary steps, and the company is actually formed. Thereafter, they start their business. Thus, there are various stages in the formation of a company form thinking of starting a business to the actual starting of the business. In this section, we shall discuss these stages along with the legal provisions relating to them.

11.2 DEFINITION OF FORMATION OF A COMPANY

Formation means establishment or creation of a corporate body by a group of persons known as association of person for the purpose of carrying on either commercial activities or non commercial activities with the approval of the government. It also signifies compliance with certain formalities prescribed under law to become a legal entity as a company.

11.3 STAGES IN FORMATION OF A COMPANY

Formation of a company is considered to be a responsible job. It involves compliance with technical formalities of the provisions under the companies Act by the promoter, who are the architects or founder father of the company. Here the entire formation of a company could be studied under following stages.

1. Promotion of a company.
2. Registration and incorporation of a company.
3. Commencement of business

11.3.1 Promotion of a Company

It is the first stage in the formation of a company. The promotion of a company refers to all those steps which are taken from the time of having an idea of starting a company to the time of the actual starting of the company business. Thus, ‘formation of a company’ means originating the idea of forming a company, and taking necessary steps in this regard. The persons who think of forming a company and take necessary steps in its formation are known as ‘promoters’ or ‘company promoters’.

11.3.2 Registration and Incorporation of a Company

It is the second stage in the formation of a company. We know that a company comes into existence when it is registered under the Companies Act. If the company is to be formed as a public company, any seven or more persons associated for any lawful purpose may form the same by getting it registered with the Registrar of Companies. A company is to be formed as a private company and two or more (but not more than 50) persons may get the same registered. The company so formed, whether public or private, may be of the following two types, namely [Section 12]

1. Limited company (limited by shares or limited by guarantee).

2. Unlimited company.

A company is got registered by filing an application with the Registrar of Companies of the area in which registered office of the company is to be situated. Such an application is filed by the approval of the proposed name from the Registrar of Companies.

After getting the approval of name, the application for registration of the company should be filed with the Registrar along with the following documents and particulars [Section 33]

1. The 'memorandum of association'. It is the document which describes the scope of company activities. It must be signed by the required number of persons which are necessary for the formation of company, and who come forward to form it (i.e. seven in case of public, and two in case of private company). The memorandum of association will be discussed in detail in following lesson.

2. The 'articles of association'. It is the document which contains the rules and regulations of the company. It must also be signed by the persons who sign the memorandum of association. It may be noted that the filing of the 'articles of association' is compulsory for three types of companies, namely, (a) unlimited companies, (b) private companies, and (c) companies limited by guarantee. However, the filing of this document is not compulsory for a public company limited by shares [Section 26]. If a 'public company limited by shares' does not file this document, it is deemed to have adopted 'Table A'. This table is a model set of articles of association given in Schedule I of the Companies Act. The articles of association will be discussed in detail in following lessons

3. The agreement which the company proposes to enter into with any individual for appointment as company's managing director, or whole-time directors or manager.

In case the company has entered into any such agreement, the same must also be filed with the Registrar at the time of registration of the company. This clause has been added by the Companies (Amendment) Act, 1988.

4. The declaration that all the requirements of the Companies Act relating to the registration of the company have been complied with. Such a declaration must be signed by any one of the following persons [section 33(2)]

(a) An advocate of the Supreme Court or of a High Court.

(b) An attorney or pleader entitled to appear before High Court.

(c) A secretary in whole-time practice in India, who is engaged in the formation of a company.

(d) A chartered accountant in whole-time practice in India, who is engaged in the formation of a company.

(e) A person named n the articles of association as a director, manager or secretary of the company.

The above-mentioned are the document which must be presented for registration to the Registrar at the time of formation of the company. By Section 33, these documents are specifically required to be registered for the incorporation (i.e. formation) of the company. Sometimes, the proposed public company having a share capital decides to appoint its first directors by its articles of association. In such case, the following three additional documents (Sr. No. 5 to 7) must also be filed with the Registrar by such a company [Section 266]:

5. A written consent of such directors to act as director of the company. It should be signed by the director himself or by his agent authorised in writing.

6. A written undertaking by such directors to take and pay for their qualification shares, if any. It should be signed by each such director.

7. A list of persons who have agreed to become the first directors of the company. Such a list becomes necessary in view of the aforesaid written consent and undertaking to be given by such persons.

The Registrar of Companies may himself ask for the above three documents in case of a public company having a share capital.

Following are some other documents which, though not required for the purpose of registration of the company, but are usually delivered by both the public and private companies to the Registrar along with the above documents:

(a) The notice stating the situation i.e. addresses of the registered office of the company. If this notice is not filed at the time of registration, it has to be filed within 30 days after the date of incorporation of the company [Section 146 (2)]

(b) The particulars (i.e. name, address, nationality, business etc.) regarding the directors, managing directors, manager, and secretary of the company. If these particulars are not filed at the time of registration, it has to be filed within 30 days from the appointment of the first directors [Section 303].

(c) A letter from the Registrar of Companies intimating that the proposed name of the company is available for adoption and may be adopted by the company

[Rule 4-A of the Companies (Central Government's) General Rules and Forms, 1956]

When the application for registration of the company along with the requisite fee and above documents is presented to the Registrar for registration, the Registrar shall satisfy himself regarding the following points, that;

(a) The company is proposed to be formed for lawful object.

(b) The 'memorandum of association' has been signed by the requisite number of persons (i.e. seven in case of public, and two in case of private company).

(c) The 'memorandum of association' and the 'articles of association' are prepared according to the provisions of the Companies Act i.e. they do not go against the Companies Act.

(d) The statutory declaration has been duly signed by the authorised person.

(e) The name of the company is acceptable i.e. the name is neither prohibited nor is similar to the name of any existing company.

On being satisfied with all the above points, the Registrar will register the company and other documents, and place the name of the company in a register known as the 'Register of Companies'. After the registration, the Registrar issues a 'certificate of incorporation' (i.e. a certificate of the formation of company). Thereafter the company comes into existence.

11.3.3 Certificate of Incorporation

A certificate of incorporation is one which certifies that the company is incorporated (i.e. formed). It is issued by the Registrar of Companies. It contains the name of the company, the date of its issue, and the signature of the Registrar with his seal. This certificate brings the company into existence. The legal effects of the certificate of incorporation may be state as under [Section 34]

1. The company comes into existence and it becomes a legal entity independent from its numbers.
2. The company's life starts from the date of the certificate of incorporation.
3. The 'memorandum, and 'articles of association, become binding upon the company and all its members.
4. The liability of the members of the limited company becomes limited.

It may, however, be noted that if the company is registered with illegal objects, then the objects do not become legal by the issue of certificate of incorporation. In other words, the certificate of incorporation is not conclusive of the legality of the objects stated in the memorandum of association.

11.3.4 Commencement of Business

We have already discussed in above that a company comes into existence when it is registered and a certificate of incorporation is issued by the Registrar of Companies. Thereafter, the company becomes entitled to commence its business. On the point of commencement of business, there is some difference; a private company can start its business immediately after obtaining the certificate of incorporation. But a public company, will have to obtain a further certificate known as the 'certificate to commence business,' before it can start its business. However, such a certificate is not necessary for a public company which has no share capital. It there fore, follows that a public company, having share capital, must obtain a 'certificate to commence business' from the Registrar of Companies. Before this certificate is obtained by the company, it is required to fulfill certain formalities (Section 149). Such formalities are different for a company which issues a 'prospectus' inviting the public to subscribe for its shares, and for a company which does not issue a prospectus, and are discussed separately in the following pages.

1. Public company which issues a prospectus inviting the public to subscribe for its shares: Such a company is entitled to obtain the 'certificate to commence business' on fulfilling the following conditions:

(a) The shares payable in cash must have been allotted up to the amount of 'minimum subscription'. The 'minimum subscription' is the amount which is stated the in the 'prospectus', and which is enough for preliminary expenses, working capital and to pay the purchase price of the property.

(b) The directors must have paid in cash, the application money and the allotment money on the qualification shares taken by them.

(c) Any money is not liable to become refundable to the applicants by reason of failure to apply for the permission or by failure to obtain permission to deal on the stock exchange.

(d) A statutory declaration duly verified by one of the directors or secretary of the company stating that all the above requirements have been complied with must have been filed with the Registrar of Companies.

2. Public company which does not issue a prospectus inviting the public to subscribe for its shares: Such a company is entitled to obtain the 'certificate to commence business' on fulfilling the following conditions:

(a) A 'statement in lieu of prospectuses must have been filed with the Register of Companies.

(b) The directors must have paid in cash the application money and the allotment money on the qualification shares taken by them.

(c) A statutory declaration signed by one of the directors or secretary of company stating that all the above requirements have complied with must have been filed with the Registrar of Companies.

On fulfilment of the above conditions the Registrar shall certify that the company is entitled to commence its business, and shall issue a certificate known as the 'certificate to commence business'. This certificate is the conclusive evidence that the company is entitled to commence the business. It may be noted that no public company having share capital can commence any business or exercise any borrowing power unless this certificate is obtained. Any contract made before obtaining the certificate to commence business, shall be provisional and shall not be binding on the company until this certificate is obtained [Section 149 (4)].

11.3.5 Companies Amendment Act, 1965

The Companies Amendment Act of 1965 has amended Section 13, which provides that the 'object clause' of the memorandum of a company, incorporated after this amendment, must be divided into two sub-clauses namely:

1. Main objects clause. This clause will state the main objects of the company, and also the objects which are incidental to the attainment of main objects.
2. Other objects clause. This clause will state those objects of the company which have not been mentioned in the above clause.

However, the objects clause of a company which is existing before the commencement of the Amendment Act of 1965, shall remain as it is. The Companies Amendment Act of 1965 has also added two sub-sections to Section 149, and has introduced a new condition for the commencement of business by a company. The effect of this amendment is that in the following cases, a public company, having a share capital, can commence its business only if it has obtained the prior approval of the shareholders by passing a special resolution in the general meeting:

1. When a company incorporated after the Amendment Act of 1965 wishes to start a business included in the 'other objects clause'.
2. When a company existing before the Amendment Act of 1965 wishes to start a business which though included in its objects but is not germane to (i.e. related to) the business which the company is carrying on at the commencement of the Amendment Act.

In both the above cases, a statutory declaration signed by one of the directors or secretary of the company stating that the requirement as to special resolution has been complied with must have been filed with the Registrar of Companies. When the Registrar is stratified about these requirements, then he will issue a certificate to commence business. It will be interesting to know that the business may also be commenced by passing an ordinary resolution if the approval of Central Government is obtained for the same.

11.4 PROCEDURE FOR INCORPORATION OF COMPANY (SECS.12 & 33)

In case of a public company any seven persons and in case of a Private Company any two persons may join to form an incorporated company. They many form the company with limited or unlimited liability, limited by shares or by guarantee. In this section, we attempt to make a brief study on the formalities shall be complied with to enable the Registrar of Companies to issue a certificate of incorporation.

1. Application for availability of name under which the company proposes to be incorporated is to be made to the Registrar of Companies in the prescribed form in the State where the registered office of the company is to be situated.

2. After the name is made available, Memorandum and Articles of Association of the company is to be filed with the registrar of Companies with necessary stamp duty and filling fees according to the authorised capital of the company. In case of a private company any two persons and in case of a public company any seven persons shall subscribe to the Memorandum and Articles of Association of the company.

3. It is advisable to file with the Registrar along with the Memorandum and Article of Association, particulars of the situation of the Registered Office of the Company and the particulars of first Directors of the company. If at this stage these particulars are not filed, then the same have to be filed with the Registrar within 30 days of obtaining the certificate of incorporation.

4. A declaration by an advocate of the Supreme Court or of a High Court or attorney or a pleader entitled to appear before a High Court or a Chartered Accountant practicing in India who is engaged in the formation of a company, or by a person named in the articles as Director, Manager or secretary of the Company, that all the requirements of the act have been complied with in respect of registration, shall be filed with the Registrar. (sec. 33)

5. If a company intends to participate in an industry included in the Schedule of Industries (Development and Regulation) Act 1951, a licence to that effect must be obtained.

If all the above requirements are complied with under the provisions of the Companies Act, the Registrar of Companies issues a certificate of incorporation.

In case of a public company, the following further requirements are to be complied with:–

(i) A list of persons who have consented to act as directors.

(ii) A written consent of the directors to act in that capacity.

(iii) A under taking by the directors to take up and pay for their qualification shares.

If the Registrar is satisfied that all the requirements under the act for purposes of registration of a company have been complied with he shall register the company and issue a certificate of incorporation under his hand and seal. Once a company is registered, the incorporation cannot be challenged even though there may be irregularities prior to registration.

Check your progress - 1

What are the conditions to be fulfilled by a public company to obtain the certificate to commence business?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

11.5 ADVANTAGES OF INCORPORATION

Here, we briefly explain the various advantages of incorporating a company

11.5.1 Corporate existence

The Company on incorporation obtains independent corporate existence. It is vested with an independent legal personality distinct from the members who compose it. It becomes a body corporate capable of immediately functioning as an incorporated individual.

11.5.2. Liability

The liability of the members is limited to the extent of nominal amount of shares subscribed in the company's share capital. In case of the company limited by guarantee, the liability of the members is limited to the extent of the amount guaranteed by each member.

11.5. 3. Transferable shares

Shares in a company can be transferred easily without the consent of other members.

11.5.4. Perpetual succession

As the company has separate legal existence independent of its members, it is not affected by the death or insolvency of a member. It has a perpetual existence.

11.5.5. Members and the Company

Company being a separate legal entity it can sue its members in the ordinary way, can give loans to members, enter into contracts with members, etc.

11.5. 6. Management

Management of the company can be vested in professionals and the members of the company can appoint capable persons to manage the affairs of the company to the general interests of the shareholders. Employees of the company can also become its shareholders.

11.5.7. Separate Property

Though capital and assets are contributed by its members, it is the company which is the owner of the capital and assets and it can enjoy and dispose of property in its won name.

11.5. 8. Capacity to sue and be sued

A company being a body corporate can sue and be sued in its own name.

Check your progress – 2

Write short notes on “Memorandum of association” “Articles of association”

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

11.6 DISADVANTAGES OF NON-REGISTERED COMPANY

Here, we briefly explain the various disadvantages of non-registered company

1. When it is not registered, it cannot sue nor be sued in its own name.
2. It cannot sell or assign or mortgage an immovable property without obtaining the approval of the general body by a special resolution.
3. Non- registered company neither prospectus could be issued nor could capital be obtained.
4. The liability of members is unlimited; each and every member will be jointly and severely liable for company's debt

11.7 LET US SUM UP

In this lesson, we have briefly touched upon the following points. The Company obtains separate legal existence after it obtains a certificate of incorporation. It is a documentary proof and conclusive evidence of the registration of the company for all purpose.

Procedure for Registration: Any two persons in case of a private company and any seven persons in case of a public company may associate themselves to register a private company or a public company, as the case may be. The following procedure is to be observed: (1) Application of availability of name is to be made; (2) Memorandum and Articles of Association to be filed with the Registrar of Companies; (3) Particulars of situation of the Registered Office of the Company and particulars of the first Direction of the company to be filed; (4) Declaration by an Advocate of the Supreme Court or High Court or by a person named in the Articles as Director, Manager or Secretary of the Company that all requirements have been complied with.

In case of a public company, list of person who have consented to act as Directors, written consent of the Directors and undertaking of he Directors to take up and pay for the qualification shares to be filed. Upon compliance of he above formalities, a certificate of incorporation is issued.

Once the certificate of incorporation is issued, the company obtains a separate legal existence and acquires perpetual succession. Property belongs to the Company and not to any other shareholder.

Advantages of Incorporation:(1) Liability of the members is limited; (2) Shares are easily transferable; (3) Company obtains a separate legal entity; (4) Company can sue its members; (5) Management of the Company can be vested in professionals; (6) The company can enjoy and dispose of property in the own name.

11.8 QUESTIONS FOR DISCUSSION

1. How is a company formed under the companies Act 1956?
2. What is meant by certificate of incorporation?
3. What are the documents that should be filed with the registrar for obtaining certificate of incorporation?
4. What are the advantages of incorporation?
5. What are the legal effects of the registration of a company?

11.9 MODEL ANSWER TO CHECK YOUR PROGRESS

Check -1 what are the conditions to be fulfilled by a public company to obtain the certificate to commence business?

A statement in lieu of prospectuses must have been filed with the Register of Companies. The directors must have paid in cash the application money and the allotment money on the qualification shares taken by them. A statutory declaration signed by one of the directors or secretary of company stating that all the above requirements have complied with must have been filed with the Registrar of Companies.

Check-2 Write short notes on "Memorandum of association" "Articles of association"

The 'memorandum of association' It is the document which describes the scope of company activities. It must be signed by the seven people in case of public, and two people in case of private company for the formation of company. . The 'articles of association'. It is the document which contains the rules and regulations of the company. It must also be signed by the persons who sign the memorandum of association.

11.10 REFERENCES

1. " Company law" -- A.K. Bagrial
2. "Principles of modern company law" – L.C.B. Gower
3. "Business Law" -- M.R. Sreenivasan

LESSON-12

MEMORANDUM OF ASSOCIATION

CONTENTS

12.0 Aims and Objectives

12.1 Introduction

12.1.1 Meaning

12.1.2 Definition of Memorandum of Association

12.2 Purpose of Memorandum

12.3 Form of Memorandum

12.4 Contents of Memorandum of Association

12.4.1. Name clause

12.4.2. Registered Office of the Company

12.4.3. Objects Clause

12.4.4. Capital Clause

12.4.5. Liability Clause

12.4.6. Subscription or Association Clause

12.5 Alteration of memorandum of association

12.5.1 Alteration of Name Clause

12.5.2 Alteration of Registered Office Clause

12.5.3 Alteration of Objects Clause

12.5.4 Alteration of Liability Clause

12.5.5 Alteration of Capital Clause

12.6 Let us sum up

12.7 Questions for discussion

12.8 Model answer to check your progress

12.9 References

12.0 AIMS AND OBJECTIVES

In the 11th lesson, we discussed the meaning, definition of formation of a Company and Stages in formation of a Company, Certificate of Incorporation, and Commencement of Business. In this lesson we discuss the meaning, definition of Memorandum of Association and Purpose, form, contents, Alteration of Memorandum of Association. After going through this lesson, you will able to

1. know the meaning and definition of Memorandum of Association
2. understand various form of Memorandum of Association
3. identify purpose of Memorandum of Association
4. understand the contents Memorandum
5 learn how to alter the contents of Memorandum of Association

12.1 INTRODUCTION

The company to be registered under the Companies Act is required to have two documents stamped, registered and filed with Registrar of Companies—they being Memorandum of Association and Articles of Association. The memorandum of association is a document of great importance in relation to the proposed company. It contains the fundamental conditions upon which alone the company is allowed to be incorporated. In this section, we attempt to make a brief study of meaning and definition of Memorandum of Association

12.1.1 Meaning

Memorandum of Association is the document which contains the rules regarding constitution and activities or objects of the company. It is a fundamental charter of the company. Company is governed by the Memorandum of Association. Its relations towards the members and outsiders are determined by this important document. The company is allowed to function within the frame work of Memorandum of Association. If it crosses the frame work, its act would be construed as ultra vires and therefore void. The Memorandum of Association defines the extent and powers of the company. A company cannot exceed the powers conferred on it under its Memorandum of Association. Whether a transaction entered into by a company can be said to be with in its powers or not has to be decided on the basis of the facts established and the provisions in its memorandum and not on the basis of any abstract rule. If the acts of the company are beyond the limits of the Memorandum of Association, such acts would be void and ultra vires. They cannot be ratified in order to be binding on the company.

The Memorandum of Association is designed to make the outside world known the state of affairs of the company. The prospective investors, shareholders or creditors, should know the extent of their risk and also possibilities of the company to over come them. It is a public document and can be inspected by anybody.

12.1.2 Definition of Memorandum of Association

Section 2 (28) of the Companies Act defines “Memorandum means the memorandum of Association of a company, as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act”.

12.2 PURPOSE OF MEMORANDUM

In this section, we explain the purpose of the Memorandum is two-fold

1. The prospective shareholders shall know the field in, or the purpose for, which their money is going to be used by the company and what risk they are undertaking in making investment.
2. The outsiders dealing with the company shall know with certainty as to what the objects of the company are and as to whether the contractual relation into which they contemplate to enter with the company is within the objects of the company

12.3 FORM OF MEMORANDUM

In this section, we attempt to make a brief study of the different form of Memorandum. The memorandum of association of a company shall be in any one of the Form in Tables B, C, D and E in Schedule I as may be applicable to the company, or in a Form as near thereto as circumstances admit (Sec. 14).

Table B : Contains memorandum of association of a company limited by shares.

Table C : Contains memorandum of association of a company limited by guarantee and not have a share capital.

Table D : Contains memorandum of association of a company limited by guarantee and having a share capital.

Table E : Contains memorandum of association of an unlimited company.

The memorandum shall be printed, be divided into paragraphs numbers consecutively and be signed by each subscriber (who shall add his address, description, and occupation if any) in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any (Sec. 15)

12.4 CONTENTS OF MEMORANDUM OF ASSOCIATION

In this section, we attempt to make a brief study of the contents of memorandum. According to Section 13 of the Act the memorandum of every company shall state

(i) Name of the company with 'Limited' as the last word of the name in case of a public company and 'Private Limited' in case if private company.

(ii) Registered office of the company.

(iii) Objects of the company.

(iv) Liability of the members.

(v) Details of share capital of the company.

(vi) Subscription of Association clause.

12.4.1. Name clause

Rules: Promoters of the company have to make an application to the Registrar of Companies for the availability of name. The company can adopt any name if :-

(i) there is no other company registered under the same or under an identical name; (ii) the name should not be considered undesirable and prohibited by the Central Government (Sec. 20). A name with misrepresents the public is prohibited by the Government under the Emblems & Name (Prevention of Improper use) Act, 1950 for example, Indian National Flag, name and pictorial representation of mahatma Gandhi and the Prime Minister of India, name an emblems of the U.N.O., and W.H.O., the official seal and Emblems of the Central Government and State Governments.

Where the name of the company closely resembles the name of the company already registered, the Court may direct the change of the name of the Company.

(iii) once the name has been approved and the company has been registered, then :

(a) the name of the company with registered office shall be affixed on outside of the business premises;

(b) if the liability of the members is limited the words "Limited" or "Private Limited" as the case may be, shall be added to the name; [Sec. 13(1)(a)].

(c) the name and address of the registered office shall be mentioned in all letter-heads, business letters, notices and Common Seal of the company, etc. (Sec. 147).

The Central Government may be license under section 25 of the Act allow a company to drop the word 'Limited' from its name.

12.4.2. Registered Office of the Company

The company shall, from the day on which it commences business or within 30 days atter the date of its incorporation, have a registered office to which all

communications and notices may be addressed. The Memorandum must specify the state in which the registered office of the company is to be situated.

Company shall give notice with in 30 days to the Registrar of the situation of the registered office (Sec. 146)

Usually, the company while submitting its papers for incorporation also files a notice of registered office of the company with Registrar of Companies. All documents and notices and notices to be served on the company, must be served at its registered office (Sec. 51). In Daimler Co. Ltd. V. Continental Tyre & Rubber Co. (1916-2A. C. 307) its has been held that the situation of the registered office of a company determines its domicile.

12.4.3. Objects Clause

The third and important clause which defines the limits and extent of the activities of the company is its objects clause.

The Memorandum must state :-

(i) the main objects of the company to be pursued by the company on its incorporation;

(ii) the objects incidental or ancillary to the attainment of the main objects; and

(iii) other objects of the company [Sec. 13 (1) (d)].

In case of companies (other then trading corporations), with objects not confined to one State, the memorandum shall state the States to whose territories the objects extend.

The activities which the company proposes to pursue immediately on incorporation are always embodied under the main objects followed by objects incidental or ancillary to the attainment of the main objects. The other objects clause includes other activities which the company may plan to pursue at any later date. The objects should not be illegal and against the provisions of the Companies Act.

The statement of objects informs the investors the purpose for which their capital is proposed to be used by the company. It ensures the shareholders that the funds raised for one undertaking are not going to be risked in another (Waman Lal v. Scindia Steam Navigation Co-AIR-1944-Bom. 131). The statement of objects serves the public interest and also prevents concentration of economic power as the corporate activities are confined within a defined field.

The objects clause enables the subscribers to the shares and creditors of the company :-

(i) to be fully aware of the objects to which their money can be employed; and

(ii) to protect the creditors by ensuring that the company's funds to which they must look for payment are not dissipated in unauthorized activities (Ashbury Railway carriage Co. v. Riche 1875 LR 7LH 653).

In Eastern Countries Railway Co.v. Howke – (1855-5 H. L. C. 331) it has been declared that "it must be now considered as a well settled doctrine that a company incorporated by Act of Parliament for a special purpose cannot devote any part of its funds to objects unauthorized by the terms of its incorporation however desirable such an application may appear to be."

12.4.4. Capital Clause

In case of a company having a share capital unless the company is an unlimited company, memorandum shall also state the amount of share capital with which the company is to be registered and division thereof into shares of a fixed amount [Sec. 13 (4)].

The capital with which the company is registered is called the Authorised or Nominal Share Capital. The amount of nominal or authorized capital of the company would be normally, that which shall be required for the attainment of the main objects of the company. In case of companies limited by guarantee, the amount promised by each member to be contributed by them in case of the winding up of the company is to be mentioned. No subscriber to the memorandum shall take less then one share. Each subscriber of the memorandum shall write against his name the number of shares he takes.

12.4.5. Liability Clause

The liability of the members is limited to the extent of the shares subscribed by the members if the company is formed with share capital or to the extent of the guaraness given by the members if the company is formed with guaranetee.

The memorandum of a company limited by shares or by guarantee shall state that the liability of its members is limited [Sec. 13 (2)]. This means that no member can be called upon to pay anything more than the nominal value of the shares held by him or so much thereof as remains unpaid. If shares are fully paid-up then his liability is nil. The memorandum of a company limited by guarantee shall also state that each member undertakes to contribute to the assets of the company in the event of it being wound up while he is a member or within one year after he ceases to be a member, for (i) payment of the debts and liabilities of the company; or (ii) of such debts and liabilities of the company as may have been contracted before he ceases to be a member; and (iii) of the costs, charges and expenses of winding up, and (iv) for adjustment of the rights of the contributories among themselves; such amount as may be required not exceeding a specified amount [Sec. 13 (3)].

12.4.6. Subscription or Association Clause

Each subscriber to the memorandum of the company shall take atleast one share. It case of a public company at least 7 persons shall subscribe to the memorandum of the company. The signatures of the subscribers shall be attested by atleast one witness.

"We the several persons whose names and addresses 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."

After incorporation, no subscriber can withdraw his name on any ground whatsoever.

After the above clause, the name, age, address, description and occupation of each subscriber is mentioned.

Check your progress - 1

What do you understand by Domicile clause?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

12.5 ALTERATION OF MEMORANDUM OF ASSOCIATION

The memorandum of association is a very important document of a company. It cannot be altered by the sweet will of the members of the company. It can be altered only by following the procedure as prescribed in the Companies Act. It may be noted that the right of the company to alter its memorandum is strictly limited to the provisions of the Companies Act. The procedure of alteration of various clauses of the memorandum may be discussed under the following heads:

1. Alteration of name clause.
2. Alteration of registered office clause.
3. Alteration of objects clause.
4. Alteration of liability clause.
5. Alteration of capital clause.

There clauses are also known as conditions of memorandum and can by altered in accordance with the legal provisions as discussed in the following pages.

12.5.1 Alteration of Name Clause

A company may later (i.e. change) its name at nay time. The only requirement is that the change must be made by following the prescribed procedure. The procedure for the change of name of the company is contained in Sections 21 to 23 of the Companies Act any may be summed up as under :

(a) By passing a special resolution; and

(b) By obtaining the approval of Central Government in writing.

However, the approval of Central Government is not required when the change involves the addition or deletion of the word 'Private' on the conversion of a public company into a private company or vice versa.

2. Sometimes, a company has been registered with a name which is identical with the name of an existing company or which, in the opinion of Central Government, is undesirable. In such cases, the company may change its name by adopting following procedure [Section 22 (1) (a)]

(a) By passing an ordinary resolution, and

(b) By obtaining the previous approval of the Central Government in writing.

3. The change of name must be communicated to the Registrar of Companies within thirty days of the change [Section 192]. On such communication, it becomes the duty of the Registrar to enter the new name in the Register of Companies, and to issue a fresh certificate of incorporation with necessary alterations. The change of name becomes effective on the issue of fresh certificate of incorporation. The Registrar shall also make necessary alterations in the Memorandum of Association. It will be interesting to know that the change of name does not affect the rights and obligations of the company. It also does not affect the pending legal proceedings by or against the company. Such legal proceedings may be continued by its new name [Section 23]

After the change of name has been effected and registered in the register of companies, the legal proceedings, if any, should be commenced by the company in its new name. The legal proceedings commenced by the company in its old name may not be held competent by the court.

However, where, after the change of name, any legal proceeding is commenced against the company in its old name, it is a case of mere misdescription of name. Such a defect can be cured by substituting the new name with the permission of the court.

12.5.2 Alteration of Registered Office Clause

The procedure for the alteration (i.e. change) of registered office of the company is contained in Section 17, 18 and 146 of the Companies Act, and may be summed up as under

1. Change of registered office from one place to another within the same city. Such a change in the registered office of the company may be made without any

formality. The only requirement is that the notice of such change must be given to the Registrar of Companies within 30 days of the change.

2. Change of registered office from one city to another within the same State. Such a change in the registered office of the company may be made by passing a special resolution to that effect. When the registered office is shifted to the new location, then the notice of the same must be given to the Registrar of Companies with in 30 days of the shifting of the office.

3. Change of registered office from one city to another. Such a change in the registered office of the company may be made by adopting the following procedure:

(a) By passing a special resolution, and

(b) By obtaining the confirmation of the Company Law board.

Thus, the change of registered office from one State to another involves a difficult and complicated procedure. It may be noted that before confirming the alteration (i.e. change), the Company Law Board will consider the objections of the persons whose interest will be affected by such change in the registered office. Thus, the Board should give an opportunity of being heard to the members, creditors and other persons interested in the company such as the State or the Registrar. The Board will confirm the change only if the shifting of the registered office from one State to another is necessary for any one of the following purposes as mentioned in Section 17 (1) of the Companies Act

(a) to carry on its business more economically or more efficiently.

(b) to attain its main purpose by new or improved means.

(c) to enlarge or change the local are a of its operation.

(d) to carry on some business which under existing circumstances, may conveniently or advantageously be combined with the business of the company.

(e) to restrict or abandon any of the objects specified in the memorandum.

(f) to sell or dispose of the whole or any part of the undertaking of the company.

(g) to amalgamate with any other company or body of persons.

When the company Law Board is satisfied with regard to the above points it may confirm the change in registered office from the State to another. After the Company Law Board has confirmed the alteration (i.e. change), a certified copy of the order of the company Law Board must be filed with the Registrar of companies of both the States within three months from the date of the order (Section 18). Thereafter, the Registrar of each state shall register the alteration. The Registrar of the State where the office was originally situated shall send to the Registrar of the other State all records and documents relating to company. When the registered office of the company is shifted to its new location, the

notice of the same must be given to the Registrar of Companies within 30 days of the shifting of the office.

Sometimes, the shifting of registered office from one State to another is opposed by the State concerned on various grounds such as (a) loss of revenue, and (b) adverse effect on employment opportunities etc. In such cases, whether or not the Company Law board should confirm the shifting of office is to be seen in the light of the judicial decisions.

In two cases before the Orissa High Court, the shifting of registered office of certain companies to a place outside Orissa was opposed by the State on the ground of loss of revenue, and employment opportunities. In both these cases, the courts declined confirmation of shifting of registered office from Orissa to another State. While deelining the confirmation in these cases, the court observed in one case that every State has got the right to protect its revenue and, therefore, the interest of the State must be taken into account in confirming the shifting of company's registered office from one State to another.

However, the reasoning given by the Orissa High Court is not adopted by the other High Courts as is evident from the following example.

The above opinion of the Calcutta High Court was followed by this court in subsequent cases, and also by the Bombay High Court. Keeping in view the judicial trend, it is submitted that the view expressed by the Calcutta, and Bombay High Courts is correct. And State's objection to the shifting of registered office out of State on the ground of loss of revenue or adverse effect on employment opportunities, is not a relevant consideration.

12.5.3 Alteration of Objects Clause

We know that the objects clause of memorandum is the most important clause. The alteration (i.e. change) in this clause involves a difficult and complicated procedure. The reason for the same is that it requires the alteration of the memorandum itself. Moreover, certain limited are also imposed on company's powers of alteration. These limits will be discussed in the next article. The procedure for the change of objects of the company is contained is Sections 17 and 18 of the companies Act. The company may change its objects by adopting the following procedure:

1. By passing a special resolution, and
2. By obtaining the confirmation of the Company Law Board

Thus, for effecting a change in the objects clause, first the company should pass a special resolution authorizing such a change (alteration). After passing the special resolution, a petition should be filed before the Company Law Board for confirmation of the alteration. It may be noted that obtaining confirmation of Company Law Board is not an easy task Before confirming the alteration, the Company Law Board must be satisfied on the following points :

(a) That a sufficient notice has been given to every debenture-holder, and to every other person whose interest is likely to be affected by the proposed alteration.

(b) That either the consent of those creditors has been obtained who have raised an objection to the alteration, or their claims have been satisfied.

The Company Law Board must serve a notice, of the petition for confirmation of the alteration, on the Registrar of Companies. And the Registrar must also be given an opportunity to appear before the Company Law Board and state his objections and suggestions with respect to the confirmation of alteration. On being satisfied, the Company Law Board may pass an order confirming the alteration. The Board has discretionary powers in this regard. It may confirm the alteration either fully or in part, or subject to such conditions as it thinks fit. However, the Board must exercise its discretionary powers fairly and judicially. Moreover, while exercising this power, the Board must have regard to the right and interest of every class of members and creditors of the company. It may also be noted that the Board can confirm the alteration if it is for the purposes stated in Section 17 (1) of the Companies Act as discussed in the next article.

The alteration of the objects clause of memorandum of association must be registered with the Registrar of Companies. As regards the registration of alteration and its effect, the following legal provisions may be noted:

1. After the confirmation order is made by the Company Law Board, a certified copy of the Board's order and a printed copy of the altered memorandum shall be filed with the Registrar of Companies within three months of the data of order [Section 18 (1)]
2. Thereafter, the registrar of Companies shall register the alteration, and issue a certificate of registration of alteration within one month of the filing of documents [Section 18 (1)]
3. The certificate of registration of alteration shall b3e the conclusive evidence to alteration. In other words, this certificate implies that all the legal requirements with respect to alteration have been complied with. The alteration is effective from the date of registration of the alteration [Section 18 (2)]
4. In case the copy of Company Law Board's order and the copy of altered memorandum is not filed with the Registrar within a period of three months, as stated in point (1) above, then the alteration and entire proceedings connected with it shall become void and inoperative. However, the Company Law Board may revive the order of alteration if an application for revival is made to it within a further period of one month after the laps of alteration (i.e. after the expiry of said period of three months) [Section 19 (2)]
5. The Company Law Board may extend the period of three months for filing the documents, as stated in point (1) above, also the period of one month for registration of alteration as stated in point (2) above, by such period as it thinks proper [section 18 (4)]

12.5.3.(i) Limits on Alteration of Objects Clause

We have discussed, in the last section, the procedure for the alteration of the objects clause of memorandum. It may be noted that there are certain limits on company's power of alteration of the objects clause. The company can alter its objects clause only if it is necessary for any one of the purposes specified in Section 17 (1) of the companies may alter its objects, may be discussed under the following heads

1. To carry on company's business more economically or more efficiently. The company may bring such a change in the objects clause of its memorandum which enables it to carry on its business more economically or efficiently. It may be noted that under this provision, the business the company is not changed. Only the mode of conducting the business is made more economical and efficient.

2. To attain the main purpose by new or improved means. The company may bring such a change in the objects clause of its memorandum which enables it to extend its trade to new areas. Here also the company's business remains the same.

3. To enlarge or change the local area of company's operation. The company may bring such a change in the objects clause of its and technical memorandum which enables it to extend its trade to new areas. Here also the company's business remains the same.

Thus, by altering its memorandum, a company can extend its existing business to new areas of operation.

4. To carry on some business this may be combined with the business of the company. The company may bring such a change in the objects clause of its memorandum which enables it to carry on some business which, under the existing circumstances, may conveniently or advantageously be combined with the business of the company. The requirement for the same is that the new business must be such which can be conveniently or advantageously combined with the existing business, and the existing circumstances must also permit the starting of such business. In other words, the new business must not be inconsistent with the existing business. Thus, if the company is financially sound, the company may start a new business which is not inconsistent with the existing business.

5. To restrict or abandon any of the objects. The company may bring such a change in the objects clause of its memorandum which is necessary to restrict or abandon any of the objects specified in the memorandum.

6. To sell the undertaking. Sometimes, a company may like to sell or dispose of the undertaking. In such cases, the company may change the objects clause of its memorandum which enables it to sell or dispose of the whole or any part of the undertaking of the company. The expression 'undertaking' here means a business unit or enterprise in which a company may be engaged as a gainful occupation e.g. each one of several factories or manufacturing plants of a company will be considered as an undertaking from the business point of view. Thus, the term 'undertaking' signifies a going concern engaged in the production, distribution etc. of goods or services. Sometimes, it also means the entire business or organization of a company [Rustom Cavasjee Cooper V. Union of India (1970) 44 Company Cases 325 (SC)].

7. To amalgamate with any other company. The company may like to amalgamate with any other existing company or body corporate. In such cases, the company may bring such a change in the objects clause of its memorandum which enable the amalgamation.

Thus, a company is not empowered to change the objects clause of its memorandum in whatever manner it likes. It can bring a change in the objects clause only if the same is necessary for any of the above stated purposes

12.5.4 Alteration of Liability Clause

We know that an important characteristic and advantage of a company is the limited liability of members (shareholders). As a matter of fact, it is the main attraction for persons to invest their money in the company. Generally, the company cannot alter the liability clause of its memorandum so as to increase the liability of the members. The liability of members can be increased only if the concerned member agrees in writing. Thus, an alteration which imposes additional liability on a member or which compels the member to buy additional shares of the company can be made only if the concerned member gives his consent in writing (Section 38).

It will be interesting to know that the liability clause may also be altered so as to make the liability of the directors or manager unlimited. However, this can be done if the company is so authorized by its 'articles of association'. In such a case, the company may alter the liability clause by passing a special resolution. But such alteration applies to the directors or manager who shall be appointed after the alteration. The existing directors or manager are bound by the alteration only if they give their consent to it. Thus, the liability of members, directors or manager cannot be increased without the consent of the concerned persons.

12.5.5 Alteration of Capital Clause

The company may alter the capital clause of its memorandum by adopting the procedure prescribed in the Companies Act. It may, however, be noted that the company can alter (change) its capital only of it is so authorized by its 'articles of association'. Certain alterations in the capital clause may be made by passing

an ordinary resolution and certain by a special resolution. Following types of alterations can be made simple by passing an ordinary resolution:

1. Increase of share capital by issue of new shares.
2. Consolidation or sub-division of existing shares into shares of larger or smaller amount.
3. Conversion of fully paid shares into stock and conversion of stock into fully paid shares.
4. Cancellation of unissued shares.

However, if the alteration is by way of 'reduction of share capital', it can be made only by passing a special resolution and obtaining the confirmation form the court.

Check your progress - 2

What do you understand by subscription clause?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

12.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points:

Memorandum of Association: The company is required to file two documents with the Registrar of Companies, i.e., the Memorandum of Association and the Articles of Association. Memorandum of Association contains the rules regarding the constitution and activities or objects of the company. It is a fundamental charter of the company. The company is governed by the Memorandum of Association. It is to work within the framework of the Memorandum of Association as otherwise its acts would be ultra -uires and void.

Contents of Memorandum of Association:

(1) Name of the Company. (2) Registered Office of the Company. (3) Objects of the Company divided into (a) main objects; (b) objects incidental to the main

objects; and (c) other objects. (4) Liability of the members. (5) Share capital of the company. (6) Subscription of Association clause

Alteration of Memorandum of Association:

(1) Change of Names: The Company shall effect the change in its name by passing a special resolution at the General Meeting and after obtaining Central Government approval thereto. The change of name shall not affect any rights or obligations of the Company. The alteration effected is only in the name and not in the identity of the company.

(2) Change in the registered office of the company: In case of change of registered office from one place to another in the same city, the change shall be effected by an ordinary Board resolution. In case of change in the registered office of the company from one city to another city in the same State, the change shall be effected by a special resolution. Incased of change in the registered office of the company from one State to another State in India, a special resolution is required besides confirmation of the change shall be obtained from the Company Law Board.

(3) Alteration of Objects Clause: Alteration in the Objects Clause shall be approved by a special resolution of the embers in general meeting and there after it shall be confirmed by the Company Law Board on petition. The alteration maybe approved wholly or in part or on such terms and conditions as may be through fit.

(4) Alteration in capital clause: The alternation of share capital may involve: (1) increase of share capital; (2) reduction of share capital; and (3) conversion of shares into stock.

Increase of share capital: The share capital of the company may be increased by further issue of capital or by consolidating and dividing all or any of its share capital into shares of larger amount. The change in the capital clause can be effected only if authorized by the Articles of the Company. It ma be done so by an ordinary resolution or by a special resolution as provided by the Articles.

Reduction of share capital: The reduction of share capital can be effected by a special resolution and by an application made by a petition to the Court of confirmation. The Court shall settle the list of creditors who may object to the reduction of share capital. On the Court, being satisfied, it may confirm the reduction of he capital on such terms and conditions as it thinks fit. The order of the Court shall be registered with the Registrar of Companies. On such registration, the Registrar shall issue a certificate which shall be conclusive evidence for reduction in he share capital of the company.

Conversion of Shares into Stock: Fully paid up shares can be only converted into stock. A sum total of fully paid up shares is stock. Fully paid up shares can be converted into stock and stock can be reconverted into fully paid up shares. Such conversion must be authorized by the Articles.

(5) Change in liability clause: The liability of the members cannot be altered so as to increase their liability. The alternation can be effected only with the consent of the members in writing.

Any other provision in the Memorandum can be altered by a special resolution.

12.7 QUESTIONS FOR DISCUSSION

1. Explain the contents of the Memorandum of Association of a Company?
2. Explain the significance of the object clause of Memorandum of Association.
3. Explain the provisions of the Companies Act relating to the alteration of Memorandum of Association.
4. Explain the significance of the object clause of Memorandum of Associations and state the procedure for alteration thereof.

12.8 MODEL ANSWER TO CHECK YOUR PROGRESS

Chcek-1 what do you understand by Domicile clause?

Domicile clause: Every company shall have a registered office from where it has to carry on its business. The name and address of the registered office shall be the address of the company

Check- 2 what do you understand by subscription clause?

We the several persons whose names and addresses 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

12.9 REFERENCES

1. “ Company law” -- A.K. Bagrial
2. “Principles of modern company law” – L.C.B. Gower
3. “Business Law” -- M.R. Sreenivasan

LESSON-13
DOCTRINE OF ULTRAVIRES

CONTENTS

13.0 Aims and Objectives
13.1 Introduction
13.1.1 Categories of ultra-vires
13.2 Summarized of legal position of the ultra- vires
13.3 Effects of Ultra- vires Acts
13.4 Exceptions to the Doctrine of Ultra-vires
13.5 Doctrine of Ultra-vires an Illusory Protection
13.6 Let us sum up
13.7 Questions for discussion
13.8 Model answer to check your progress
13.9 References

13.0 AIMS AND OBJECTIVES

In the 12th lesson, we discussed the meaning, definition of Memorandum of Association and Purpose, form, contents, Alteration of Memorandum of Association. In this lesson we discuss the meaning, category, the legal position, Effects of Ultra- vires Acts and Exceptions to the Doctrine of Ultra-vires. After going through this lesson, you will able to

1. know the meaning of Doctrine of Ultra-vires
2. understand various category of Doctrine of Ultra-vires
3. known the legal position of Doctrine of Ultra-vires
4. understand the Effects of Doctrine of Ultra-vires
5 understand the Exception of Doctrine of Ultra-vires

13.1 INTRODUCTION

The term 'ultra' means beyond, and the term 'vires' means powers. Thus term 'ultra-vires' means doing an act beyond the powers. In this section, we explain the ultra-vires acts may be categorized as under

13.1.1 Categories of ultra-vires

1. An act ultra-vires the directors. It is an act which is beyond the powers of the directs.
2. An act ultra-vires the articles of association. It is an act which is beyond the powers given by the articles of association.
3. An act ultra-vires the memorandum of association. It is an act which is beyond the powers given by the memorandum of association. As a matter of fact, such act is beyond the legal powers of the company, and is also known as 'ultra-vires the company'.

It the company does any act which is ultra-vires the directors; the act is not altogether void and inoperative. It can be ratified by the general body of shareholders. Whe the act is so ratified, the company becomes bound by the same. Similarly, an act which is ultra-vires the articles of association, is also not altogether viod and inoperative. It can also be ratified by the company by making necessary alterations in the articles of association by passing a special resolution. Thereafter, the company becomes bound by such act. It may, however, be noted that such an act can only be ratified if it is intravires the company i.e. within the powers of the company.

The acts which are 'ultra vires the company' are wholly void and inoperative as they are beyond the legal powers of the company. The company is not bound by such acts. It may be noted that such acts cannot be ratified even by the whole body of shareholders. The doctrine of ultra-vires is generally meant for this category of ultra-vires is generally meant for this category of ultra-vires acts. We know that a company is formed only for the objects stated in its memorandum of association. The company, therefore, has the powers to do the following acts :

(a) Which are essential for the attainment of the objects stated in 'memorandum of association'.

(b) Which are reasonably and fairly incidential to the attainment of its objects.

(c) Which are otherwise authorized by the Companies Act.

If the company does any other act which is not covered by the above powers, that will be ultra vires the memorandum (or company), and shall be wholly void and inoperative. The company is not bound by the acts which are ultra vires the 'memorandum of association' i.e. beyond the legal powers of the company. However, if the acts are within the powers of the company, any irregularity in doing the acts may be cured with the consent of all the shareholders. The purpose of this doctrine is to protect the interest of the investors and creditors. The interest of investors is protected in a way that they know the purpose for which their money is going to be used, and due to this doctrine the company cannot depart from its objects. Similarly, the interest of creditors is also protected as they fell assured that company's assets will not be risked in unauthorised business activities. The application of the doctrine of ultra vires is clear from the following examples based on decided cases.

The doctrine of ultra vires has also been affirmed by the Supreme Court of India in a case before it which is disuussed in the following example.

Whether a particular act on the part of the company is within its powers is a question of fact, and is to be decided on the construction of the terms of its 'memorandum'. However, the doctrine of ultra vires should not be understood and applied unreasonably. The acts which are reasonably fair and incidental to the objects of the company, should not be regarded as ultra-vires unless they are expressly prohibited. The Compani9es Act itself requires that the incidental objects should be stated in the objects clause. Even if they are not stated, they should be allowed by the principle of reasonable construction.

It may, however, be noted that a company cannot carry on the activities which are neither essential nor incidental to the fulfillment of its objects.

Sometimes, company's main object comes to an end, or the company abandons its main object. In such cases, the company cannot continue to pursue its subsidiary objects.

13.2 SUMMARIZED OF LEGAL POSITION OF THE ULTRA- VIRES

In this section, we summarized the legal position of the ultra- vires acts:

1. An act which is ultra vires the director i.e. beyond the powers of the directors is not altogether void and inoperative. It can be ratified by the general body of shareholders if it is within the powers of the company.
2. An act which is ultra views the articles of association i.e. beyond the powers given by the articles, is also not altogether void and inoperative. It can be ratified by the company by making necessary alteration in its articles by passing a special resolution.
3. An act which is ultra views the memorandum i.e. beyond the powers given by the memorandum is in fact ultra- vires the company itself.

13.3 EFFECTS OF ULTRA- VIRES ACTS

The effects of ultra- vires acts may be discussed under the following heads :

1. Injunction against the company. In case any ultra- vires act has been done or is about to be done, any member of the company can obtain an injunction from the court i.e. he may obtain a court order restraining the company from proceeding with the ultra- vires acts.
2. Personal liability of directors to the company. The direetors of the company are personally liable to the company for the ultra- vires acts. It is the duty of the directors to see that company's capital is used for the legitimate objects of the company. If company's money is used for any purpose which is in no way connected with the company's objects, the directors will be personally liable for the same i.e. they can be compelled to restore such fund to the company.

Sometimes, the persons receiving the money know that the payment to them is ultra- vires. In such cases, the directors can recover the money from such persons.

3. Personal liability of directors to third party. The directors of the company are also personally liable to the third party as they exceed their authority by doing ultra- vires acts. It is the duty of an agent to act within the scope of his authority. If he exceeds his authority he will be personally liable to the third party. The directors are the agents of the company, therefore they should not go beyond their authority. If they induce any outsider (third party), to contract with the company in a matter in which the company has no power to act, they will be personally liable for any loss suffered by the outsiders.

4. Ultra- vires contracts are void. A contract which is ultra-v the company i.e. beyond company's powers, is void and without any legal effect. This is so because the company is not at all competent to enter into such contracts. It may be noted that the ultra-vires contracts cannot become ultra-vires by subsequent ratification.

Though the ultra vires acts are void, but the company is entitled to bring a legal action for the protection of its property even if acquired by unauthorised acts or expenditure.

13.4 EXCEPTIONS TO THE DOCTRINE OF ULTRA-VIRES

We have discussed, the doctrine of ultra-vires according to which the ultra-vires acts i.e. the acts which are beyond the powers of the company, are void and inoperative. However, in the following exceptional circumstances, the ultra-vires acts are not absolutely inoperative.

1. If the company acquires some property by ultra-vires expenditure, the company's right over the property will be protected. The reason for the same is that such property though acquired by making unauthorized expenditure, represents the company's property.

2. If the company acquires some property under an ultra-vires contract, the same can be recovered from the company it if exists and is traceable in the hands of the company.

3. If the company takes an ultra-vires loan and uses it to pay of its own debts, then the money-lender gets the rights of that creditor whose loan has been paid by the company, and can recover him money from the company.

4. If any person borrows money from the company under an ultra-vires contract, the company has the right to sue and recover the money from him.

5. If a director of a company makes payment of certain money, which is ultra-vires the company, he can be compelled by the company to refund it. However, the director may claim indemnity (i.e. compensation) from the person who received the money knowing that it is ultra-vires.

6. The company may be held liable for the ultra-vires torts (i.e. civil wrongs) of its employees. However, the company will be liable only if the following points are proved, that

(a) The tort was committed in the course of an activity which falls within the scope of company memorandum, and

(b) The employee committed the tort within the course of his employment.

Check your progress -1

What do you mean by Ultra vires contract?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

13.5 DOCTRINE OF ULTRA-VIRES AN ILLUSORY PROTECTION

We know that the purpose of the doctrine of ultra-vires is to protect the interest of the shareholders and creditors of the company. But it has been criticized by the Bhabha Committee on Company Law Reforms which has observed that "doctrine is an illusory protection to the shareholders, and a pitfall for third parties dealing with the company". The reason for such criticism of this doctrine is that it has not been proved effective in protecting the interest of the shareholders and creditors. This criticism of the doctrine is due to the following reasons :

1. The 'memorandums of association' are so widely drafted that all probable acts are covered in the objects clause. It is then possible for the company to extend its operations at any time and therefore, the doctrine becomes ineffective However, this has been protected by the Companies (Amendment) Act 1965 to some extent. After this amendment, the companies are required to state their objects in two sub-clauses namely (a) main objects clause, and (b) other objects clause.

2. The company may do any act which is 'incidental to and consequential upon the main objects'. This also provides a scope of ambiguity.

3. The company may also start new business under certain circumstances. This power may be misused by the company. Section 17 (1) (d) of the Companies Act provides that the company may alter its objects clause so far as it is necessary "to carry on some business which, under the existing circumstances, may conveniently or advantageously be combined with the business of the company". This is also against the interest of the shareholders and the creditors because they never know at what time the company may start a new business. However, as the sanction of Company Law Board is compulsory for this purpose, and the members and creditors are also given the notice, the misuse of this clause may be checked.

4. The directors generally consider that all their activities are within the powers until they are challenged in the courts of Law. The shareholders may not go to courts all the time. And thus they may not be actually protected by the doctrine of ultra-vires.

Thus, certain complications are there in the application of the doctrine of ultra-vires. The English Company Law Revision Commission (known as the Cohen Committee, 1945) recommended the abolition of the doctrine of ultra-vires. It was further suggested that the memorandum should make a contract only between the shareholders and company. Every contract made on behalf of the company whether within or beyond its powers should be make valid. Thus, some efforts are necessary to protect the interest of share holders and the third parties dealing with the company.

13.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points.

Doctrine of ultra vires: Any act done by the company which is neither authorized by its objects nor by the Companies Act is called an ultra vires act. Such an act cannot bind the company.

The act may be ultra vires the Articles, but intra vires the Memorandum. An act ultra vires the Articles; but not the Memorandum can be ratified by the shareholders. An act ultra vires the Articles but within the powers of the Memorandum, can be ratified by altering the Articles. But an act ultra vires the Memorandum is ultra vires the Company and, therefore, void and as such cannot, be ratified. The aggrieved party has a relief against the Directors of the Company for ultra-vires acts.

13.7 QUESTIONS FOR DISCUSSION

1. Explain fully the doctrine of Ultra Vires in relation to companies.
2. What are the liabilities of a company and its agents for ultra-vires acts?
3. What is meant by Doctrine of Ultravires ?
4. Explain with an illustration. State the effect of Doctrine of Ultravires transaction on the company, and on its directors.

13.8 MODEL ANSWER TO CHECK YOUR PROGRESS

Check -1 what do you mean by Ultra vires contract?

Any contract entered into by a company with others or vice veres upon an ultra vires Act, is void ab initio and it has no legal effect.

13.9 REFERENCES

1. " Company law" -- A.K. Bagrial
2. "Principles of modern company law" – L.C.B. Gower
3. "Business Law" -- M.R. Sreenivasan

LESSON-14
ARTICLES OF ASSOCIATION

CONTENTS

14.0 Aims and Objectives

14.1 Introduction

14.1.1 Meaning

14.1.2 Definition

14.2 Contents of Articles

14.3 Model form of Articles

14.4 Regulations required

14.5 Adoption and application of Table A

14.6 Alteration of Articles

14.7 Procedure of Alteration

14.8 Distinction between Memorandum of Association and Articles of Association

14.9 Doctrine of Indoor management

14.10 Let us sum up

14.11 Questions for discussion

14.12 Model answer to check your progress

14.13 References

14.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning, category, the legal position, Effects of Ultra- vires Acts and Exceptions to the Doctrine of Ultra-vires. In this lesson we discuss the meaning, definition of Contents of Articles, Model form of Articles, Regulations required, Adoption and application of Table A, Alteration of Articles. After going through this lesson, you will able to

1. know the meaning and definition of Articles of Association
2. understand various item contents of Articles of Association
3. known various Model form of Articles 5 learn how to alter the contents of Articles of Association

14.1 INTRODUCTION

The Articles of Association or just Articles are the rules, regulations and bye-laws for the internal management of the affairs of company. They are framed with the object of carrying out the aims and objects as set out in the Memorandum of Association.In this section , we discuss the meaning and definition of Articles of Association

14.1.1 Meaning

The Articles of Association is next in importance to Memorandum. The Articles are next in importance to the Memorandum of Association which contains the fundamental conditions upon which alone a company is allowed to be incorporated. They are as such subordinate to, and controlled by, the Memorandum

14.1.2 Definition

'Articles' mean "the Articles of Association of a company as originally framed or as altered from time to time in pursuance of this Act. They include the regulations contained in Table A in Schedule I to the Act, in so far as they apply to the company" [Sec. 2 (2)].

Must not violate the Memorandum and the Act. In framing the Articles of a company care must be taken to see that regulations framed do not go beyond the powers of the company itself as contemplated by the Memorandum or the Association. They should also not violate any of the provisions of the Companies Act. If they do, they would be ultra vires the Memorandum or the Act and will be null and void. For example, according to Sec. 250, dividend can be paid by a company only out of profits. Any provision in the Articles contrary to this provision of the companies Act is void. The following cases illustrate the point:

Peveril Gold Mines Ltd., Re (1898) 1 Ch. 122. The Articles of company provided that no petition for a winding up could be presented unless [a] 2 directors consented in writing, and [b] the petitioner held 1/5th of the issued share capital. Neither of these conditions was fulfilled. Held, the restrictions were invalid and perdition could be presented.

14.2 CONTENTS OF ARTICLES

In this section, we discuss the Articles contain provision relating to the following matter:

[1] Share capital, rights of shareholders, variation of these rights, payment of commissions, share certificate.

[2] Lien on shares.

[3] Calls on shares.

[4] Transfer of shares.

[5] Transmission of shares.

(6] Forfeiture of shares.

[7] Conversion of shares into stock.

[8] Share warrants.

[9] Alteration of capital.

[10] General meetings and proceedings thereat.

[11] Voting rights of members, voting and poll, proxies.

[12] Directors, their appointment, remuneration, qualifications, powers and proceedings of Board of directors.

[13] Manager.

[14] Secretary.

[15] Dividends and reserves.

[16] Accounts, audit and borrowing powers.

[17] Capitalisation of profits.

[18] Winding up.

14.3 MODEL FORM OF ARTICLES

Schedule I to the Act gives various model forms of Memorandum of Assoication and Articles of Association of various types of companies. The Schedule is divided into Tables which serve as a model for various companies.

Table A deals with regulations for management of a company limited by shares.

Table B contains a model form of Memorandum of Association of a company limited by shares.

Table C gives model forms of Memorandum and Articles of Association of a company limited by guarantee and having a share capital.

Table D gives model forms of Memorandum and Articles of Association of a company limited by guarantee and having a share capital. The Articles of such a company contain in addition to the information about the number of members with which the company proposes to be registered, all other provisions of Table A.

Table E contains the model forms of Memorandum and articles of Association of an unlimited company.

Companies which must have their own articles [Sec. 26]

The following companies shall have their own Articles, namely,

[a] unlimited companies,

[b] companies limited by guarantee,

[c] private companies limited by shares.

The Articles shall be signed by the subscribers of the Memorandum and registered along with the Memorandum.

14.4 REGULATIONS REQUIRED

In this section, we attempt to make a brief study of the regulations required. A public company may have its own Articles of Association. If it does not have its won articles, it may adopt table A given in Schedule I to the Act. Regulations required in case of an unlimited company, a company limited guarantee and a private company [Sec. 27]

1. Unlimited company. In the case of an unlimited company, the Articles shall state : -

[a] the number of members with which the company is to be registered and

[b] if it has a share capital, the amount of share capital with which the company is to be registered.

2. Company limited by guarantee. In the case of company limited by guarantee, the Articles shall stat the number of members with which the company is to be registered.

3. Private company. In the case of a private company having a share capital, the articles shall contain provisions which --

[a] restrict the right to transfer shares.

[b] limited the number of its members to 50 [not including employee-members], and

[c] prohibit any invitation to the public to subscribe for any shares in, or debentures of, the company.

In the case of any other private company, the Articles shall contain provisions relating to matters specified in Clauses [b] and [c] given above.

14.5 ADOPTION AND APPLICATION OF TABLE A [SEC. 28]

There are 3 alternative forms in which a public company may adopt Articles:

1. It may adopt Table A in full
2. It may wholly exclude Table A and set out its won Articles in full.
3. It may frame its own Articles and adopt part of Table A.

In other words, unless the articles of a public company expressly exclude any or all provisions of Table A, Table A shall automatically apply to it.

For of Articles in the case of other companies [Sec. 29]

The articles of any company, not being a company limited by shares, shall be in such one of the forms in Tables C, D, and E in Schedule I to the Act, as may be applicable, or in a Form as near thereto as circumstances admit. Further, such a company may include any additional matters in its Articles in so far as they are not inconsistent with the provisions contained in the form in any of the Tables C, D, and E adopted by the company.

Form and signature of Articles [Sec. 30]. The Articles shall be—

[a] printed,

[b] divided into paragraphs, and

[c] signed by each subscriber of the Memorandum [who shall add his address, description and occupation, if any] in the presence of at least 1 witness who will attest the signature and likewise add his address, description and occupation, if any.

The articles of Association printed on computer laser printer should be accepted by the Registrar for registration of a company provided they are neatly and legible printed [Press Note, issued by the Department if Company Affairs, dated 22-6-1993].

14.6 ALTERATION OF ARTICLES

In this section, we attempt to make a brief study of the meaning of Alteration of Articles. Companies have been given very wide powers to alter their Articles. The right to alter the Articles is so important that a company cannot in any manner, either by express provision in the Articles or by an independent contract, deprive itself of the power to alter its Articles. Any clause in the Articles that restricts or prohibits alteration of Articles is invalid. If, for example, the Articles of a company contain any restriction that company shall not alter its Articles, it will be contrary to the companies Act and, therefore, inoperative.

Check your progress - 1

List out companies which must have their own Articles

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

14.7 PROCEDURE OF ALTERATION [SEC. 31]

A company may, by passing a special resolution, alter its Articles any time Again any Articles may be adopted which could have been lawfully included originally. A copy of every special resolution altering the Articles shall be filed with the Registrar with the Registrar within 30 days of its passing and attached to every copy of the Articles issued thereafter. Any alteration so make in the articles shall be as valid as if originally contained in the Articles. In this section, we attempt to make a brief study of the procedure of alteration of Articles .

14.7.1Madhav Ramchandra kamath v. Canara Banking Corpn. Ltd., A.I.R.[1941] ad. 354. A company passed a resolution expelling a member and authorising the directors to register the transfer of his shares without transfer deed. Held, the resolution was in violation of provision relating to transfer under the Act.

14.7. 2. Must not conflict with the Memorandum. The alteration of the Articles must not exceed the power given by the Memorandum, or conflict with the provisions of the Memorandum shall prevail. Reference may, however, be made to the Articles to explain any ambiguity in the Memorandum. The articles may also be referred to in case the Memorandum is silent on a particular point.

14.7.3. Must not sanction anything illegal. The alteration must not purport to sanction anything which is illegal. But if it is legal and it is not clearly prohibited by the Memorandum, it may be held to be valid even where it alters the whole structure of the company.

Andrews v. Gas Meter Co. Ltd., (1897) 1 Ch. 361. The Memorandum of a company provided that the nominal capital of the company was £ 60,000 divided into 600 shares of £ 100 each. The Memorandum and the Articles did not contain any express provision as to issue of preference shares. The company, by a special resolution, altered its Articles so as to give itself power to issue preference shares, and then issued then. Held, the issue was valid.

14.7.4 Must be for the benefit of the company. The alteration must be made bona fide for the benefit of the company as a whole. On Allen v, Gold Reefs of West Africa Ltd., (1900) 1 Ch. 656, it was observed that the power of alteration must be "exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities."

The phrase 'the company as a whole' means the company as a general body. It should not discriminate between the majority shareholders and the minority shareholders so as to given the former an advantage of which the letter are deprived. Not the following cases:

Shuttleworth v. Cox Bros. & Co. [Maidenhead] Ltd., [1927] 2 K.B. 9 [C.A.]. The Articles of a company provided that S and 4 others should be permanent directors of the company. They could however be disqualified by any of the 6 specific events. S failed to account for the company's money on 22 occasions within 12 months. The Articles were accordingly altered and a 7th event disqualifying a director was added. The event added was that if a director was so requested in writing by all the other directors he should resign. S was so requested to resign. Held, the alteration was bona fide for the benefit of the company as a whole, and was valid.

Greenhalgh v. Arderne Cinemas, ltd., [1951] Ch. 286 [C.A.]. The Articles of company prohibited transfer of its shares to a non-member so long as the other members were willing to buy them. The holders of the majority of the shares wished to transfer some of the shares to a non-member. The Articles were accordingly altered so as to permit a transfer to any person with the sanction of an ordinary resolution. Held, the alteration was valid as it was made in good faith and for the benefit of the company.

It is for the company to decide whether the alteration is for the benefit of the company as a whole.

Brown v. British Abrasive Wheel Co. Ltd., [1919] 1 Ch. 290. A company was in financial difficulties. The majority of the shareholders were willing to provide more capital if the remaining 2 per cent shareholders would sell them their shares. The majority then passed a special resolution altering the Articles so as to enable 9/10ths of the shareholders to buy out any other shareholders. Held, the alteration of the articles could be restrained as it was designed to allow the majority to do compulsorily what they could not do by agreement and it was not for the benefit of the company as a whole.

But if an alteration is bona fide and is made for the benefit of the company as a whole it is immaterial that it inflicts hardship on a minority. The leading case on the point is :

Sidebottom V. Kershaw Leese Co. Ltd., [1920] 1 Ch. 154 [C.A.]. In a private company the directors held a majority of the shares. The company altered its Articles so as to give power to the directors to require any shares, at their full value, to the nominees of the directors. S held a minority of the shares and was made bona fide for the benefit of the company as a whole.

14.7. 5. Must not increase liability of members [Sec. 38]. The alteration must not in any way increase the liability of the existing members to contribute to the share capital of, or otherwise pay money to, the company unless they agree in writing before or after the alteration is make. But where the company is a club or association, the Articles may be altered to provide for subscription or charges at a higher rate.

14.7. 6. Alteration by special resolution only. The alteration can be made only by a special resolution. Even clerical errors in the Articles should be set right by a special resolution [Evans v. Chapman, [1902] 18 L.T. 506

14.7. 7. Approval of Central Government when a public company is converted into a private company. The alteration in the Articles which has the effect of converting a publish company into a private company can be made only if it is approved by the Central Government, a printed copy of the Articles as altered shall be filed by the company with the Registrar within 1 month of the date of receipt of order of the approval.

14.7. 8. Breach of contract. A company is not prevented from altering its Articles even if such an alteration would result in breach of some contract. The affected party may, however, files a suit for damages for the breach of contract.

Chidambaram Chettiar v. Krishna Iynger, I.L.R. 33 Mad. 36. The Articles of a company contained a clause that the company's secretary shall get a salary of Rs.25,000 per month. S accepted the post on this salary Later on, the company altered its Articles reducing the salary to Rs.20,000 per month. S could not succeed in an action against the company as any one dealing with the company must take the risk of the Articles being altered.

Southern Foundries (1926) Ltd. V. Shirlaw, (1940) A.C. 701. S, a director of company B, was appointed to the manager director for 10 years by a contract outside the Articles. The Articles, however, provided that he would cease to be the managing director if he ceased to be a director. Company F acquired nearly all the shares of Company B. The Articles of Company B were altered to given power to Company F to remove any of the directors. S was upheld by the court, but since it was an implied term of the contract that Company B would not remove S from his position as director duration the term of 10 years, Company B was held liable to S for breach of contract.

Where compensation would not be an adequate remedy, the Court may restrain the company from altering its Articles

British Murac Rubber Syndicate Ltd. V. Alperton Rubber Co. Ltd., (1915) 2 Ch. 1 86. Company A entered into a contract with Company B whereby it was agreed that so long as Company A held 5,000 shares of Company B, Company A should have the right to nominate 2 of the directors in Company B. It was also agreed that a clause in the Articles providing for this right of nomination should not be altered by Company B. Company B disapproved of the nominees of Company A

and a notice was given of a meeting at which it was proposed to pass a resolution altering the Articles and depriving company A of the right to nominate. The Court issued an injunction restraining Company B from altering the Articles.

14.7. 9. Must not result in expulsion of a member. An assumption by the Board of directors of a Company of any power to expel a member by amending its Articles is illegal and void. Any provision in the Articles conferring such a power on the Board of directories is repugnant to the various provisions in the Companies Act pertaining to the rights of a member in public limited company.

14.7.10 No power of the Court to amend Articles. The Court has no power to amend or rectify the Articles even where there is a mistake or drafting error which the Court would rectify in the case of any other contract [Evans v. Chapman, (1902) 18 L.T.R. 506]. The Court can only declare some clause to be ultra vires [Scott v. Frank Scott (London), Ltd., (1940) Ch. 794].

14.7. 11. Alteration may be with retrospective effect. The Articles may be altered with retrospective effect and the fact the some members suffer a detriment does not make it void.

Allen v. Gold Reefs of West Africa Ltd., (1900) 1 Ch. 656. The Articles of a company gave lien to the company on all shares "not fully paid up", for calls due to the company. Z was the only of fully paid shares. He also owed money to the company for calls due on other shares. After his death, the company altered the Articles so as to give it a lien over his fully paid shares. Held, as the lien was for the benefit of the company as a whole, the alteration was valid, notwithstanding that in effect it was retrospective and to Z's disadvantage.

Check your progress - 2

What are the alternative forms in which a public company may adopt Articles

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

14.8 DISTINCTION BETWEEN MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION

In this section, we attempt to make a brief study of the distinction between Memorandum of Association and Articles of Association

Memorandum of Association	**Articles of Association**
(1) It is a charger of a company determining constitution and activities of the company.	(1) It contains rules and regulation regarding internal management of the company.
(2) It is a fundamental charter.	(2) It is subsidiary to memorandum. In case of conflict between the two memorandums prevails.
(3) Every company must have a memorandum.	(3) Public company limited by share may or may not have articles.
(4) Alteration of Memorandum is much difficult and strictly regulated.	(4) Articles can be easily altered by a special resolution.

14.9 DOCTRINE OF INDOOR MANAGEMENT

There is one limitation to the doctrine of constructive notice of the Memorandum and the Articles of a company. The outsiders dealing with the company are entitled to assume that as far as the internal proceedings of company are concerned, everything has been regularly done. They are presumed to have read these documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more; they need not inquire into the regularity of the internal proceedings as required by the Memorandum and the Articles. They can presume that all is being done regularly. This limitation of the doctrine of constructive notice is known as

(a) the "doctrine of indoor management", or

(b the rule in Royal British Bank v. Turquand, or

(c) just Turquand Rule.

Thus, whereas the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsider against the company. If the directors have power and authority to bind the company but certain preliminaries are required to be gone through on the part of The| Company before that power can be duly exercised, then the person contracting with the directors is not bound to see that all these preliminaries

have been observed. He is entitled to presume that the directors are acting lawfully in what they do.

The gist of the rule is that persons dealing with limited liability companies are not bound to inquire into the regularity of the internal proceedings and will not be affected by irregularities of which they had no notice.

First: The memorandum and Articles are public documents. They are open to inspection by everybody. But the details of internal proceedings are not open to public inspection. An outsider is presumed to know the constitution of a company, but not what may or may not have taken place within the doors it are closed to him.

Secondly, the lot of creditors of a limited liability company is not a particularly happy one it would he unhappier still if the company could escape liability by denying the authority of the officers to act on its behalf.

Exceptions to the doctrine of indoor management

1. Knowledge of irregularity. Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management,

He cannot claim the benefit under the rule of indoor management. He may in some cases be himself a part of the internal procedure. The rule is based on Common sense and any other rule would “encourage ignorance and condone dereliction of duty.”

2. Negligence. Where a person dealing with a company could discover the irregularity if he had made proper inquiries, he cannot claim the benefit of the rule of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry. If, for example, an officer of a company purports to act outside the scope of his apparent authority, suspicion should arise and the outsider should make proper inquiry before entering into a contract with the company.

3. Forgery. The rule in Turquand’s case does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

4. Acts outside the scope of apparent authority. If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound. In such a case, the plaintiff cannot claim the protection of the rule of indoor management simply because under the Articles the power to do the act could have been delegated to him. The plaintiff can sue the company only if the power to act has in fact been delegated to the officer with whom he entered into the contract A. But if an officer of a company acts fraudulently under his ostensible authority on behalf of the company, the company is liable for his fraudulent act.

14.10 LET US SUM UP

In this lesson, we have briefly touched upon the following points.

Articles of Association

The Articles contain rules and regulations for the internal management of the company subject to provisions of the Companies Act. Table A of Schedule I to the Act gives the proforma form of the Articles. A public company may or may not have the Articles. However, a public company limited by guarantee or a private company limited by shares shall file with the Registrar the Articles of Association for registration along with the Memorandum of Association.

Contents of Articles

The Articles shall state the number of members with which the company is to be registered. It shall state the share capital in case the company is to be registered with a share capital. The private limited company shall specifically provide for three restrictions under section 3 (1) (iii) of the Act. The Company may adopt all or any of the regulations contained in Table A in Schedule I of the Act. The Articles of Association of the Company not limited by shares shall be in such forms as in Table C, D and E in Schedule I as may be applicable. Articles of Association shall also contain particulars regarding the alternation of capital, transfer, lien, transmission, forfeiture, etc., of shares, rights of shareholders, meetings of the companies; appointment, remuneration, qualification, powers, etc., of the Board of Directors, accounts and audit, dividends, indemnity, and winding-up.

Alteration of Articles and limitations thereto**:**The Articles subject to the Companies Act and the Memorandum may be altered by a special resolution. The alteration of Articles shall not violate the provisions of the Memorandum. Clauses in the Articles which are ultra vires the Memorandum shall be null and void. The intimation of the alteration of the Articles shall be filed by the company with the Registrar of Companies.

14.11 QUESTIONS FOR DISCUSSION

1. What must be the contents of Articles of a company?
2. Define Articles of Association? Is it necessary for a company to have its own articles.
3. “Articles of Association is a mandatory document for incorporation of any company”. Discuss.

14.12 MODEL ANSWER TO CHECK YOUR PROGRESS

Chick-1 List out companies which must have their own Articles

The following companies shall have their own Articles, namely i) unlimited companies, ii) companies limited by guarantee and iii) private companies limited by shares

Check-2 What are the alternative forms in which a public company may adopt Articles

There are three alternatives 1.It may adopt Table A in full.2.It may wholly exclude Table A and set out its own Articles in full.3.It may frame its own Articles A and adopt part of Table A.

14.13 REFERENCES

1. " Company law" -- A.K. Bagrial
2. "Principles of modern company law" – L.C.B. Gower
3. "Business Law" -- M.R. Sreenivasan

LESSON-15

PROSPECTUS OF A COMPANY

CONTENTS

15.0 Aims and Objectives

15.1 Introduction

15.1.1 Meaning

15.1.2 Definition

15.2 Contents of Prospectus

15.2.1 Matter Contained in Part I of Schedule II of the Companies Act

15.2.2 Reports contained in Part II of Schedule II of the Companies Act

15.2.3 Part III of Schedule II

15.2.4 Dating of prospectus

15.3 Registration of prospectus

15.3.1 Penalty for non-registration of prospectus

15.3.2 Objects of registration of prospectus

15.4 Deemed Prospectus

15.4.1 The provisions of Sec. 64 are summed up as under

15.5 Mis-Statements In The Prospectus

15.5.1 Civil Liability

15.5.2 Criminal Liability:

15.5.3 Defences against Civil Liability

15.5.4 Defences against Criminal Liability

15.6 Let us sum up

15.7 Questions for discussion

15.8 Model answer to check your progress

15.9 References

15. 0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning, definition of Contents of Articles, Model form of Articles, Regulations required, Adoption and application of Table A, Alteration of Articles In this lesson we discuss the meaning,

Definition of prospectus, Contents of Prospectus of a company, Deemed Prospectus and Misstatement in Prospectus.. After going through this lesson, you will able to

1. know the meaning and definition of Prospectus
2. understand the contents of Prospectus
3. known “Deemed Prospectus”
4. study the different of liabilities regarding Misstatement in Prospectus

15.1 INTRODUCTION

Capital is very much needed for any activity of corporate enterprise. Mobilisation of capital from the public is not an easy task. Unless the public is made aware of the purpose for which capital is required, they will not come forward to invest their hard earned savings in companies’ business. For disclosing to the public, the sum of money that is required and the purpose for which it is to be used , the company has to issue a circular, notice, advertisement or document revealing the nature of the business it proposes to conduct along with other details regarding resource facilities and managerial abilities, etc. In terms of Company Act, such document is termed as “Prospectus”. In this section, we discuss meaning and definition.

15.1.1 Meaning

After formation, the Company needs the necessary amount of money to fiancé its business activities. The necessary money for this purpose may either be raised from the general public, or be obtained through private contracts. The money from the general public is raised by inviting deposits from the public, or inviting offer to purchase the shares or debentures of the company. Such deposits or offers may be invited from the public by issuing a document knows as “prospective”. A private company cannot invite public to subscribe towards its share capital in view of the restriction. Hence private companies need not issue a prospectus. It is only the privilege of a public company to invite general public to participate in its investments. In simple words prospectus means “any document inviting deposits from the public. Such invitation may be in the form of a document or a notice, circular, advertisement etc. The only requirement is that the invitation must be made to the public.

15.1.2 Definition

The term “prospectus” is defined in sectim 2 (36) of the companies Act, “A prospectus means any document prescribed or issued as a 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”.

15.2 CONTENTS OF PROSPECTUS

We know that a prospectus is issued to the public to purchase the shares or debentures of the company. Every person wants to invest his money in some sound undertaking. The soundness of a company can be known from the prospectus of a company. Thus, the prospectus must disclose the true nature of company's activities which enable the public to decide whether or not to incest money in the company. In fact, the public invest money in the company on the faith of the representation contained in the prospectus. Therefore, everything should be stated with strict accuracy, and the complete and true position of the company should be disclosed to the public. Every prospectus should disclose the following matters (Section 56) :In this section, we explain in detail the content of prospectus.

1. Matters contained in Part I of Schedule II of the Companies Act.
2. Reports contained in Part II of Schedule II of the Companies Act.

15.2.1 Matter Contained in Part I of Schedule II of the Companies Act

The following matters are contained in Part I of Schedule II of the Companies Act, which are to be specified in the prospectus:

1. The main objects of the company and the names, addresses, description and occupation of the signatories to the memorandum of association. However, this is not necessary when the prospectus is published as a newspaper advertisement (Section 66).

2. The number and classes of shares. And if the company issues redeemable preference shares, their number and date of redemption.

3. The interest of shares fixed by the articles of association as the qualification share of directors.

4. The names, description and addresses of directors, proposed directors, managing directors or managers along with their terms of appointment, remuneration or compensation payable for loss of office.

5. The names, description and addresses of directors, proposed directors, managing directors or managers alongwith their terms of appointment, remuneration or compensation payable for loss of office.

6. The amount of minimum subscription, where the shares are offered to the public. The term 'minimum subscription' means the minimum amount which, in the opinion of prometers, of required for certain purposes such as (a) for the payment of preliminary expenses, (b) for the payment of underwriting commission, (c) for the repayment of any money borrowed by the company, and (d) for the working capital.

7. The time of opening of the subscription list. This time cannot be earlier than the beginning of the 5th day after the publication of prospectus.

8. The amount payable on application and allotment on each share.

9. The particulars of any option or preference right to be given to any person to subscribe for the shares or debentures of the company.

10. The number of shares or debentures which have been issued for a consideration other than cash within the preceding two years.

11. The particulars about the premium received or to be received on shares within the preceding two years.

12. The names of the underwriters alongwith the opinion of the directors that the resources of underwriters are sufficient to discharge their obligations. It is required to be stated when any issue of shares or debentures is underwritten.

13. The particulars of a vendor from whom any property has been purchased or is to be purchased by the company. The amount of purchase consideration should also be stated in the prospectus.

14. The amount or rate of underwriting commission paid within the two preceding years. Any amount which is payable to the underwriters should also be stated in the prospectus.

15. The amount or estimated amount of preliminary expenses alongwith the names of persons by whom these expenses are payable.

16. The name and addresses of the auditors, if any.

17. The amount or estimated amount of preliminary expenses alongwith the names of persons by whom these expenses are payable.

18. The particulars as to date, parties and nature of the material contracts.

19. The full particulars of interest of directors or promoters in the promotion of the company alongwith their interest in the property acquired or proposed to be acquired by the company within two years of the date of prospectus.

20. The voting right and the rights as to the capital and dividend attached to different classes of shares. It is required to be stated where the shares are of more than one class.

21. The nature and extent of restrictions if any, imposed by the articles on the members' right to attend, speak, or vote at meetings of the company, and also on their rights to transfer shares. Moreover, the restrictions upon directors in respect of their powers of management should also be stated in the prospectus.
22. The length of time during which the company has carried on the business. And if the company proposes to acquire a business which has been carried on for less than three years, then the length of time during which the business has been carried on should be stated in the prospectus.
23. The particulars of capitalization of reserves or profits of the company. Moreover, the particulars of the surplus which arise from any revaluation of the assets of the company should also be stated in the prospectus.
24. The reasonable time and place at which copies of all accounts (i.e. Balance Sheet, and Profit and Loss Accounts), on which the report of auditors is based, may be inspected.

15.2.2 Reports contained in Part II of Schedule II of the Companies Act

The following reports are contained in Part II of Schedule II of the Companies Act 1956, which are to be set out in the prospectus:

1. Auditor's report. In case of a company carrying on the business for the last several years, an auditor's report disclosing the following particulars must be set out in the prospectus :

(a) The profits and losses of the company for the last five financial years before the issue of the prospectus.

(b) The assets and liabilities of the company at the last date upto which company's accounts were made up.

(c) The rates of dividends paid by the company in respect of each class of shares for the last five financial years before the issue of the prospectus.

In case the company also has subsidiary companies, then the auditor's report shall also disclose the particulars of profits and losses, and of assets and liabilities of the subsidiary companies.

(2) Accountant's report. In case of a company which purchases some business or acquires some shares in another company which becomes a subsidiary of the company acquiring shares, an accountant's report disclosing the following particulars must be set out in the prospectus:

(a) The profits and losses of that business or of subsidiary company for the last five financial years before the date of issue of the prospectus.

(b) The assets and liabilities of that business or of subsidiary company at the last date upto which the accounts were made up. In case of assets and liabilities of the business purchased, such a date must be within 120 days before the issue of the prospectus.

The name of the account who prepared the report should also be disclosed in the prospectus.

In addition to the matters discussed in the provisions of Section 68A (1) of the Companies Act must also be reproduced in the prospectus. This section reads as under:

Any person who

(a) makes in a fictitious name an application to a company for acquiring, or subscribing for any shares therein, or

(b) otherwise induces a company to allot, or register any transfer of shares therein to him or any other person in a fictitious name, shall be punishable with imprisonment for a term which may extend to five years".

15.2.3 Part III of Schedule II

1. If a prospectus is issued more than 2 years after the date at which the company is entitled to commence business, it need not give particulars of the signatories of the Memorandum and the shares subscribed for by them and the details of the preliminary expenses.
2. If the company has been carrying on business for less than five financial years, reference to that number of financial years for which business has been carried on.
3. Any report required by Part II shall make adjustments or indicate adjustments as respects figures of any profit or loss or assets and liabilities which appear to be necessary.
4. Any report by accountants required by Part II shall be made by qualified auditors.

15.2.4 Dating of prospectus

A prospectus issued by or in relation to an intended company must be dated and that date is, unless the contrary is proved, taken as the date of publication of the prospectus.

Check your progress – 1

List out characteristics of Prospectus

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

15.3 REGISTRATION OF PROSPECTUS (SEC. 60)

In this section, we attempt to make a brief study of meaning of registration of prospectus. A prospectus can be issued by or on behalf of a company only when a copy thereof has been delivered to the Registrar for registration. The registration must be made on or before the date of publication thereof. The copy must be signed by every person who is named therein as director or proposed director of the company, or by his agent authorized in writing. Further such a prospectus must state on the face of it that a copy of it has been delivered to the Registrar for registration on or before the date of its publication. The copy for registration must be accompanied with the following documents :

1. Consent of the expert to the issue, if a report by the expert is to be published.
2. A copy of every contract, appointing or fixing remuneration of a managing director of manager.
3. A copy of every material contract, not being a contract entered into in the ordinary course of the business or a contract entered into more than 2 years before the date of the prospectus.
4. A written statement by the persons making any report relating to the adjustments, if any, as respects the figures of any profits or losses or assets and liabilities dealt with by the report set out in the prospectus in pursuance to Part II of Schedule II, giving the reasons therefore.
5. The consent in writing of the person, if any, named in the prospectus is issued without a copy thereof being delivered to the Registrar for registration, or without the necessary documents or the consent of the experts, the company and every person, who is knowingly a party to the issue of the prospectus, shall be punishable with fine which may extend to Rs.50,000.

The prospectus must be issued within 90 days of the date on which a copy thereof is delivered for registration. If a prospectus is not issued within this period, it is deemed to be a prospectus, a copy of which has not been delivered to the Registrar.

15.3.1 Penalty for non-registration of prospectus

If a prospectus is issued without a copy thereof being delivered to the Registrar for registration, or without the necessary documents or the consent of the experts, the company and every person, who is knowingly a party to the issue of the prospectus, shall be punishable with fine which may extend to Rs.50,000.

15.3.2 Objects of registration of prospectus

The objects of registration of a prospectus are

(1) to keep an authenticated record of the terms and conditions of issue of shares or debentures, and

(2) to pinpoint the responsibility of the persons issuing the prospectus for statements made by them in the prospectus.

Prospectus is not required to be issued. The issue of a prospectus is not necessary in the following cases:

1. Where an offer is made in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures.
2. Where the shares or debentures are not offered to the public. This will be the case when promoters are confident of raising capital through private shares and contacts.
3. Where the shares or debentures are offered to the existing members or debenture-holders (i.e., right issue) of the company.
4. Where the shares or debentures offered are uniform in all respects with shares or debentures previously issued and quoted on a recognized stock exchange.

Where any prospectus is published as a newspaper advertisement, it is not necessary to specify the contents of the Memorandum or the signatories thereto, or the number of shares subscribed for by them.

Form of application to be accompanied by a memorandum containing salient features of prospectus [Sec. 56 (3)]. No one shall issue any form of application for shares in or debentures of a company, unless the form is accompanied by a memorandum containing such salient features of a prospectus as may be prescribed. The italicized words have been substituted by the Amendment Act of the word ‘prospectus’. This has been done with a view

(i) to reducing the cost of public issue of capital, and

(ii) to giving brief and meaningful information to the prospective investors.

A copy of the prospectus shall however be furnished on a request being made by any person before the closing of the subscription list.

15.4 DEEMED PROSPECTUS (SEC. 64)

In this section, we attempt to make a brief study of meaning of deemed prospectus. The provisions relating to a prospectus (as regards registration, contents and full disclosure) are very stringent and the duty of preparing and

filing a prospectus in accordance with the law is extremely onerous. These requirements used to be evaded by companies in the part by allotting the whole of an issue of shares or debentures to an Issuing House at a certain price. The Issuing House then published an advertisement in the nature of an offer for sale inviting public to buy the shares or debentures from it at a higher price. Sec. 64 now specifically provides that a document by which an 'offer for sale' is made to the public is within the definition of prospectus.

When application are received by the Issuing House, it renounces its interest in the shares or debentures to the extent of the number of the number of shares or debentures allotted in favour of the application. When this is done, the applicant becomes an allottee of the company.

15.4.1 The provisions of Sec. 64 are summed up as under :

1. Prospectus by implication. All document containing offer if shares debentures for sales are included within the definition of the term 'prospectus', and are deemed to be a prospectus by implication of law. Where a company allots or agrees to allot any shares in, or debentures of, the company to an Issuing House with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is make by the Issuing House is, for all purposes, deemed to be a prospectus issued by the company and all enactments and rules of law in regard to a prospectus are applicable thereto.

2. Intention to offer shares or debentures to the public. Unless the contrary is proved, an allotment of, or agreement to allot, shares or debentures to an Issusing House is 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 shares or debentures for sale was made within 6 months after the allotment or agreement to allot ; or

[b] that at the date when the offer was make, the whole consideration to be received by the company in respect of shares or debentures had not been received by it.

3. Additional information. The following additional information is required to be given in the document deemed to be prospectus :

[a] Consideration and time and place of inspection of contract.

[i] The net amount of the consideration received or to be received by the company in respect of the shares or debentures to which the offer relates ; and

[ii] 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.

[b] Issuing House to be deemed director. The persons making the offer of sale to the public are to be deemed directors of the company for the purpose of registration of the prospectus.

[c] Signing of prospectus. Where the Issuing House, i.e., the person making the offer, is a company or a firm, it is sufficient if the prospectus is signed on behalf of the company by 2 directors of the company or by not less than one-half of the partners in the firm, as the case may be. Any such director or partner may sign by his agent authorized in writing.

Check your progress – 2

Write short notes on 'Deemed Director'

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

15.5 MIS-STATEMENTS IN THE PROSPECTUS

In this section, we discuss the meaning and the person liable for mis-statements in the prospectus and also different types of liabilities. Every person authorizing the issue of prospectus has a primary responsibility to see that the prospectus contains the true state of affairs of the company and does not give any fraudulent picture to the public. People invest in the company on the basis of the information published in the prospectus. They have to be safeguarded against all wrongs or false statements in the prospectus. Prospectus must therefore make full and honest declaration of material facts without concealing or omitting any relevant fact. This is known as the Golden Rule for framing prospectus as laid down in New Brunswick etc. Co. v. Muggeridge (1860 3 LT 651). The true nature of company's venture should be disclosed. The statements which do not qualify to the particulars mentioned in the prospectus, or any information is intentionally and willfully concealed by the Directors of the company, would be construed as mis-statement. They are in other words either false or untrue statements in the prospectus, or information which ought to have been disclosed is concealed, or omission of any material fact. Statements which produce wrong impression of actual facts would also be construed as mis-statements.

Mis-statements include : (i) untrue statements; (ii) statements which produce wrong impression; (iii) statements which are misleading (iv) concealment facts; and (v) omission of facts.

The prospectus must make all statements with absolute accuracy and not state the facts which are not strictly correct. A statement may be false not only because of what it states but also because of what it conceals or omits.

A statement included in a prospectus shall be deemed to be untrue, if

(i) the statement is misleading in the form and context in which it is included; and

(ii) the omission from a prospectus of any matter is calculated to mislead (Sec. 65).

Who are liable for mis-statements in the prospectus ?

(i) Every person who is a director of the company at the time of the issue of the prospectus;

(ii) Every person who has authorized himself to be named and is named in the prospectus either as a director or as having agreed to become a director, wither immediately or after an interval of time;

(iii) Every person who is a promoter of the company; and

(iv) Every other person who has authorized the issue of the prospectus.

Liability : The liability may be civil or criminal.

15.5.1 Civil Liability:

1. Compensation : The above persons shall be liable to pay compensation to every person who subscribes for any shares or debentures for any loss or damage sustained by him by reason of any untrue statement included therein [Sec. 62 (1)].

In Me Connell v. Wright (1903 ICH 546) it has been held that the measure of the damages is the loss suffered by reason of the un-true statements, omissions, etc., the difference between the value which the shares would have had and the true value of the shares at the time of the allotment.

2. Damages for deceit or fraud : Any person induced to invest in the company by fraudulent statement in a prospectus can sue the company and person responsible for damages. The shares should be first surrendered to the company before the company is sued for damages.

Fraud occurs when any statement is made without belief in the truth or carelessly. A statement made with knowledge that it is false, will constitute fraud or deceit. In the leading case on the point—Derry v. Peek (1889-14 AC 337), it has been held that if the person making the statement honestly believes it to be true, he is not guilty of fraud, even if the statement is not true. The fact of this case were :

The Tramway Company has power by special act to make tramways and to use steam power with the consent of the Board of Trade. The plans of the company were approved. The directors of the company honestly believed that since the

plans were approved, permission to use steam power from Board of Trade was only a formality and would be granted. Prospectus was issued wherein the directors stated that the consent to use steam power was obtained by the Company. Subsequently the consent was refused and the Company has to be would up. On the action by plaintiffs for deceit it was held that the directors were not liable for fraud as they honestly believed that the consent would be obtained, though the statement was untrue.

3. Recission of the contract for misrepresentation: Recission means avoiding the contract. Any person can apply to the Court for recission of the contract if the statements on which he has taken the shares are false or caused by mis-representation whether innocent or fraudulent.

The misrepresentation must be false. It must be of material fact and not of law. The applicant of shares must have acted on the statements contained in the prospectus or must have been induced to act on the statements. It should be noted that a person cannot claim recission of contract on mis-representation, if he had the means of discovering the truth with ordinary diligence.

4. Liability for non compliance with Sec. 56 : A director or other person responsible shall be liable in damages for non-compliance with or contravention of any of the matters to be stated and reports to be set out in prospectus as provided by Section 56 [Sec. 56 (4)].

5. Liability under General Law : Any person responsible for the issue of prospectus may be held liable under the general law or under the Act for mis-statements or fraud.

6. Penalty for contravening Secs. 57 or 58 : If any prospectus is issued in contravention of section 57 (expert to be unconnected with formation or management of company) or section 58 (expert's consent to issue of prospectus containing statement by him), the company and every person who is knowingly a party to the issue thereof, shall be punishable with fine which may extend to Rs.5,000/- [Sec. 59 (1)].

7. Penalty for issuing the prospectus without delivering for registration : If a prospectus is issued without a copy thereof being delivered to the Registrar, the company and every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extend to Rs.5,000/-

15.5.2 Criminal Liability:

Every person who authorizes the issue of prospectus shall be punishable for untrue statements with imprisonment for a term which may extend to 2 years or with fine which may extend to Rs.5,000/- or with both. [Sec. 63(1)].

Fraudulently inducing persons to invest money : (Sec. 68) Any person who either knowingly or recklessly makes any statement, promises or forecasts which is false, deceptive or misleading or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into;

(i) any agreement with a view to acquiring, disposing of, subscribing for, or underwriting shares or debentures; or

(ii) any agreement, the purpose of which is to secure a profit to any of the parties from the yield of shares or debentures, or by reference to fluctuations in the value of shares or debentures; shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to Rs.10,000/- or with both.

15.5.3 Defences against Civil Liability

Every person made liable to pay compensation of any loss or damages may escape such liability by proving that:

(1) Withdrawal of consent before issue : Having consented to become a director of the company, he withdrew his consent before the issue of the prospectus and that it was issued without his authority or consent;

(2) Issued without knowledge : The prospectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

(3) Withdrawal of consent after issue : After the issue of prospectus, and before allotment thereunder, he, on becoming aware of any untrue statement therein withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and the reasons therefor; or

(4) Reasonable belief : As regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or a statement, he has reasonable ground to believe, and did upto the time of the allotment of the shares or debentures, as the case may be, believe that the statement was true; and

(5) Statement by an expert : As regards every untrue statement purporting to be a statement by an expert or contained in what purports to be a copy or an extract from a report or valuation of an expert, the person charged can escape liability on proving that

(a) it was correct and fair representation of the statement; or

(b) a correct copy of, or a correct and fair extract from the report or valuation; and

(c) he had reasonable ground to believe, and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it; and

(d) that the person (expert) had given the consent to the issue of prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or before allotment.

(6) Statement by an official person or extract from public official document :

As regards every untrue statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from the document.

15.5.4 Defences against Criminal Liability

Any person made criminally liable can escape the same on proving that :

(i) having given his consent, he withdrew it in writing before delivery of a copy of the prospectus for registration;

(ii) after delivery of a copy of the prospectus for registration and before allotment there under, he on becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and of the reason therefore; or

(iii) he was competent to make the statement and that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures believe that the statement was true.

15.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points. Any invitation to the public subscribes for shares or a debenture of the company is a prospectus. A public company inviting public to subscribe towards its share capital shall do so through a prospectus. This is done in order that the prospective investor shall know the financial background of He Company. Provisions or prospectus do not apply to a private company since it's a governed by three restrictions under section 3(1) of the Act. Any document containing offer of shares or debentures for sale shall be deemed to be prospectus.

Contents of the prospectus:

Prospectus must state the matters specified in part I of Schedule II ad Reports specified in Part II of Schedule II subject to he provisions contained in Part III of Schedule II. The prospectus shall dated and that date shall be taken as the date of the publication. Copy of the prospectus shall be registered with the Registrar of Companies. The prospectus shall be attached with consent to the issue of the prospectus from any person as an expert. It shall also have the required documents when its is delivered for registration. It shall be issued within 90 days of the delivery of the copy for registration.

Mis-statements in the prospectus**:**

The prospectus shall make full and honest declaration of material facts without concealing or omitting any relevant facts. This is known as the 'Golden Rule' for framing the prospectus. Mis-statements may be either untrue statements or statements which produce wrong impression or statements which are misleading or those which conceal material facts or omit facts.

Every person who is a director of the company, or who has authorized himself to be named in the prospectus or who is a promoter of the company, or every other person who has authorized the issue of the prospectus shall be liable for mis-statements in the prospectus. The liability may be civil or criminal. Any person induced to invest by fraudulent statement may sue the company and person responsible for damages or he may apply to the Court for recession of the contract if the statements are false or fraudulent.

Any person made liable to pay compensation may present the following defences: (1) that he withdrew his consent before the issue of the prospectus. (2) that the prospectus was issued without his knowledge; (3) that he withdrew his consent after the issue of prospectus and before allotment, (4) that he had reasonable ground to believe that the statement was true. (5) where the statement was purported to be a statement by an expert, he can escape liability by proving that there was a correct and fair representation of the statement or it was a correct and fair extract from the document. The expert also has defences if he is made liable.

A prospectus which containing misleading statements is called 'Misleading Prospectus'.

Statement in lieu of prospectus:

A company having a share capital and not issuing a prospectus or a company which has issued a prospectus but has not proceeded to allot any of its shares shall not allot its shares unless at least three days before the allotment of shares or debentures it has filed with the Registrar of Companies, a statement in lieu of prospectus. The statement in lieu of prospectus shall contain particulars as set out in Part I of Schedule III and Reports as specified in Part II of Schedule III subject to the provisions contained in Part III of that Schedule. The private company on becoming a public company shall also file a statement in lieu of prospectus containing particulars as specified in Part I of Schedule IV with the Reports as specified in Part II of Schedule IV subject to the provisions in Part III of that Schedule.

15.7 QUESTIONS FOR DISCUSSION

1. What is 'Prospectus'? Explain the liability for mi-statements contained the prospectus.
2. Who are liable for mis-statements in the prospectus? Explain the extent civil and criminal liability for such mis-statements?
3. What are the remedies open to an allottee of shares who had applied them on the face of a false and misleading prospectus?
4. What are the defences available to the Directors of the Company who have issued false and misleading prospectus?
5. Define minimum subscription. What are the consequences if a company is not able to raise minimum subscription?

15.8 MODEL ANSWER TO CHECK YOUR PROGRESS

Check-1 List out characteristics of Prospectus

1. A prospectus must be an invitation to offer.
2. A prospectus is a document meant for public.
3. Prospectus by implication

Check- 2 Write short notes on 'Deemed Director'

The issuing houses offering the shares to the public are regarded as directors for the purpose of registration of the prospectus.

15.9 REFERENCES

1. " Company law" -- A.K. Bagrial
2. "Principles of modern company law" – L.C.B. Gower
3. "Business Law" -- M.R. Sreenivasan

LESSON-16
SHARES

CONTENTS

16.0 Aims and Objectives
16.1 Introduction
16.1.1 Meaning
16.1.2 Definition
16.1.3 Nature of shares
16.2 Stock and share certificate
16.2.1 Stock
16.2.2 Share certificate
16.2.3 Distinction between share and stock
16.3 Types of shares
16.3.1 Equity or ordinary shares
16.3.2 Characteristics of the Equity Shares
16.3.3 Sweat Equity Shares
16.3.4 Preference shares
16.3.5 Kinds of preference shares
16.4 Let us sum up
16.5 Questions for discussion
16.6 Model answer to check your progress
16.7 References

16.0 AIMS AND OBJECTIVES

In the 15th lesson, we discussed the meaning, definition of prospectus, contents of Prospectus of a company, Deemed Prospectus and Misstatement in Prospectus. In this lesson we discuss the meaning, definition and types of shares. After going through this lesson, you will able to

1. know the meaning and definition of share
2. understand various types of shares

16.1 INTRODUCTION

The money required by the company for its business activities is raised by it from the public. The money so raised is called to capital of the company which is usually divided into different units of a fixed amount. These units are called the "share". In this section, we discuss the meaning, definition and nature of share

16.1.1 Meaning

A share in a company represents the unit into which the total capital of the company is divided. In simple term, a share is nothing but a fraction of the whole which goes to make up the capital as a whole. That portion or the part or fraction of money contributed by a person to make up the capital is known as the share. In simple word "Share" means share in the share capital of a company.

16.1.2 Definition

The term "Share" is defined in section. 2 (46) of the companies act,

"Share means a share in the share capital of a company, and includes stock except where a distinction between stock and share is expressed or implied". The persons who hold the share of a company are called the members of share holders of the company. The definition of "share" given in section 2 (46) is simple but not exhaustive.

A share is not a sum of money, but an interest measured by sum of money and made up of various rights and liabilities of the share holders. In other words, a share indicates the pecuniary interest of the share holders and their rights and liabilities. In this sense, it may be defined as an "existing bundle of rights ad liabilities".

16.1.3 Nature of shares:

The shares or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. The movable property of a person is of two kinds, namely (a) choose-in-possession and (b) choose-in-action. Choose-in-possession means the property which is in the physical possession of a person e.g., goods of any kind. The shares also included in the legal definition of goods.

Choose-in-action means the property which is not in the immediate physical possession of a person. But the person has right to the property which can be enforced by legal action. This right is generally evidenced by a document e.g. a bill of leading, railway receipt etc. A share certificate is the evidence of share holder's rights which can be enforced by legal action. Share certificate is not a negotiable instrument.

Stock and shares of a company are goods. These can be bought, sold, hypothecated and bequeathed.

16.2 STOCK AND SHARE CERTIFICATE

In this section, we attempt to make a brief study of stock, share certificate and Distinction between share and stock

16.2.1 Stock

Stock is the aggregate of fully paid-up shares, consolidated and divided, for the purpose of convenient holding into different parts. It may be transferred split up into fraction of any amount, without regard to the original face value of the share.

16.2.2 Share certificate:

A "share certificate" is a document which specifies the shares held by any member. It is issued by the company under its common seal. Every person whose name is entered as a member in the register of members, is entitled to receive share certificate from the company. The share certificate may be in any form. But a valid share certificate must satisfy the following requirements.

1. It must have the common seal of the company affixed on it.
2. It must specify the number of share. The nominal value of shares and the amount actually paid should also be stated in it.
3. It must also state the name, address and occupation of the shareholder.
4. It must be signed by one or more directors of the company.

16.2.3 Distinction between share and stock

	Share	**Stock**
1.	Shares cannot be issued or transferred in fragments	Stock can be divided into unequal amount and therefore can be issued and transferred in fragments.
2.	Shares need no e fully paid up.	Stock is always fully paid up
3.	Shows bear distinctive numbers.	Fractions of stock do not bear distinctive numbers.
4.	Shave an issued directly	Stock cannot be issued directly.

Check your progress -1

What do you mean by Right share?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

16.3 TYPES OF SHARES

In this section, we attempt to make a brief study of different types of share

Share can be classified into following three types

1. Ordinary shares
2. Preference shares
3. Deferred shares

According to section 85 of the companies Act 1956,companies can issue the following two types of shares

1. Equity shares
2. Preference shares

Note: These shares were mostly taken by the founders of the company. These shares often used to get the remaining profits of the company after preference share holders and ordinary share holders were paid out. Deferred shares which were previously in existence are no longer in use now

16.3.1 Equity or ordinary shares:

The equity shares are these which are not preference shares. Equity shares do not enjoy any preferential rights thus for the purpose of dividend and repayment of capital, the equity shares rank after the preference shares generally, their rate of dividend is not fixed equity share holders are entitled to share the whole surplus profit next to preferences share holders. It the rate of dividend varies from year to year depending upon the profits of the company. The rate of dividend is determined by the directors of the company.

The equity shareholder are entitled to get dividend only when the company makes profit and furthermore, on the recommendation of the Board of Directors.

Sometimes, in spite of huge profits made by the company, the Directors may not recommend for payment of dividend. That is the reason for calling the Equity capital as 'Risk capital'. In other words, the fortune of the equity shareholders is tied up with ups and downs o the performance of the company. If the company fails to make profit, the risk falls mainly on the shareholders with no return for their investment in shares. If the company is successful in its business, the equity shareholder equally get benefited by its profit.

According to Section 87 (1) (a), the equity shareholders have normal voting rights on every resolution that is passed in the Annual General Body meetings. Equity shares are always irredeemable and the liability of the members is limited to the face value of the shares. Equity shares with reference to company limited by shares are those which are not preference shares [Section 85 (2)].

16.3.2 Characteristics of the Equity Shares

The characteristics of the equity shares are as follows:

(a) Equity shares carry voting rights at the annual general body meetings of the company and they have the right to control the management of the company.

(b) Equity shares always enjoy the right to participate in the profits of the company in the form of distribution of dividend.

(c) In the case of winding up of the company, the equity shareholders will be entitled for the return of their capital only after the claims of all creditor and preference shareholders are satisfied.

(d) Besides the above, the equity shareholders enjoy the following rights

(i) Right of Pre-emption in the matter of fresh issue of capital (Section 81)

(ii) Right to apply to the Court to have variation of their right set aside [Section 10 (7)].

(iii) Right to receive copy of the statutory report [Section 165].

(iv) Right to apply to Central Government to call for annual general body meeting when the company has defaulted (Section 167).

(v) Right to apply to the Company Law Board for calling an Extraordinary general body meeting of the company (Section 186).

(vi) Right to recover copy of the Annual Accounts along with Auditor's Report [Section 210 & 21a].

16.3.3 Sweat Equity Shares [Section 79 (A)]

Sweat equity shares means (a) equity shares issued at discount or (b) for consideration other than cash; (c) These shares are given in lieu of cash for

providing know-how to the company; (d) The shares may be allotted to a party in consideration for making available rights in the nature of Intellectual property rights to the company; (e) the shares may be given to the party who has added value to the company.

Conditions for issue of Sweat Equity Shares

(a) Companies can issue swear equity shares which should belong to or form part of the shares already issued. Further, the following conditions must also be fulfilled.

(b) The issue of sweat equity shares should be authorized by a special resolution.

(c) The resolution that is passed must specify the following details with regard to issue of sweat equity shares.

(i) the number of shares that are to be issued.

(ii) the current market price at which these shares have to be sold.

(iii) the class or classes of directors or employees to whom such shares have to be issued.

(iv) One year should have passed since the date on which the company was entitled to commence business for issuing this kind of sweat equity shares.

(v) The sweat equity shares issued by the company where equity shares are already listed on recognized Stock Exchange must be issued according to the guidelines prescribed by Security Exchange Board of India.

(vi) All restrictions and provisions relating to equity shares shall be applicable to sweat equity shares also.

16.3.4 Preference shares:

The preference shares are these which have some preferential rights over the other types of shares i.e., which some priority over the equity shares preference shares got a preference of privilege over payment of divided and repayment of capital.

Preference shares have the following characteristics

1. Preference shares have a preferential right to be paid dividend during the lifetime of the company.

2. Preference shares have a preferential right to the return of capital when the company goes into liquidation.

16.3.5 Kinds of preference shares:

Preference shares may be of the following kinds.

1. Cumulative preference shares
2. Non-cumulative preference shares
3. Participating preference shares
4. Non-participating preference shares
5. Convertible preference shares
6. Non-convertible preference shares
7. Redeemable preference shares
8. Irredeemable preference shares

1. Cumulative preference shares:

The cumulative preference shares are those which are assured of the dividend every year even it there are no profits in a particular year. It in a particular year there are no profit to pay the dividends, the unpaid dividend of such preference share is treated as arrear and is carried forward to the subsequent years. Thus, the unpaid dividend goes on accumulating and is paid when there are sufficient profits in the subsequent years.

It the company goes into liquidation, no arrears of dividends are payable unless either the articles contain an express provision to this effect.

2. Non-cumulative preference shares:

These are the shares on which the dividend does not go on accumulating. It have is no profit the company cannot pay dividend to its share holders. If company fails to pay dividend in one year on non-cumulative preference shares, it cannot carry forward such arrears of dividend for the next year. It no dividend is paid in any particular years, it lapses. The non cumulative preference share will be treated as in equity shares in case dividend has not been paid for a total period of three years out of six years ending the expiry of the financial year. In the absence of any specific provision to the contrary, preference shares are presumed to be cumulative. Whether preference shares are cumulative or non cumulative depends upon the terms of issued and provisions contained in the article.

3.Participating preference shares

These shares are not only entitled for payment of a fixed rate of dividend, but they are also entitled to a share in the surplus profit remaining as residue after distribution of dividend to the equity shareholders. They are entitled to share profit upto a limit of 15%. The surplus profits are distributed in accordance with the agreed ratio between the holders of the participating preference shares and the equity shares. If the Articles and Memorandum and silent with regard to participating preference shares, all the preference shares are treated as non participating preference shares.

4.Non participating preference shares

These kinds of share are entitled only to a fixed rate of dividend. The shareholders do not have a right in the surplus of profits which go only to the equity shareholders. All preference shares are non participating shares, if the Articles are silent.

5.Convertible preference shares

The holders of the shares are given the option to convert the shares held them into equity shares within a certain period.

6.Non convertible preference shares

These kinds of shares do not confer on the holder a right of conversion of these shares into equity shares. If the Articles are silent, all preference shares are deemed to be non-convertible preference shares.

7.Redeemable preference shares

One of the best methods adopted for economy in the long range capital planning is the issue o redeemable preference shares. Section 80 of the Companies Act authorizes a company limited by shares, to issue redeemable preference shares'. Redeem means to 'pay back'. In this kind of shares, the capital the capital contributed by the shareholders could be returned to them after a certain period in accordance with the terms of issue. The paying back of capital is called redemption. After the Companies Amendment Act of 1988 i.e., from 15.6.1988, only such preference shares as are redeemable within 10 years from the date of issue can be allotted. But for the purpose of issue of these kinds of shares, the company has to observe the following conditions-

(a) Articles must authorize to issue these kinds of shares.

(b) Only fully paid up shares can be redeemed. The shares may have to be redeemed from out of profit.

(c) If profit haws been used for redeeming these kinds of shares, an equal amount has to be credited into an account known as Capital Redemption Reserve Account.

(d) If adequate profits are not available for redemption of these shares, fresh issue of shares can be made. But this has to be made under the authority given to the company by its Articles.

(e) The proceeds out of the fresh issue must be realized within a period of one month failing which the company may have to pay stamp duty on excess portion of the capital.

(f) If any premium is payable on redemption of the redeemable preference shares, such premium must be paid from out of the share premium account.

(g) Redemption of preference shares should not be taken as reduction of capital.

(h) The new issue of shares for the purpose of redemption shall not amount to increase in share capital for stamp duty purposes, provided the shares are redeemed within one month after making fresh issue.

Penalty: Every officer found guilty of contravention or violation of the provisions of the Companies Act shall be punishable with fine which may extend to Rs.1,000/-.

Notice to Registrar: The redemption of redeemable preference shares must be notified to the Registrar within 30 days from the date of redemption.

8.Irredeemable Preference Shares

Irredeemable Preference Shares are shares allotted to the shareholder with no option given to them to get back the value they have paid on their shares. In other words, the company which allotted the shares will not repay the subscription to the shareholders who had paid on those shares.

The repayment by company on such shares is possible only on winding up of the company. After the commencement of the Companies (Amendment) Act 1988 (W.e.f. 15.6.88), issue of any future Irredeemable preference shares is prohibited (New Subsidies 80 (5A).

9.Redemption of Irredeemable Preference Shares (Section 80A)

The gist of the 1988 Amendment Act is as follows:

(i) All existing irredeemable Preference shares must be redeemed by the company within a period of five years from commencement of the Amendment Act 1988 i.e., from 15.6.88.

(ii) All existing redeemable preference shares which are not redeemable before the expiry of ten years from the date of issue must be redeemed as per the terms of the issue or within a period of ten years from the commencement of the Amendment Act 1988, whichever is earlier.

(iii) A company may have to issue further redeemable preference shares of an equal amount to irredeemable preference shares with the approval of the Company Law Board. This would arise only if the company is unable to redeem the said irredeemable shares as per the Section.

Penalty: If default is made in complying with the provisions of Section 80A,

(a) the company making such default shall be punishable with fine which may extend up to Rs.10,000 for every day during which such default continues:

(b) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend upto 3 years and shall also be liable for fine.

Check your progress -2

What do you mean by share certificate?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

13.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points; Share means a share in the share capital of the company. It includes stock. The holder of a share is entitled to a share certificate. It is a movable property and transferable. Each share is distinguished by its appropriate number. Shares can be converted into stock when they are fully paid up.

Classification of shares:

Shares under the Act are classified into (1) Preference shares; (2) Equity shares. Preference share capital is a sum total of preference shares that carry preferential rights as regards dividends and as regards return of capital on winding up. Preference share are further divided into Cumulative Preference Shares and non-Cumulative Preference Shares. Where the dividend is accumulated on he shares, they are called Cumulative Preference Shares Where the dividends do not accumulate or lapse, they are called non-Cumulative Preference Shares.

Preference shares are further classified into Redeemable Preference Shares and Irredeemable Preference Shares.

Redeemable Preference Shares:

The company reserves its rights to call back the shares at any time. These shares are called redeemable preference shares. The shares can be redeemed only out of the profits of the company or out of the proceeds of the fresh issue of shares. Only fully paid-up shares can be redeemed. The premium payable on redemption shall be provided only out of the profits or out of the company’s share Premium Account.

Irredeemable Preference Shares:

These shares cannot be purchased back by the company.

Preference shares are also classified into participating preference shares and convertible preference shares.

Equity Shares:

All shares which are not preference shares are called equity shares. These share do not enjoy any special preferences like the preference shares.

13.7 QUESTIONS FOR DISCUSSION

1. What is a Share?
2. What different class of shares can be issued?
3. Distinguish between stock and shares

13.8 MODEL ANSWER TO CHECK YOUR PROGRESS

Check-1 what do you mean by Right share?

According Section 81, the existing equity shareholders have a first right to be allotted the new issue of shares. Shares so issued are called Right shares

Check-2 what do you mean by share certificate?

A "share certificate" is a document which specifies the shares held by any member. It is issued by the company under its common seal. Every person, whose name is entered as a member in the register of members, is entitled to receive share certificate from the company. The share certificate may be in any form. But a valid share certificate must satisfy the following requirements

13.9 REFERENCES

1. " Company law" -- A.K. Bagrial
2. "Principles of modern company law" – L.C.B. Gower
3. "Business Law" -- M.R. Sreenivasan

LESSON - 17

DEBENTURE

CONTENTS

17.0 Aims and Objectives

17.1 Introduction

17.1.1 Meaning

17.1.2 Definition

17.2 Characteristic Features of Debentures

17. 3 Classification of Debenture

17.3.1. Classification according to Transferability

17.3.2 Classification According to securities

17.3.3 Classification According to permanence

17.3.4 Classification According to Convertibility

17.3.5 Classification according to Priority

17.4 Legal provision relating to debentures

17.5 Comparison between a share-holder and a debenture-holder

17.6 Let us sum up

17.7 Questions for discussion

17.8 Model answer to check your progress

17.9 References

17.0 AIMS AND OBJECTIVES

In the 16th lesson, we discussed the meaning, definition and types of shares. In this lesson we discuss the meaning, definition and types of debenture. After going through this lesson, you will able to

1. know the meaning and definition of debentures
2. understand various types of debentures

17.1 INTRODUCTION

The money required by the company for its business activities is raised by it from the public by borrowing. The most usual form of borrowing by a company is by the issue of debentures. In this section, we discuss the meaning, definition and characteristic of debentures

17.1.1 Meaning

Debenture means a document which either creates a debt or acknowledges. It is issued by a company and is usually in the form of a certificate. The amount might be payable by instalments on application, allotment and calls. But usually the amount is payable in one lump sum.

17.1.2 Definition

According to Sec 2 (12), Debenture has been defined "as one that includes debenture stock, bonds and any other security of a company, whether constituting charge on the company's assets or not which either create a debt or acknowledgement and any document which fulfils either of these conditions is a debenture". Mr.Topham has stated that "debenture is a document given by a company as evidence of a debt to the holder usually arising out of a loan and most commonly served by charge".

In common sense, we can define a debenture as a deed of document acknowledging the loan adcanced by third party creditors under certain terms and conditions to the company. [Levy vs Abercorris State Slab & Co., (1887) 37 Ch.D. 260] Debenture issue is one of the methods under which a company could mobilize funds for its capital. It is issued like shares through publication of prospectus. Funds got through debentures issue form part of borrowed capital.

17.2 CHARACTERISTIC FEATURES OF DEBENTURES

In this section, we explain the Characteristic Features of Debentures

1. Debenture can be issued at any time by all companies, whether private or public. The power to issue the debentures rests with the Board of Directors of the company (Section 292).
2. Debenture is a bond which acknowledges the loan advanced by third party creditors to the company.
3. It must have serial number and must be duly signed by the directors and/ or officers as per the regulations contained in the Articles with the Common Seal of the company.
4. The debenture deed should bear the date of issue and the date on which the amount secured on it is repayable. On that date, the said debenture deed must be presented to the company for repayment. Of late, issue of perpetual debenture has been prohibited.

5. Debentures are usually issued to the creditors, with security i.e., with charge over specific property or one the overall assets of the company. It may also be issued without charge or security. This is known as Debenture without security or charge.
6. A debenture holder has no right to participate in the shareholders' meeting.
7. Holding debentures is not an eligible qualification to become a director.

Check your progress -1

What is the nature of debenture?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

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17. 3 CLASSIFICATION OF DEBENTURE

In this section, we attempt to make brief explain of different kinds of debentures. Debenture may be classified according to the following characteristics, viz.,

1. Transferability
2. Security
3. Permanence
4. Convertibility
5. Priority

17.3.1. Classification according to Transferability

From the point of transferability, debentures could be divided as Bearer debenture and Registered debentures.

i) Bearer Debenture

(a) A bearer debenture conveys title or ownership by mere delivery and transfer of possession.

(b) It is a chose in possession in that sense mere possession conveys ownership.

(c) It is payable to the bearer of the deed.

(d) It can also be termed as a negotiable instrument and is transferable by delivery.

(e) A bona fide transferee for value is not affected by any defect in the title of the transferor.

Example:

A bearer debenture deed was kept in the safe, payable to B Company. The secretary, stole the bearer debenture and pledged the debenture with a bank as security for a loan taken by him. The bank took the debenture bona fide. The court held that the bank was entitled to the debentures as against the company, as it happened to be Bearer debenture

ii) Registered Debentures

These are the debenture which are payable to the registered holders. A holder is one whose name appears both on the debenture certificate and in the company's register of debentures. The registered holder of the debenture can transfer them like shares but a transfer to be complete has to be registered with the company.

17.3.2 Classification According to securities

From the angle of security, debentures are dividend as secured and unsecured debentures.

i)Secured Debentures: These debentures that are held by persons who are said to be secured creditors. This is due to the reason that secured debentures are supported with fixed property or assets that are given as security and charged therein for the long obtained on the said debentures.

Fixed Charge: When a specific property asset is given as security and charged for the loan on the debenture, then the said debenture is termed as debenture with fixed charge.

Floating charge: When overall assets are given as security and charged therein for the loan obtained on the debenture, then it is known as Debenture with floating charge.

ii) Unsecured Debentures or naked debentures: These debentures are not supported by any security or assets with which charge is created for the said debentures. Therefore, they are known as naked or unsecured debentures. The holders of these debentures are ordinary creditors or unsecured creditor of the company.

17.3.3 Classification According to permanence

Form the point of view of permanency, company creditors are classified into Redeemable and Irredeemable debenture holders.

i) Irredeemable or Perpetual Debentures: When the principal amount secured on the debenture is not repayable, then such debentures are known as

irredeemable debentures. When no period is fixed for repayment of the principal sum on the debenture or repayment is made conditional on the happening of an event, which is not likely to happen, then such debenture is known as irredeemable debenture. When the principal sum is made payable only at the time of winding up, then such debentures on which the loan is obtained are known as irredeemable debentures. (Section 120).

In a case 75 houses and other properties belonging to a company were mortgaged to secure Rs. 10,000 repayable by instalments over 40 years. No repayment of principle was allowed before 40 years. No repayment of principal was allowed before 40 years. The court held that the mortgage was a debenture and valid under law. [Knightbridge Estates vs Byrne (1940) A.C. 613]

ii) Redeemable Debentures: When the principal amount secured on the debenture is repayable, and then such debentures are known as redeemable debentures.

17.3.4 Classification According to Convertibility

On the basis of convertibility, debentures can be classified as convertible and non convertible debentures.

i) Convertible Debentures: The debenture holders of this type are given the option to convert the same into equity shares at certain rates of exchange after a particular period. Once the holders of debentures convert them into equity shares, they are no longer creditors of the company, but become members of the company.

Convertible debentures may be further classified as Fully convertible debentures (FCD) and partially convertible debentures (PCD). The former could be fully exchanged for shares and in the latter only a portion of it could be exchanged for shares.

ii) Non convertible debentures: In this kind of debentures, option is not given to the holders of debentures to convert the loan covered under the debenture into shares. These debentures have to be paid on the due date of maturity. Sometimes, even non convertible debentures also could be converted as shares according to the direction of the Central government through Company Law Board.

17.3.5 Classification according to Priority

i) First come should be first served is the principle. If any of the creditors had advanced loan to the company against issue of debentures, they shall be paid first on the maturity of the debenture deed. Subsequent creditors who had advanced loan to company on later dates are entitled to get back the loan according to the order of priority. On the basis of priority with regard to repayment of loan, money due on debentures will be divided into (a) debentures without pari passuclause and (b) debenture with pari passu clause.

Meaning of pari passu clause: Pari passu clause means a clause that is found in the debenture deed in respect of repayment of loan advanced by the third part creditors to the company on priority basis. The term pari passu clause signifies discharge of loan to several creditors on equal footing, on prorate basis and particularly on priority basis. That is to say, first receipts of loan to be discharged first in order of the series.

Debenture without pair passu clause: If no mention is made in the debenture deed with regard to repayment of loan on maturity, it is understood that those creditors who had advanced loan earlier would get back their funds prior to the other creditors who had advanced subsequently. This is said to be the ordinary way of redeeming the debentures. Debentures without pari passu clause are to be repaid according to the date on which they have been issued.

Debenture with pari passu clause: A number of creditors would have advanced loan to the company on different months throughout the year. For example, a company may be its Articles, may treat the debenture issued during April, May June as falling in one category. During July, August, September as another category and October, November and December as yet another category. And January, February and March as another category. Those debentures in the first batch will be numbered under A series, the debentures in the second batch under B series, 3rd under C series and 4th under D series. All those creditors who were issued debenture bonds during April, May and June would be treated equally on a par with one another. Repayment of their loans would be made ratably or in proportionate order among them. It is only after the 1st series, the 2nd, 3rd and 4th would be taken for repayment.

17.4 LEGAL PROVISION RELATING TO DEBENTURES

In this section we attempt to make a brief study of the various provisions of the companies act relating to the debentures.

1. Issue of debentures. The debentures are issued in the same manner as shares in a company. Thus, the legal provisions as to the prospectus, application for debentures, allotment, issue of certificate etc. applicable to shares is also applicable to debentures. However, the condition of minimum subscription is not applicable to the issue of debentures.

The debentures are issued in accordance with he provisions of articles of association, and usually by a resolution of the Board of Directors. The debentures may be issued at par, at premium or at a discount. In case of issue at discount, no formalities like those in case of issue of shares at discount are required to be observed. Thus, the debentures can be issued at a discount without any restrictions. The reason for the same is that they do not form part of the capital of the company. It may, however, be noted that the convertible debentures cannot be issued at a discount entitling the holders to exchange them for the shares of par value. Because , it would base an indirect way of

issuing shares at discount. It convertible debentures are to be issued at discount, and then the legal provisions relating to the issue of shares at discount must be complied with. The debentures hall not be taken to have been issued until actually issued to the holders of the debentures.

Note. The interest payable on debentures may be paid out of capital.

2. Debentures not to carry any voting right. The companies cannot issue any debentures carrying voting rights at any meeting of the company (Section 117). This provision is made so that the debenture-holders may not be in a position to influence the policy of the company which may be detrimental to the interest of the general body of share-holders. However, the debentures issued before the commencement of the companies Act (i.e. before April 1956) may continue to have voting rights.

3. Re-issue of redeemed debentures (Section 121). The debentures which have been redeemed (i.e. paid off) by the company may be kept alive for re-issue. The company may re-issue such debentures unless here is no contrary provision in the articles of association, or in the conditions of previous issue, or in any other contract entered into by the company, or the company has not shown any intention to cancel them e.g. by passing a resolution to that effect. Such re-issue may be made either by re-issuing the same debentures, or by issuing other debentures in their place.

It will be interesting to know that one that reissue of the redeemed debentures, the new debenture-holder shall have the same rights re-issued debentures are treated as new debentures for the purpose of stamp duty.

4. Debentures with pari-passu clause. The term 'pari-passu' may be defined as 'to rank together' as regards security. The debentures with pari-passu clause means that all the debentures of the same series are to rank together, without any priority of one over the other, as regards the charge created by them. It is immaterial that these are issued at different and varying times. The effects of such a clause is that the debentures are to be discharged rateably. And in the event of insufficient assets to pay in full al the debenture-holders secured by the charge, the amount is distributed in proportion to the amount owing to each of them. Thus, each of them will lose rateably (i.e. proportionately). It may, however, be noted that a company cannot create a new series to rank pari-passu with the old series, unless the power do so is expressly reserved by the company with itself.

In the absence of pari-passu clause, the debentures will be payable according to the date of issue. And if all of them were issued on the same data and are serially numbered, they will be payable according tot their numerical order.

5. Transfer of debentures. We have already discussed that the debentures may be bearer debentures (payable to the holder), or registered debentures (payable to the person in whose favour these are registered). The bearer debentures are transferable by simple delivery. And any person holding the debentures become entitle to the payment of money on due date. And the registered debentures are

transferable in the same manner in which the shares and stamped transfer document, which should be submitted to the company for registration.

6. Register of debenture-holders (Section 152). Every company issuing the debentures must maintain a register of its debenture-holders. The following particulars should be entered in the register:

(a) The name, address and occupation, if any, of each debenture-holder.

(b) The debentures held by each holder, showing the amount paid or considered as paid on these debentures. And each debenture should be distinguished by its number.

(c) The date at which each person was entered in the register as debenture-holder.

(d) The date at which any person ceased to be debenture-holder.

It may be noted that if the company has more than 50 debenture-holders, it must maintain and index of the names of the debenture-holders.

The register of debenture-holders may be maintained in such a manner which constitutes an index. Or the company may maintain a separate index. The index must contain a sufficient indication t enable the entries relating to each debenture-holder in the register to be readily found. Any alteration in the register should be entered in the index within 14 days of the change.

17.5 COMPARISON BETWEEN A SHARE-HOLDER AND A DEBENTURE-HOLDER

In this section, we attempt to make a brief study of the comparison between a share-holder and a debenture-holder.

S.No.	Share-holder	Debenture-holder
1.	He is the member and joint owner of the company.	He is simply a creditor of the company who has given some loan at time company.
2.	He has a right to vote at the meetings of the company.	He has no right to vote at any meeting of the company.
3.	He is entitled to get dividends only out of profits.	He is entitled to fixed rate of interest whether there are profits or not.
4.	He has full right to control company's affairs. In fact, the ultimate destiny of the company is in the hands of share-holders.	He has no right to interfere with the business of the company. However, in case of company's default in paying their debt, he may enforce their security.

5.	He cannot be paid back so long as the company is a going concern.	He can be paid back unless he is a perpetual debenture-holder.
6.	I case of winding up of the company, he is paid after satisfying all other claims.	In case of winding up, a secured debenture-holder is paid prior to the share-holder.

17.6 LET US SUM UP

In this lesson, we have briefly touched upon the following points; Debenture means a document which either creates a debt or acknowledges “debenture is a document given by a company as evidence of a debt to the holder usually arising out of a loan and most commonly served by charge”. Debenture is a bond which acknowledges the loan advanced by third party creditors to the company. It must have serial number and must be duly signed by the directors and/ or officers as per the regulations contained in the Articles with the Common Seal of the company. Debenture may be classified according to the following characteristics, viz, Transferability, Security, Permanence, Convertibility, and Priority.

17.7 QUESTIONS FOR DISCUSSION

1. What is debenture?
2. What are the different kinds of debentures?
3. What is meant by a debenture payable pari- passu ?

17.8 MODEL ANSWER TO CHECK YOUR PROGRESS

Chcek -1 Nature of debenture: The debentures of a company are a movable property, transferable in the manner provided by the Articles.

17.9 REFERENCES

1. “ Company law” -- A.K. Bagrial
2. “Principles of modern company law” – L.C.B. Gower
3. “Business Law” -- M.R. Sreenivasan

LESSON -18
DIRECTORS

CONTENTS

18.0 Aims and Objectives
18.1 Introduction
18.2 Number of Directors
18.3 Qualification of Director
18.4 Disqualification of Director
18.5 Appointment of Director
18.5.1 First Directors
18.5.2 Appointment in Board Meetings
18.5.3 Appointment by central Government
18.5.4 Appointment by Proportional Representation
18.5.5 Restrictions on appointment of directors
18.6 Removal of Director
18.7 Remuneration of Director
18.8 Power of Director
18.9 Duties of Director
18.10 Disabilities
18.11 Rights
18.12 Liabilities of Director
18.13 Let us sum up
18.14 Questions for discussion
18.15 Model answer to check your progress
18.16 References

18.0 AIMS AND OBJECTIVES

In the 17th lesson, we discussed the meaning, definition and type of debenture. In this lesson we discuss the meaning, Number of Directors, qualification, disqualification of director, appointment, removal, remuneration, power, duties and liabilities of Director of a company. After going through this lesson, you will able to

1. know the meaning of Director
2. understand Qualification and disqualification of Director of a company
3. study the methods of appointment of Director
4. know the power, duties and liabilities of Director of a company

18.1 INTRODUCTION

The company being an artificial person carries on its activities and business through individual called directors. Director includes any person occupying the position of a director by whatever name called. The directors of a company collectively are referred to as “Board of Directors” or “Board”. A director controls the company’s affairs. If a person performs the functions of a director, he will be deemed to be a director, even if he is not so designated.

18.2 NUMBER OF DIRECTORS

In this section, we discuss the number directors required for different type of companies. According to section 252; every public company shall have at least 3 directors. Every other company shall have at least 2 directors. The maximum number of directors is fixed by the articles. The maximum permissible limit of directors is12.Any increase in number beyond 12 directors requires Central Government approval.

18.3 QUALIFICATION OF DIRECTOR

In this section, we discuss the Share Qualification of a Director. Share qualification means the shares to be taken by a director to qualify him as a director of the company. It shall be the duty of every director who is required by the articles of the company to hold a specified share qualification, and who is not already qualified in that respect, to obtain his qualification within 2 months after his appointment as director.

The Act however does not prescribe any share qualification. If the articles of a company do not provide for share qualification, beneficial ownership of share sis not necessary. A company can by provision in its articles exempt itself from the above provision.

The nominal value of the qualification shares shall not exceed Rs.5,000/- or the normal value of one share, where it exceeds Rs.5,000/-. The office of the director shall fall vacant if a director fails to acquire his qualification shares within the prescribed period.

18.4 DISQUALIFICATION OF DIRECTOR

In this section, we discuss the disqualification of Director .A person shall not be capable of being appointed director of a company if

(1) he has been found to be of unsound mind by a Court of competent jurisdiction and the findings are in force;

(2) he is an undercharged insolvent;

(3) he has applied to be adjudicated as an insolvent and his application is pending;

(4) he has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than 6 months period and a period of 5 years has not elapsed from the date of expiry of the sentence;

(5) he has not paid any call in respect of shares of the company held by him, whether alone or jointly with others, and 6 months have elapsed from the last day fixed for the payment of the call; or

an order disqualifying him from appointment as a director has been passed by a Court on account of fraud or misfeasance, and is in force, unless the leave of the Court has been obtained for his appointment

18.5 APPOINTMENT OF DIRECTOR

In this section, we discuss the various methods of appointment of Directors.

18.5.1 First Directors: If directors are not duly appointed, then subject to any regulation in the articles of the company, subscribers of the Memorandum who are individuals shall be deemed to be the first directors of the company. The Memorandum and Articles when filed for registration with the Registrar usually mention the first directors of the company. They hold office until directors are duly apointed in the general meeting.

Appointment in General Meeting: The directors shall be appointed by the company in the general meeting (Sec. 255). It has been held in Ram Kissandas v. Satyacharan (A.I.R. 1950 PC 81) that the articles may, however, be so expressed as to delegate the power of appointing new directors to the Board to the exclusion of the general meeting.

However, where the power of appointment vested in the shareholders, having been usurped by the directors, the appointment by directors shall be void. Where there are no validly appointed directors functioning, the4 shareholders have the right to appoint directors at the annual general meeting.

Right of persons to stand for directorship: A person who is not a retiring director shall be eligible for appointment to the office of a director at any general

meeting, if he or some member intending to propose him, not less than 14 days before the meeting, leaves at the office of the company a notice in writing under his name, certifying his candidature for the office of the director or the intention of such member to propose him as a candidate for that office, as the case may be.

The company shall inform its members of the candidature of a person for the office of a director or the intention of a member to propose such person as a candidate for that office by serving individual notices on the members not less than 7 days before the date of the meeting.

The above provision shall not apply to a private company, unless it is a subsidiary of a public company and also to a Government company in which the entire paid-up capital is held by the central Government or by any State Government or governments or by the Central Government or by the Central Government and any one or more State Governments (Sec 257).

18.5.2 Appointment in Board Meetings:

1. Casual Vacancies: The Board of directors at a meeting of the Board may fill in casual vacancy among the directors. A casual vacancy among the directors, A casual vacancy arises when the office of any director appointed by the company in a general meeting is vacated before his term of office expires in the normal course. Any person so appointed shall hold office only upto the date upto which the director in whose place he is appointed would have held office if it would not have been so vacated (Sec. 262).

2. Additional Directors: The Board of Directors may appoint additional directors to hold office only upto the date of the next annual general meeting of the company. However, the number of the directors and additional directors together shall not exceed the maximum strength fixed for the Board by the articles (Sec. 260)

In Krishna Prasad Pilani V. Colaba Land & Mills co. (1959 Com case 273) it has been held that a director appointed as an additional director vacates his office at the latest on the last day on which the annual general meeting could have been called and cannot continue in office thereafter on the ground that the meeting was not or could not be called within the time prescribed. The expression "upto the date of the annual general meeting" means "upto the date when the next annual general meeting ought to be held at the latest".

3. Alternate Director: The Board of directors of the company may, if so authorised by the articles, or by a resolution passed by the company in a general meeting, appoint an alternate director to act for the original director during his absence for a period of not less than 3 moths from the State in which meetings of the Board are ordinarily held.

An alternate director shall not hold office as such for a period longer than that permissible to the original director in whose place he has been appointed and shall vacate office if and when the original director returns to the State in which meetings of the Board are ordinarily held (Sec. 313).

18.5.3 Appointment by central Government:

The Central Government may appoint such umber of persons as it may by order in writing specify as being necessary to effectively safeguard the interests of the company or its share holders or the public interest to hold office as directors there of for such period not exceeding 3 years on any one occasion as it may think fit to, in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any member of the company or in a manner which is prejudicial to the interests of the company or to public interest.

Directors so appointed shall not be required to hold any qualification shares nor shall their period of office be liable to determination by retirement of directors by rotation. Such a director may be removed by Central government at any time.

The Central Government may require the persons appointed directors or additional directors to report to the Central government from time to time with regard to the affairs of the company (Sec. 408).

18.5.4 Appointment by Proportional Representation :

The articles of a company may provide for the appointment of not less than 2/3rds of the total number of directors of a public company or of a private company which is a subsidiary of a public company, according to the principles of proportional representation, whether by the single transferable vote or by a system of cumulative made one in every 3 years and interim casual vacancies must be filled in by the Board of directors in the Board meetings.

The directors of a company shall be appointed by election, by the members at a general meeting. At a general meeting of a public company or a private company which is a subsidiary of a public company, a motion shall not be made for the appointment of two or more persons as directors of the company by a single resolution, unless a resolution that it shall be so made has first been agreed to by the meeting without any vote being given against it. A resolution moved in contravention shall be void, whether or not objection was taken at the time of it being so moved. (Sec. 262).

Consent of Directorship : Every person proposed as a candidate for the office of the director sign, sign, and file with the company, his consent in writing to act as a director, if appointed.

Consent in writing to act as director need not be filed in the following cases:-

(i) a person other than a director re-appointed after retirement by rotation or immediately on the expiry of office; or

(ii) an additional or alternative director, or a person filling a causal vacancy in the office of a director, appointed ad director or re-appointed as an additional or alternation director, immediately on the expiry of his term of office; or

(iii) a person named as a director of the company under its articles as first director.

(iv) A person who is appointed as a Director of a private limited company.

Except in the above cases, no person shall act as a director of the company unless he has within 30 days of his appointment signed and filed with Registrar his consent in writing to act as a director.

Non-filling of consent with the company is at the most only an irregularity and will not render invalid an appointment made without such consent having been filed.

The above provisions shall not apply to a private company unless it is a subsidiary of a public company (Sec. 209).

Acts done by a person as a director shall be valid, not with-standing that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in the act or in the articles (Sec. 290).

18.5.5 Restrictions on appointment of directors:

Number of Directorships: No person shall hold office at the same time as director in more than 20 companies (Sec. 275).

Where a person already holding the office of director in 20 companies, is appointed, as a director of any other company, the appointment shall not take effect unless such person has within 15 days thereof effectively vacated his office as director in any of the company in which he was already a director. The appointment shall become void immediately on the expiry of 15 days if he has not, before such expiry, effectively vacated his office as director in any of the other company (Sec. 277).

Exclusions: In calculating the number of companies of which a person my be a director, the following companies shall be excluded:

(i) a private company which is neither a subsidiary nor a holding company of a public company;

(ii) an unlimited company;

(iii) an association not carrying on business for profit or which prohibits the payment of a dividend; or

(iv) a company in which such person is only an alternate director (Sec. 278).

18.6 REMOVAL OF DIRECTOR

In this section, we discuss the various methods of removal of Directors.

18.6.1. By Shareholders: (Sec. 284)

A company may by ordinary resolution remove a director before expiry of his period of office by:

(i) Special notice of any resolution to remove a director at a meeting at which he it to be removed;

(ii) On receipt of notice of a resolution to remove a director, the company shall forthwith send a copy there of to the director concerned. The director shall be entitled to be heard on the resolution at the meeting.

Where notice is given of a resolution to remove a director and the director concerned makes representations in writing to the company and requests the notification of representations to members of the company, the company shall :

(i) In any notice of the resolution given to members of the company state the facts of the representations; and

(ii) Send a copy of the representation to every member of the company to whom the notice of the meeting is sent. If a copy of the representations is not sent because they were received too late or because of the company's default the director may require that the representations shall be read out at the meeting.

Copies of the representations need not be sent out and the presentations need not be read out at the meeting if:

(i) on the application either of the company or of any other person who claims to be aggrieved, Court is satisfied that the rights are being sucure needless publicity for defamatory matter; and

(ii) the Court may order the company's costs of the application to be paid in whole or in part by the director.

Exceptions: The following directors however, cannot be removed:

(i) directors appointed by the Central Government;

(ii) in the case of a private company, the director holding office for life as on 1-4-1952;

(iii) when the director has been appointed by the principle of proportional representation.

A vacancy so created by the removal of a director may, if appointed by the company in general meeting or by Board, be filled by appointment of another director in his place by the meeting at which he is removed, provided special notice of the intended appointment has been given.

A director so appointed shall hold the office until the date up to which his predecessor would have held office if he had not been removed as aforesaid. If the vacancy is not so filled, it may be filled as a casual vacancy. However, a director who was removed from office shall not be re-appointed as a director by the Board of Directors.

The person removed from the directorship shall not be deprived of any compensation or damages payable to him in respect of the termination of his appointment as a director (Sec. 284).

18.6. 2. By Central Government: (Secs. 388B—388E)

The Central Government may state a case against any person referring the same to the High Court with a request that the High Court may inquire into the case and record a decision as to whether or not such person is a fir and proper person to hold the office of a director.

Every case shall be state in the form of an application to High Court containing concise statement of such circumstances. The person against whom the case is referred to the High Court shall be joined as a respondent to the application.

The High Court may direct during the pendency of a case that the director shall not discharge any o the duties of his office until further orders and appoint a suitable person in his place to discharge the duties. At the conclusion of the hearing of the care, the High Court shall stall record its decision stating whether or not the respondent is a fit and proper person to hold the office of the director.

The Central Government shall, by order, remove from office any director of a company against whom there is a decision of the High Court. The person who is so removed shall not hold office of a director during a period of 5 years from the date of the order of removal. The director so removed shall not be entitled to, or be paid, any compensation for the loss or termination of office. The company may, with the previous approval of the Central Government, appoint another person to that office.

18.6.3 By Court

On the application by any member of the company in cases of oppression (Sec. 397), or mismanagement (Sec. 398), the Court may terminate, set aside or modify any agreement between the company and a director or managing director (Sec. 402). No director or managing director whose office is so terminated shall for a period of 5 years from the date of the order terminating or setting aside the agreement, without the leave of the Court, be appointed, or act as the managing or other director. Such a director or manager shall not be entitled to any claim for damages or for compensation (Sec. 407).

18.6.4 Retirement of Directors by Rotation (Secs. 255 & 256)

Unless the articles provide for the retirement of all directors at every annual general meeting, not less than 2/3rds of the total number of directors of a public company, or of a private company which is a subsidiary of a public company, shall be persons whose period of office is liable to determination by retirement of directors by rotation [Sec. 255 (1)]. Only 1/3rd can be given permanent appointment.

At the first annual general meeting of a public company or a private company which is a subsidiary of a public company, held next after the date of the general meeting at which the first directors are appointed and at every subsequent

annual general meeting, 1/3rd of such of the directors for the time being as are liable to retire by rotation or if the number is not 3 or a multiple of 3 then, the number nearest to 1/3rd shall retire from office. In other words, at one annual general meeting, only 1/3rd of such directors shall retire by rotation.

The directors to retire y rotation at every annual general meeting shall be those who have been longest in office since last appointment. As between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot. A director who is to retire by rotation at an annual general meeting cannot continue in office after the last day on which the annual general meeting in each year should have been held.

At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto. The retiring director is therefore eligible for re-appointment. If the place of retiring director is not so filled up, the retiring director shall be deemed to have been reappointed at the adjourned meeting unless:

(i) at the meeting a resolution for the reappointment of such director has been put to the meeting and lost;

(ii) the retiring director has by a notice in writing addressed to the company or its Board of Directors, expressed his unwillingness to be so reappointed; or

(iii) he is not qualified or is disqualified from appointment;

(iv) a resolution whether special or ordinary is required for his appointment or reappointment;

(v) where a resolution for the appointment of two or more directors by a single resolution is passed.

The above provisions shall not apply to a private company and also to a Government company in which the entire paid-up capital is held by the Central Government or by any State Government or Governments or by the Central Government and any one or more State Governments.

18.6.5 Removal of Directors

In the absence of any provision either in the Companies Act, 1956 or in the Memorandum of Association or Articles of Association of the Company, regarding resignation by a Director the ordinary rule of common law must be applied and a director who had submitted his resignation would be deemed to have resigned from his office from the date of the submission of his resignation, when his intention is unequivocally expressed either orally or by a letter (S. S. Lakshmana Pillai v. Registrar of Companies and another – 1977-47 Comp. Cas-652).

The disqualification shall not take effect :

(a) for 30 days from the date of adjudication, sentence or order;

(b) where any appeal or petition is preferred within 30 days against the adjudication, sentence or conviction resulting in the sentence or order, until the expiry of 7 days from the date on which such appeal or petition is disposed of, or

(c) where within 7 days aforesaid, any further appellation, sentence, conviction, or order, resulting in the removal of the disqualification, until such further appeal or petition is disposed of.

A private company which is not a subsidiary of a public company may, by its articles provide that the office of director shall be vacated on any grounds in addition to those specified above.

Vacation of Office of Directors: (Sec. 283)

The office of the director shall become vacant if:

1. he fails to obtain within 2 months, or at any time thereafter ceases to hold the share qualification, if any, required of him by the articles of the company;
2. he is found to be of unsound mind by a Court of competent jurisdiction;
3. he applies to be adjudicated insolvent;
4. he is adjudged insolvent;
5. he is convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than 6 months;
6. he fails to pay any call in respect of shares of the company held by him, whether alone or jointly with other, within 6 months from the last date fixed for the payment of the call unless the Central Government has, by notification in the Official Gazette, removed the disqualification incurred by such failure;

1. he absents himself from 3 consecutive meetings of the Board of Directors, of from all meetings of the Board for a continuous period of 3 months, whichever is longer without obtaining leave of absence from the Board;
2. of any firm in which he is a partner or any private company of which he is director, accepts a loan, or any guarantee or security for a loan, from the company without the approval of the Central Government;
3. he fails to make disclosures to the Board in respect of contracts in which he is interested;

4. he becomes disqualified by an order of Court for being convicted of an offence in respect of the promotion, formation or management of a company, or in the course of winding up he is guilty of fraud or misfeasance;
5. he is removed before the expiry of period of his office;
6. having been appointed a director by virtue of his holding any office or other employment in the company, he ceases to hold such office or other employment in the company;
7. he resigns from his office (resignation tendered cannot be withdrawn without the Company's or Board's consent).

Check your progress - 1

What do you mean by Alternate director?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

18.7 REMUNERATION OF DIRECTOR

In this section, we discuss the various methods of remuneration of Directors The remuneration payable to the directors of a company, including any managing of whole-time director, shall be determined in accordance with provisions of sections 198 and 309 either by the articles of the company, or by resolution, or it the articles so require by a special resolution passed by the company in general meeting.

Overall maximum remuneration : (Sec. 198) The total managerial remuneration payable by a public company, or a private company which is a subsidiary of a public company to its directors and its manager in respect of any financial year shall not exceed 11% of the net profits of that company for that financial year. The remuneration of the directors shall not be deducted from the gross profits.

The percentage aforesaid shall be exclusive of any fees payable to directors by way of fee for each meeting of the Board; or a committee thereof, attended by him.

Limits in case of Managing or whole-time Director : If in any financial year, a company has no profits or its profits are inadequate, the company may, subject to the approval of the Central Government, pay to its directors (including any managing or whole-time director) or manager, or if there are two or more of them holding office in the company, to all of them together by way of minimum remuneration, such sum not exceeding Rs. 50000/- per annum.

However, where a monthly payment is being made to any managing or whole-time director or the manager, or to any one or more of them and the Central Government is satisfied that for the efficient conduct of the business of the company minimum remuneration of Rs. 50000/- per annum, is insufficient, the Central Government may be order sanction any increase in the minimum remuneration to such sum for such period and subject to such conditions, if any, as may be specified in the order.

2. The remuneration payable to any such director shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity.

Any remuneration for services rendered by any such director in any other capacity shall not be so included if :

(a) the services rendered are of a professional nature;

(b) in the opinion of the Central Government, the director possesses the requisite qualifications for the practice of the profession [Sec. 309 (1)].

A director may receive remuneration as a director and he may also get it in a capacity other than that of a director (Ramaben A. Thanawala v. Jyoti Ltd – AIR 1958 Bom. 214).

3. A director who is either in the whole-time employment of the company or a managing director may be paid remuneration either by way of monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

Except with the approval of the Central Government, such remuneration shall not exceed 5% of the net profits for one such director and if there is more than one such director, 10% for all of them together [Sec. 309 (3)].

Limits in case of other directors : Remuneration to a director who is neither a managing director nor a whole-time director, may be paid by way of monthly, quarterly or annual payment with the approval of the Central Government or by way of commission if the company by special resolution authorises such payment. The special resolution shall remain in force for 5 years at a time. However, the remuneration paid to such director or where there are more than one such director, to all of them together, shall not exceed :

(i) 1% of the net profits of the company, if the company has a managing or whole-time director or a manager;

(ii) 3% of the net profits of the company, in any other case.

The company in general meeting may, with the approval of the central government, authorise the payment of such remuneration at a rate exceeding 1%, or as the case may be, 3% of its net profits.

Summary of the provisions regarding remuneration of directors:

1. Remuneration of the directors shall be determined subject to the provisions of sections 198 and 309, either by the articles or by resolutions passed in general meeting of the members of the company.
2. If a director gives professional services, he may be paid for it by the company provided the Central Government is satisfied that the director has the requisite qualifications for the profession.
3. Overall remuneration of directors must not exceed 11% of the not profits or Rs.50,000/- per annum, whichever is more.
4. A managing or whole-time director may receive remuneration by monthly payment or at specified percentage of the net profits of the company or partly by one way or partly by the other.
5. A whole-time director or managing director's remuneration shall not exceed 5% of the net profits for one such director except with the approval of the Central Government.
6. Remuneration of a director not being a managing or whole-time director may be paid by way of monthly, quarterly or annual payment with the approval of the Central Government, or by way of commission if authorized by special resolution.
7. A director not being a whole-time or managing director may be paid remuneration not exceeding 1% of the net profits in case the company has a managing or whole-time director. The directors may be paid remuneration – 3% of the net profits in any other case and not in excess of it in any case, unless approved by the company in general meeting and by the Central Government.
8. Excess drawn to be refunded to the company.
9. Remuneration of directors may be paid out of the capital if there are no profits.
10. Ay increase in the remuneration requires Central Government approval.
11. The net profits of the company for a financial year shall be computed in the manner laid down in sections 349, 350 and 351. Remuneration of the directors shall not be deducted from the gross profits.
12. The above rules do not apply to a private company.
13. Directors may be paid over and above the limits of remuneration, feeds upto Rs.250/- for attending Board Meetings. Any increase in fees above Rs.250/- requires approval of Central Government.

18.8 POWER OF DIRECTOR

In this section, we discuss the various powers of Directors. The Board of directors derives their powers from

(i) The companies Act;

(ii) Articles of Association;

(iii) Board resolutions;

(iv) Resolutions in general meeting;

(v) Agreements or contracts with the company.

Subject to the provisions of this act, the Board of Director of a company shall be entitled to exercise all such powers and do all such acts and things, as the company is authorized to exercise and do. The Board shall not exercise any power of thing with is required to be done by the company in a general meeting.

The Board of Directors shall exercise the following powers on behalf of the company by means of resolutions passed at the meetings of the Board:

(i) the power to make calls on shareholders in respect of money unpaid on their shares;

(ii) the power to issue debentures;

(iii) the power to borrow moneys otherwise than on debentures;

(iv) the power to invest the finds of the company; and

(v) the power to make loans

The Directors have power to change the method of accounting adopted by the Company.

Restrictions on powers of Board: The Board of Directors of a public company; or a private company which is a subsidiary of a public company, shall not exercise the following powers except with the consent of the company in a general meeting :

1. Sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company;
2. Remit, or give time for the repayment of any debt due by a director;
3. Invest otherwise than in trust, securities the amount of compensation received by the company in respect of the compulsory acquisition of any undertaking or any premises or property;
4. Borrow moneys, where the moneys to be borrowed together with the moneys already borrowed by the company (apart from temporary loans obtained form the company's bankers in the ordinary course of business) will exceed the aggregate of the paid-up capital of the company and its free reserves;

5. Contribute to charitable and other funds not directly relating to the business of the company or the welfare of its employees any amounts the aggregate of which will, in any financial year exceed Rs. 50000 or 5% of its average net profits, during the three financial years immediately preceding, whichever is greater.

Directors are agents not of a majority of the shareholders but of a company, of the whole entity made up of all the shareholders. If the whole entity of shareholders has entrusted the directors with a particular power, a simple majority could not interfere in the exercise of it. The members are not allowed to interfere in the directors discretion, Similarly, the directors are not allowed to exercise a poser expressly vested in the shareholders. However, where the directors act mala fide, or where the Board becomes incompetent to act, the majority of shareholders in a general meeting is competent to act and redress the wrong, even in a matter delegated to the Board.

The Board of Directors shall not contribute to any political party or for any political purpose to any individual or body. The Board of directors may contribute such amount as it thinks fit to the National Defence. Fund or any other Fund approved by the Central Government for the purpose of national fund.

Check your progress - 2

What is the position of the Director?

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

18.9 DUTIES OF DIRECTOR

In this section, we discuss the various duties of Directors

1. Act honestly.
2. Employ reasonable degree of skill and diligence in the interest of the company.

The diligent director is one who exhibits in the performance of his duties the same degree of care and prudence that men prompted by self-interest generally exercise in their own affairs.

3. Must not make secret profits.
4. Attend board meetings.
5. Send his consent of his appointment as a director to the Registrar where applicable.
6. Obtain qualification shares where applicable.
7. Pay call amount.
8. Disclose his interest in the contracts etc. Interest must conflict with the director's duties' towards the company, Interest which is personal must be disclosed.
9. Disclose his name, occupation, nationality, etc.
10. Not to delegate his functions except to the extent authorised by the act or the articles of the company.

It should be noted that the duties of a director very according tot eh nature and size of the company and have t be ascertained on the facts of each case.

18.10 DISABILITIES

The term "disability" means the restrictions on directors' powers to do certain act. To protect the interest of the company and the shareholder, the company Act imposes certain restrictions on directors. In this section, we discuss the various disabilities of Directors

1. He cannot assign his office or delegate his functions.
2. He cannot take any loan from the company except with prior approval of the Central Government.
3. He cannot hold any place of profit in the company without consent of the company by a special resolution.

18.11 RIGHTS

In this section, we discuss the various rights of Directors

1. To attend meetings of the company.
2. To participate in the management of the company's affairs.
3. To received remuneration if any fixed.

18.12 LIABILITIES OF DIRECTOR

In this section, we discuss the various liabilities of Directors. They may be held liable to pay compensation for damages suffered by the company in case of breach of their duties or negligence in performing their duties. The directors will also be liable to the company where they commit breach of trust regarding profits and funds of the company.

The directors are also liable to pay compensation to third parties in following cases:

7. For untrue statements in the prospectus;
8. For contracts entered into on behalf of the company where the directory act in their own name:
9. For ultra vires acts;
10. For irregular allotment of shares:
11. where the directors act unlaw fully:

Where directors fail to perform statutory obligation laid down in the act like failure to maintain accounts, filling returns, etc., they render themselves liable to penalties and prosecutions. They may also be held criminally liable with fine and imprisonment for untrue statements in the prospectus, failure to keep registers, finalization of books of accounts; filling of returns, etc.

If should be noted that a company is necessary party to the proceedings. Directors can be convicted only if company is convicted. Complaint against Direction alone is not cognizable. Complaint is bad if it does not state who the officers were in default. (Ajit Kumar Sarkar v, Asstt. Registrar of companies 1979-99 comp. Cas-909).

Section 201 of the act lays down that any provision exempting any officer of the company or indemnifying his agent against liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty shall be void. The director the refore cannot 'contract out' of his liability. However Section 633 of the act provides relief to the directors. If it appears to the court that any officer of a company who may be liable in respect of the negligence, default, misfeasance, breach of duty, or breach of trust, but that he has acted honestly and reasonably and that he ought fairly to be excused, the Court may relieve him, cither wholly or partly from his liability. But in a criminal proceeding, the court shall have no power to grant relief from any civil liability.

Directors with unlimited liability: The Memorandum of the company may provide for unlimited liability of any director or directors or any member in a limited company (Sec. 322). If memorandum does not so provide, then the limited company may, if so authorised, by special resolution alter its memorandum so as to render the liability unlimited of any its directors or manager.

No alteration of the memorandum making the liability unlimited shall apply, if such director or manager was holding the office before the date of alteration, until the expiry of his term, unless he accorded his consent to his liability becoming unlimited (Sec. 323).

18.13 LET US SUM UP

In this lesson, we have briefly touched upon the following points; The company carries on its business through individuals called Directors. Collectively they are called Board of Directors. Every public company shall have at least three Directors. Every other company shall have at least two Directors. The maximum number shall be twelve. Any increase beyond twelve requires the Central Government approval. Subscribers to the Memorandum of the Company shall be deemed to be the first Directors of the Company.

Appointment of Directors**:** The Directors shall be appointed by election by the members in the General Meeting. A person who is a retiring Director shall be eligible for reappointment to the office of a Director at any General Meeting.

Share qualification of a Director: Share qualification means the shares to be taken by a Director to qualify him as a Director of the company. The Director shall obtain hi qualification shares within two months after his appointment as a director. He shall vacate the office if he fails to acquire the qualification shares within the prescribed time.

Disqualification of Directors**:** A person shall not be capable of being appointed as a Director if he possesses any of the disqualification enumerated in section 274 of the Act.

Remuneration of Directors**:** The overall maximum remuneration shall not exceed 11% of the net profits or Rs.50,000 per annum, whichever is more. The Whole-time Director or Managing Director's remuneration shall not exceed 5% of the net profits. The Director who is not a whole-time Director or Managing Director may be paid remuneration not exceeding 1% of the net profits, where the Company has a Managing or a Whole-time Director. In other cases, the Directors may be paid remuneration not exceeding 3% of the net profits. The remuneration shall be paid out of the capital when there are no profits. The Directors may be paid sitting fees of attending Board Meeting upto Rs.250/-.

Powers of Directors**:** The Board of Directors derive their powers from the Companies Act, Articles, Board Resolution, Resolutions in General Meetings and Agreements, or contracts with the company. The Board shall exercise the power of making calls on he shareholders, power of issuing debentures, power to borrow moneys, power to invest the funds of the Company and power to make loans, by means of Resolutions passed at the meetings of the Board. However, certain powers of the Board of Directors cannot be exercised except with the consent of the company in a general meeting. The Directors also enjoy certain rights and have certain duties to be performed to the Company. They may be

held liable to pay compensation for damage suffered by the company in case of breach of their duties. They suffered also from certain disabilities. The Memorandum of the Company may provide for unlimited liability of any Director in a limited company.

18.14 QUESTIONS FOR DISCUSSION

1. Discuss briefly the provision of the companies Act in regard to the appointment of and removal of directors.
2. Explain the categories of person who are disqualified from being appointed as direction of a company.
3. What are the powers, rights, duties, liabilities and disabilities of directors?

18.15 MODEL ANSWER TO CHECK YOUR PROGRESS

Check-1 **what do you mean by Alternate director?**

An alternate director is appointed to act in place of a director who is absent for a period of more than three months from the state in which the board meetings are ordinarily held.

Check-2 **what is the position of the Director?**

1. Directors as agent.
2. Directors as trustees.
3. Directors as managing partners

18.16 REFERENCES

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LESSON-9

COMPANY SECRETARY

CONTENTS

19.0 Aims and Objectives

19.1 Introduction

19.2 Qualification of Secretary

19.3 Qualification of Secretary

19.4 Appointment of Secretary

19.5 Removal of Secretary

19.6 Duties of Secretary

19.7 Liabilities of Secretary

19.8 Let us sum up

19.9 Questions for discussion

19.10 Model answer to check your progress

19.11 References

19.0 MS AND OBJECTIVES

In the 18th lesson, we discussed the meaning, Number of Directors, qualification, disqualification of director, appointment, removal, remuneration, power, duties and liabilities of Director of a company .In this lesson we discuss the meaning, qualification, disqualification of Secretary, appointment, removal, remuneration, power, duties and liabilities of Secretary of a company. After going through this lesson, you will able to

1. know the meaning of Secretary
2. understand Qualification and disqualification of Secretary of a company
3. study the methods of appointment of Secretary
4. know the power, duties and liabilities of Secretary of a company

19.1 INTRODUCTION

The secretary is an important officer of the company who is appointed to perform the ministerial or administrative duties. In modern times, the secretary has become almost an indispensable person in trade, industry and other social institutions. The secretary helps in conducting all correspondence, keeping all records and accounts, writing of minutes, and also acts as public relations officer of the employer i.e. acts as a liaison officer between the management and the staff as well as the outsiders. The secretary is entrusted with the responsibility for due compliance with all such legal formalities. As a matter of fact, the secretary ensures that the affairs of the organization are conducted in accordance with law.

19.1.1 Definition

The term secretary is defined in Section 2 (45) of the Companies Act, 1956 which reads as under:

"Secretary means a company secretary within the meaning of clause (c) sub-section (1) of Section 2 of the Company Secretaries Act, 1980, and includes any other individual possessing the prescribed qualification and appointed to per form the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties".

Clause (c) of sub-section (1) of Section 2 of the Companies Secretaries Act, 1980, referred to in the above section, reads as under:

"A company secretary is a person who is a member of the Institute of Company Secretaries of India".

Thus, it is evident from the above two provisions that a company secretary is a person who is a member of the Institute of Company Secretaries of India, and includes any individual who is appointed to perform ministerial or administrative duties and to ensure that the affairs of the company are conducted in accordance with the provision of the Companies Act, and articles of association of the company. It may, however, he noted that a secretary duty is not to mange the affairs of the company but to ensure that company's affairs are conducted in accordance with law. Thought, it is not secretary's duty to manage the affairs of the company, but he plays an important role in the day to day business of the company. Now-a-days, he has become an important executive officer of the company. He regularly makes representations on behalf of the Company and enters into contracts on its behalf which come within the day-to-day running of company's business.

19.2 QUALIFICATION OF SECRETARY

In this section, we discuss the qualification of a secretary .The qualifications of a secretary are prescribed in the companies (Appointment and Qualifications of Secretary) Rules, 1988 . These qualifications are different for those companies

having the paid up share capital of Rs.25lacs or more (i.e. not less than Rs.25lacs), and for all other companies, and are discussed separately hereunder:

1. In the case of a company having a paid up share capital of not less than rupees twenty five lacks. In the case of such a company, a person to be appointed as a secretary must have the following qualification:

Membership of the Institute of Company Secretaries of India (ICSI).

2.In the case of ay other company. I the case of any other company i.e. other than that mentioned above, a person to be appointed as secretary must have one or more of the following qualifications:

(a) Member of the Institute of Company Secretaries of India.

(b) Membership of the Institute of Chartered Accountants of India.

(c) Membership of the Institute of Cost and Works Accountants of India.

(d) Membership of the Association of Secretaries and Mangers, Calcutta.

(e) Degree in law granted by any University.

(f) Post-graduate degree in commerce or corporate secretary-ship granted by any University.

(g) Post-graduate degree of diploma in management sciences granted by any University or by the Institute of Management, Ahemdabad, Bangalore, Calcutta or Lucknow.

(h) Diploma in corporate laws and management granted by the Indian Law Institute.

(i) Post-diploma in company secretary ship granted by the Indian Law Institute of Commercial Practice, Delhi.

(j) Pass in the intermediate examination conducted by the Institute of Company secretary of India.

It may, however, be noted that when the paid up share capital of such company is increased to rupees twenty-five lacks or more, it must appoint a whole-time secretary with the prescribed qualification (i.e. who is a member of the Institute of Company Secretaries of India) within one year from the data of such increase in the paid up share capital.

19.3 DISQUALIFICATION OF SECRETARY

In this section, we discuss the disqualification of secretary. Only an individual can be appointed as a secretary. A firm or a body corporate cannot be appointed as the secretary of the company

19.4 APPOINTMENT OF SECRETARY

In this section, we discuss the methods of appointment of secretary. Normally, the secretary is appointed by a resolution of the Board of Directors, and a service agreement is executed between the company and the secretary in which the terms and conditions of his appointment, remuneration, retirement etc. are stated. The first secretary, if any, like the first directors, may be nominated in company's articles of association whose appointment may subsequently be confirmed by a resolution of the directors passed in their first meeting after hiss appointment. It may, however, be noted that a mere nomination in the articles of association does not give a person the right to be appointed as the secretary, unless an independent contract is proved between the company and the secretary so named in the articles. As a matter of fact, a mere nomination in the articles does not constitute a contract binding on the company to employ the person so nominated. The person so nominated should ensure that his appointment is confirmed at the first meeting of the Board of Directors after the incorporation of the company. Otherwise, he will have no right against the company.

The particulars about the appointment of a secretary by the company must be sent to the Registrar of Companies within 30 days of appointment [Section 303].

19.5 REMOVAL OF SECRETARY

In this section, we discuss the methods of Dismissal of a secretary. We have already discussed in the last article that a secretary is generally appointed by a resolution of the Board of Directors. Likewise, a secretary may be dismissed (i.e. remove from office) by a resolution of the Board of Directors. Since, the secretary is an employee of the company, his dismissal is governed by the general law applicable to master and servant. Thus, a notice of termination of secretary's employment must be given to him. In case, secretary's contract of employment provides for the notice of termination then his services can be terminated by giving him the agreed notice. And if there is no express provision about such notice in his contract of employment, then he is entitled to a respectable notice. It will be interesting to know that in certain circumstances, a secretary may also be dismissed from service without giving any notice of termination e.g., where he is guilty of willful disobedience, misconduct or is incompetent or suffers from permanent disability. The services of a secretary may also be terminated without giving any notice if he makes secret profits.

It may be noted that even if the appointment of the secretary is for a fixed period. He can be removed from office before the expiry of his term after giving proper notice in this regard.

Check your progress - 1

Explain the Status of Secretary

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

19.6 DUTIES OF SECRETARY

In this section, we discuss the various duties of a secretary. We know that a secretary is an important officer of the company. However, he is only a subordinate officer, and has no managerial functions. He being appointed by the Board has no original authority. He is required to perform the duties assigned to him under the Companies Act, and by the Board of Directors. The duties of a secretary may be discussed under the following two heads, namely:

1. Statutory duties, and
2. General duties.

1.Statutory duties

These are the duties which a secretary is required to perform under the Companies Act. Following are some of the important statutory duties of a secretary:

1. To keep and maintain various registers (i.e. statutory books) of the company, such as

(a) Register of investments held by the company in the name of its nominees [Section 49 (7)].

(b) Register of charges [Section 143].

(c) Register of members [Section 150].

(d) Register of debenture-holders [Section 152].

(e) Register of contracts in which directors are interested [Section 301].

(f) Register of Directors, managing director, manager, and secretary [Section 303].

(g) Register of shares held by directors [Section 307].

t is also secretary's duty to make available for inspection the aforesaid registers.

2. o file with the Registrar of Companies, necessary documents and returns, such as

(a) Return of allotment of shares [Section 75].

(b) Annual return [Section 159, 160].

(c) Special resolutions and agreements [Section 192].

(d) Annual accounts i.e. Balance sheet, and Profit & Loss Account [Section 220].

3. To give notice to the Registrar for increase of share capital [Section 97].

4. To issue the certificates of shares, debentures and debenture stock [Section 113].

5. To make necessary entries in the Register of members re-cording the fact of issue of share warrant [Section 115].

6. To deliver for registration, to the Registrar, the particulars of mortgages and changes [Section 125-127, 142].

7. To make statutory declaration for obtaining the certificate of commencement of business [Section 149].

8. To keep minutes of the general meetings and make them available for inspection [Section 196].

9. To sing the annual accounts of the company and send out their copies to every member [Sections 215, 219].

10. To issue the necessary notice for calling the meetings of the shareholders, and of the directors on the instructions of the Board of Directors [Sections 171, 286].

11. To arrange for issue of capital, to send letters of allotment, to issue call notices, to certify valid transfer of shares, and to prepare dividend warrants etc.

12. To assist in preparing the statement of affairs, in the case of company's winding up, for the purpose of submitting it to the liquidator [Section 454].

2.General duties

These are the duties which a secretary is required to perform independent of his statutory duties. The general duties of secretary vary with the size and nature of the company, and the terms of his contract of employment. These may be summed up as under:

1. To carry out the orders of the Board of Directors, and to perform such other duties as may be entrusted to him by the Board from time to time.
2. To perform all statutory requirements on behalf of directors, managing directors etc.
3. To advise the chairman to convene general meetings and to make necessary arrangements in this behalf.
4. To attend all meetings of the Board of Directors and of the shareholders, and record the proceedings of all such meetings, and to carry out the instructions given at these meetings.
5. To superwise all issues of shares and debentures, and to perform all necessary things in this respect e.g., issuing prospectus, inviting applications, arranging for allotment, and issuing share certificates and debentures.
6. To conduct correspondence with the shareholders in respect of calls on shares, transfers of shares, forfeiture etc. of shares, and also to conduct correspondence with the debenture-holders and the public.
7. To act as link i.e. a medium of communication between the shareholders and the company, and to furnish the information required by the shareholders after taking permission of the directors.
8. To organize and control the staff of the company, and to supervise their work.
9. To look after the internal or office management of the company, and to perform all ministerial acts.
10. Not to make any secret profits on account of his position as a secretary. Moreover, he should also not disclose the confidential information relating to the affairs of the company.

19.7 LIABILITIES OF SECRETARY

In this section, we discuss the various liabilities of a secretary **.**We know that it is the duty of a secretary to se that company's affairs are conducted in accordance with the provisions of the Companies Act, and articles of association. If default is made in complying with certain provision of the Companies Act, the secretary may be held liable for fine and punishment. The reason for the same is that Companies Act impose criminal liability on the 'officers in default' for

certain provisions. A secretary being an officer of the company [Section 2 (30)], he is also liable in all such cases. The liability of the 'Officer in default' has already been discussed in detail in Art. 12.20 under the heading 'criminal liability of directors'. Some of the important provisions are stated below, ad the secretary may be held liable in these cases:

1. If default is made in filing the return of allotment of shares with the Registrar, every officer in default shall be punishable with fine upto Rs.500 for every day during which the default continues [Section 75].
2. It default is made in delivering the certificates of share or debenture, every officer in default shall be punishable with fine upto Rs.500 for every day during which the default continues [Section 113].
3. It default is made in marinating the register of members, the company and its every officer in default shall be punishable with fine upto Rs.50 for every day during which the default continues [Section 150]. In case the default is in respect of register of debenture-holder, the total fine is Rs.50 [Section 152].
4. It default is made in maintaining the register of directors, managing director, the company and its every officer in default shall be punishable with fine upto Rs.50 for every day during which the default continues [Section 303]. In case the default is in respect of register of shares held by directors, the total fine is Rs.5,000 [Section 307].
5. If default is made in exhibiting the name and address of the registered office of the company, the company and its every officer in default shall be punishable with the upto Rs.50 for every day during which the default continues [Section 147] the Registrar of Company, every officer in default shall be punishable with fine upto Rs.500 for every day during which the default continues [Sections 125, 142].
6. If default is made in filling the annual return with the Registrar of Companies, every officer in default shall be punishable with fine upto Rs.50 for every day during which the default continues [Sections 159, 162]. The default in filling the copies of annual accounts (i.e. balance sheet, & profit and loss account) is also punishable with the same fine as stated above [Section 220].
7. If default is made in holding the statutory meeting, every officer in default shall be punishable with fine upto Rs.500 [Section 165]. The default in holding the annual general meeting is also punishable with fine upto Rs.5,000, and if the default continues, a further fine may extend to Rs.250 for ever day during which the default continues [Section 168].
8. If default is made in circulating members' resolution, every officer in default shall be punishable with fine upto Rs.5,000 [Section 188].
9. If default is made in registering the resolutions and agreements requiring registration under the Act, the company and ever officer in default shall be punishable with fine upto Rs.20 for every day during which the default continues [Section 192].

10. If default is made in recording the minutes of the meetings of the shareholders and of the Board, the company and every officer in default shall be punishable with fine upto Rs.50 [Section 193].
11. If default is made in giving the due notice of the Board meetings, every officer in default shall be punishable with fine upto Rs.100 [Section 286].
12. If with the intention of defrauding or deceiving any person, the secretary destroys, mutilates, alters or falsifies any books, papers etc., he shall be punishable with imprisonment upto seven years and shall also be liable to fine. A secretary shall be liable to the same punishment if he makes any false or fraudulent entry in any register, books of accounts or document belonging to the company [Section 539].
13. If the secretary makes a false statement in any return, report, certificate, balance-sheet, prospects etc., be shall be punishable with imprisonment upto two years, and shall also be liable to fine [Section 628].
14. If the secretary intentionally gives the false evidence, he shall be punishable with imprisonment upto seven years, and shall also be liable to fine [Section 629].

19.8 LET US SUM UP

In this lesson, we have briefly touched upon the following points; The secretary is a person who is appointed under the Act to perform the duties as a secretary and carry out other ministerial or administrative duties. .The company having the paid up share capital of such amount as may be prescribed by the Central Government, must have a whole time secretary. If such company fails to comply in default shall be punishable with fine. However, two or more small companies having paid up share capital less than the amount prescribed by the Central Government may employ a common part time secretary. A company may have more than one secretary. A director can also be appointed as a secretary of the company besides being a director. Only an individual can be appointed as a secretary. A firm or a body corporate cannot be appointed as the secretary of the company

19.9 QUESTIONS FOR DISCUSSION

1. Define “Secretary”
2. Which company should have a secretary?
3. What are the qualifications prescribed for a secretary?
4. What are the duties of secretary of a company?
5. What are the liabilities of secretary?

19.10 MODEL ANSWER TO CHECK YOUR PROGRESS

Check-1 **Explain the Status of Secretary**

1. Secretary is a mere servant
2. Secretary as a statutory officer
3. Secretary as a co-ordinator
4. Secretary as an administrative officer

19.11 REFERENCES

1. " Company law" -- A.K. Bagrial
2. "Principles of modern company law" – L.C.B. Gower
3. "Business Law" -- M.R. Sreenivasan

LESSON-20
MEETING

CONTENTS

20.0 Aims and Objectives
20.1 Introduction
20.2 Requisition of Valid Meeting
20.2.1. Proper authority
20.2. 2. Proper notice
20.2.3. Contents of notice
20.2.4. Quorum for meeting
20.2.5. Chairman of the meeting
20.3 Types of Meeting
20.3.1. Meeting of Members (shareholders
20.3.1 (i). Statutory Meeting
20.3.1. (ii) Annual General Meeting
20.3.1. (iii). Extra-ordinary General Meeting
20.3.1. (iv) Class meeting
20.3.2 . Other Meetings
20.3.2. (i). Meetings of directors
20.3.2. (ii). Meetings of creditors
20.3.2. (iii). Meetings of debenture-holders
20.3.3 One-member Meeting
20.4 Let us sum up
20.5 Questions for discussion
20.6 Model answer to check your progress
20.7 References

20.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning, qualification, and disqualification of Secretary, appointment, removal, remuneration, power, duties and liabilities of Secretary of a company. In this lesson we discuss the meaning of meeting, Requisites of Valid Meeting and types of meeting. After going through this lesson, you will able to

1. know the meaning of meeting
2. Understand requisites of Valid Meeting
3. study the various types meeting

20.1 INTRODUCTION

We know that the business of the company is carried on by the selected representatives of the members, called the directors. The directors take decision by calling their meetings. There are also certain matters which are to be decided by the whole body of shareholder of the company. The share holders also decide the matters by calling their meetings from time to time. The matters are decided by passing resolutions.

20.2 REQUISITION OF VALID MEETING

In this section, we attempt to make a brief study of the essentials and Legal Rules for a Valid Meeting

The company meetings are called to take decisions on the matters discussed in the meeting. And such decisions are binding on the persons in respect of whom the matters are decided. However, the decisions will have binding effects only if the meeting is valid and is conducted in accordance with the procedure. The following are the essentials and legal rules (i.e. procedure) for a valid meeting:

20.2.1. Proper authority. It is an important requirement of a valid meeting that it should be called by a proper authority. The proper authority to call a general meeting of the members in the Board of Directors. The Board of Directors should pass a resolution at Board meeting to call the general meeting. If meeting of Board of Directors is itself unlawful (e.g., some lawfully constituted directors are prevented from attending the Board meeting), then the decision taken at such meeting to call the general meeting of the shareholders shall also be invalid [Harben V. Phillips (1883) 23 Ch. D. 14].

But if the meeting of the Board of Directors is only irregular i.e. not properly constituted (e.g., there is some defect in the appointment or qualifications of the directors), then the general meeting of members called by a resolution at such Board meeting may not be invalid [Brown V. La Trinidad (1887) 37 Ch. D. 1]

20.2. 2. Proper notice. It is another important requirement of a valid meeting that a proper notice to call the meeting should be given to every member of the company. It may be noted that deliberate omission to give notice to a single member may invalidate the meeting. However, an accidental omission to give notice to, or non-receipt of it by, a member will not invalidate the meeting [Section 172 (3)]. The notice should be in writing, and it should be given 21 days before the date of the meeting (Section 171). In computing the period of 21 days, the date of receipt of notice and the date of the meeting should be excluded. Thus, the gap should be of 21 clear and whole days [Pioneer Motors (P) Ltd. V. Municipal Council, Nagarcoil, AIR 1967 SC 684].

The period of 21 days is computed from the date of receipt of notice by the members. It will be interesting to know that the notice is deemed (i.e. considered) to have been received by the members at the expiration of 48 hours after the letter containing the notice is posted [Section 53 (2) (b) (i)].

Similarly, a notice posted on 16th October, for a meeting to be held on 7th November was held to be invalid. Here also the gap was only of 20 clear days (i.e. from 18th October to 6th November).

It will be interesting to know that in the following circum-stances, a meeting can also be called by giving a shorter notice (i.e. notice of less than 21 days). These circumstances have been recognized by the Companies Act itself [Section 171 (2)]:

(a) In the case of annual general meeting, if all the members entitled to vote agree for a shorter notice.

(b) In the case of any other meeting, if the members who hold 95% of the paid yup share capital and are entitled to vote, agree for a shorter notice. If the company has no share capital, the members who hold the 95% of the total voting power agree for a shorter notice.

It may also be noted that the members may give their consent for a shorter notice either before the meeting, at the meeting or after the meeting [re Self Help Private Industries Estate Ltd. (1972) 42 Company Cases 605, (1975) 45 Company Cases 157].

20.2.3. Contents of notice. The notice of meeting must specify the following particulars:

(a) The place, day and hour of the meeting.

(b) The nature of the business to be transacted at the meeting [Section 172 (1)]. The business to be transacted at the meeting may be of the following two kinds (Section 173) :

(i) Special business, and (ii) General business.

The notices of special business must state the purpose giving full disclosure of all facts for which the meeting is called. It is necessary to enable the shareholders to understand the nature of the business so that they may make

up their mind whether to attend the meeting or not. The purpose of meeting may be made known to the members by annexing a explanatory statement to the notice. If the notice does no given full disclosure of the purpose of the meeting, it is bad in law i.e. invalid. And the meeting held in pursuance of such notice is also invalid.

Thus, if the notice does not specify the nature of the business to be special and does not give full disclosure in this regard, it is bad in law.

20.2.4. Quorum for meeting. The term 'quorum' may be defined as the minimum number of members that must be present at the valid meeting so that the business can be validly transacted at the meeting. If the quorum is not present, the meeting shall not be valid and the proceedings of such meeting shall be invalid. Generally, the quorum is fixed by the articles of association of the company. However, Section 174 of the companies Act provides for the minimum number of members to constitute the quorum.

(a) In case of public company, 5 members personally present at the meeting.

(b) In case of any other company, 2 members personally persent at the meeting.

Thus, the articles of association cannot provide for a smaller quorum than the above though it may provide for a larger quorum. It may be noticed that for the purpose of quorum, only the members present personally are counted, and no 'proxy' shall be counted. Even the company cannot, by its articles of association, provide for the 'proxy' being counted for the purpose of quorum.

The following points are important in connection with the quorum of a meeting:

(a) The quorum required is the quorum to be present at the time of beginning to consider the business, and it need not be present throughout or at the time of taking vote on any resolution [Re Hartley Baird Ltd. (1955) 1 Ch. 143; (1954) All England Reporter 695

(b) Any resolution passed without a quorum is invalid.

(c) In case, the total number of members of a company becomes reduced below the quorum fixed for a meeting, then the rules as to quorum will be satisfied if all the members of the company are present e.g., where the number of members of a company is 400 and the quorum fixed by the articles is 75 members. Subsequently 350 members have sold their shares to the remaining 50 members. In this case, all the 50 members present personally will constitute a valid quorum even if the quorum fixed by the articles is 75 members.

(d) In case, the meeting is called on the requisition of members, it shall stand dissolved if the quorum is not present within half an hour from the time for holding the meeting of the company. But in other cases (i.e. where it is not called on the requisition of members), the meeting shall stand adjourned to re-assemble in the next week on the same day at the same time and place, or to such other day, time and place as the Board of Directors may determine. And if at the re-assembled meeting also the quorum is not present within half an hour from the time of holding the meeting, as many members as are actually present shall constitute quorum. However, the articles of the company may provide otherwise.

20.2.5. Chairman of the meeting (Section 175). A chairman is necessary for conducting a meeting properly. He presides over the meeting, and his main function is to keep order and see that the business is properly conducted. Legally speaking, the chairman is the proper person to put resolution to the meeting, count the votes, declare the result and authenticate the minutes by signature.

The appointment of the chairman is usually regulated by the articles of association of the company. But if there is nothing in the articles, the members personally present at the meeting shall elect one of themselves to be the chairman of the meeting. Sometimes, there are differences among the members, and a peaceful meeting is impossible under the chairmanship of a person appointed by one group. In such cases, the chairman may be appointed by the court [Selvaraj V. Mylapore U.P Fund (1968) 1 Company Law Journal 93 (Madras)].

The duties of a chairman may briefly be stated as under:

(a) He must act honestly and in the interest of company as a whole.

(b) He must ensure that the meeting is properly called and constituted, and also ensure that the proceedings at the meeting are properly and regularly conducted.

(c) He must give a reasonable chance to members who are present to discuss any proposed resolution.

(d) He must exercise correctly and honestly his powers of adjournment of the meeting and of demanding a poll.

(e) He must preserve order in the meeting.

Check your progress – 1

Explain with example “Ordinary business” and “Special business”

Note:

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

20.3 TYPES OF MEETING

In this section, we discuss different types of meetings. The meeting of a company may broadly be classified into the following two categories:

1. Meeting of members
2. Other meetings

20.3.1. Meeting of Members (shareholders)

The meeting of the shareholders can be of four kinds, namely

1. Statutory meeting.
2. Annual general meeting.
3. Extra-ordinary general meeting.
4. Class meeting

20.3.1 (i). Statutory Meeting

It is the first meeting of the members of the company after its incorporation. It must be held within 6 months from the date at which the company is entitled to start business (Section 165). It may be noted that the statutory meeting is held only once in the life time of the company. The purpose of this meeting is to acquaint the members with all the important facts relating to the new company to enable them to know the position and future prospects of the company. Every public company limited by shares and every public company limited by guarantee and having a share capital is required to hold this meeting. A private company and a public company limited by guarantee which has no share capital, is not required to hold the statutory meeting. The legal provisions

relating to the statutory meeting are contained in Section 165 and may be summed up as under

The statutory meeting must be held within a period of not less than one month and not more than six months from the date of which the company is entitled to commence business. In other words, it must be. held within 6 months from the date on which the company is entitled to start the business but it cannot be held within the first one month from that date, e.g., a company entitled to commence business on 1st July 2002, must held its statutory meeting within the period commencing from 1st August, 2002 to 31st December,2002 .

The Board of Directors is required to prepare a report called the 'statutory report'. This report must be sent to every member of the company at least 21 days before the day on which the meeting is to be held. However, the delay in sending the report may be condoned by all the members who are entitled to attend and vote at the meeting.

The statutory report is sent to the members to enable them to know the full information on all the important matters relating to the company. It must contain the following particulars:

(a) The total number of shares allotted giving their all details.

(b) The total amount of cash received by the company in respect of all the shares allotted.

(c) An abstract of receipts and payments of the company and the particulars of balance in hand.

(d) The particulars of directors, managers, secretary and auditors.

(f) The particulars of a contract requiring company's approval.

(g) The arrears of calls due from directors, managers.

4. The statutory report must be certified as correct by at least two directors, one of whom must be a managing director if there is any. After the report is certified as above, it should also be certified as correct by the auditors of the company.

5. After the copies of the statutory report have been sent to the company, a certified copy of the report should also be sent to the Registrar of Companies for registration.

6. At the commencement of the meeting, the Board of Directors shall produce a list of members showing their names, addresses and occupations along with the number of shares held by them. Such list shall remain open and accessible to any member of the company during the continuance of the meeting.

7. The members present at the meeting shall be at liberty to discuss any matter relating to the formation of the company. They may also discuss any matter arising out of the statutory report.

8. The meeting may adjourn from time to time. A resolution may be passed at any such adjourned meeting if due notice has been given in the meantime.

We have noted above that a private company is not required to hold a statutory meeting. But if it subsequently becomes a public company under Section 43-A i.e. a deemed public company (e.g., where 25% of the paid up share capital of a private company is held by one or more body corporate), it is required to hold the statutory meeting if such conversion from private to public company takes place within six months of its incorporation.

20.3.1. (ii) Annual General Meeting

It is the regular meeting of the members of the company. It must be held in each year in addition to any other meeting [Section 166 (1)]. The purpose of this meeting is to provide an opportunity to the members of the company to express their views on the management of company's affairs. Thus, this meeting enables the shareholders to exercise control over the company because they may discuss and review the working of the company. They may ask any question relating to the accounts and affairs of the company. The interest of the shareholders is therefore, protected by the annual general meeting. The legal provisions relating to the annual general meeting are contained in Sections 166 to 168, with may be summed up as under:

1. The annual general meeting must be held once in each year in addition to any other meetings. And the gap between one meeting and the next should not be more than 15 months. However, for special reason, the registrar of Companies may extend the time within which the annual general meeting shall be hold, but the extension cannot exceed 3 months.
2. The first annual general meeting must be held within 18 months of the incorporation of the company, and this time cannot be extended even by the Registrar. The subsequent annual general meetings should be held in each year within 15 months from the last meeting.
3. At least 21 days notice of the meeting in writing, must be given to every member of the company. A shorter notice may also be given if agreed to by all the members who are entitled to vote at the meeting. The place, day and hours should be specified in the notice (Section 171,172).
4. The meeting must be held during the business hours and on a day which is not a public holiday.
5. The meeting must be held during the business either at the registered office of the company, or at some place within the city, town or village in which the registered office is situated.
6. If the company fails to hold the annual general meeting, the consequences will be as under:

(a) Any member of the company can apply to the Company Law Board for calling the meeting. On such application, the Company Law Board may order the calling of the meeting or it may issue directions for calling the meeting. A meeting called by the order of the Company Law Board shall be deemed to be an annual general meeting of the company (Section 167).

(b) The company and every officer in default shall be punishable with fine up to Rs. 5000, and if the default continues, with a further fine upto Rs. 250for every day after the first day of default during which the default continues. This penalty is also there if the meeting is not held in accordance with the directions of the Company Law Board (Section 168).

Thus, there must be one annual general meeting per year, and as may meetings as there are years. If this meeting is not held in any year, the company and every officer in default shall be punishable with fine, as stated above.

It may, however, be noted that when the first annual general meeting is held within 18 months of incorporation of the company, than no annual general meeting will be required for the year of incorporation or for the following year [Section 166].

The annual general meeting is an important meeting of the company which gives an opportunity to the members to review the working of the company and to express their views on the management of company's affairs. The importance of this meeting is evident from the following points. :

(a) The annual accounts of the company are presented at this meeting for consideration of the shareholders.

(b) The dividends are declared at that meeting.

(c) The auditors of the company retire at this meeting, and their appointments are also made.

(d) The directors, liable to retire by rotation retire at this meeting, and appointments in their place are also made at the meeting. This enables the shareholders to appoint the directors who can best protect their interest.

20.3.1. (iii). Extra-ordinary General Meeting

It is the meeting other than the statutory and the annual general meeting of the company (Clause 47 of Table A, Schedule I). This meeting is called for dealing with some urgent special business which cannot be postponed till the next annual general meeting. The legal provisions relating to the extra-ordinary general meeting are contained in Section 169 and may be summed up as under:

1. The extra-ordinary general meeting may be called by the Board of Directors on its own motion whenever it thinks fit to call the meeting (Clause 48 of Table A, Schedule I).

2. The extra-ordinary general meeting becomes necessary on the requisition of members. As a matter of fact, on requisition of members, the directors are bound to call an extra-ordinary general meeting.

3. The requisition for calling this meeting must be signed by such number of members who hold at least 1/10 of the paid up capital of the company, and have the right to vote at the meeting on the matter. And if the company has no share capital it must be signed by such number of members who have at least 1/10 of the total voting power.

4. The requisition must set out the matters for the consideration of which the meeting is to be called, and it must be signed by the requisitionists. And it should be deposited at the registered office of the company.

5. Only such matter can be taken up at the meeting which is specified in the requisition and in respect of which the requisitionists have the voting strength as stated in clause (3) above.

6. On deposit of a valid requisition at company's registered office, the directors must move to call a meeting within 21 days, and the meeting must actually be held within 45 days from the date of deposit of requisition.

7. If the Board does not proceed to call the meeting, the requisitionists may themselves proceed to call the meeting. However, the requisitionists must hold the meeting within 3 months from the deposit of the requisition.

Note. The requisitionists may also claim from the company the reasonable expenses incurred by them in calling the meeting. And the company may deduct such sums out of the remunerations payable to the directors in default.

8. The Company Law Board also has the powers to call extraordinary meetings which may be discussed as under (Section 186) :

(a) Sometimes, it is impracticable to call, hold or conduct the meeting of a company, other than, an annul general meeting. In such cases, the Company Law Board is empowered to call, hold and conduct the meeting. The term 'impracticable' means not possible to call, hold or conduct the meeting in a manner prescribed by the Companies Act, or articles of association of the company.

(b) The Company Law Board can order a meeting to be called, held or conducted in accordance with its directions.

(c) The Company Law Board can make such order either of its own motion or on the application of any director or member who is entitled to vote at the meeting.

20.3.1. (iv) Class meeting

It is the meeting of a particular class of shareholders. Generally, the companies have two classes of shareholders, namely (a) equity shareholders and (b)

preference shareholders. In order to discuss the matters affection one class, only a meeting of the particular class of shareholders is held. It may be noted that at a class meeting, only the shareholders of the particular class have the right to be present. E.g., if the rate of dividend on preference shares is to be reduced, the meeting of preference shareholders will be called at which only the preference shareholders are entitled to be present. The most frequent case of holding the class meeting is that if the rights attached to the shares of any particular class of shareholders are to be varied, a separate meeting (i.e. class meeting) of that particular class of shareholders must be held and the matter should be approved at the meeting by a special resolution (Section 106).

20.3.2. Other Meetings

We have discussed in previous sections, only the meetings of the members of the company. In addition to these meetings, there are other company meetings also which may be discussed under the following heads:

20.3.2.(i) Meetings of Directors.

According to Section 285, we know that the directors are responsible for the overall control and supervision of the affairs of the company. The directors generally act collectively i.e. as Board of Directors unless the powers have been delegated to individual directors. It will be interesting to know that their meetings are more frequent than the meetings of shareholders. A company must hold meeting of its Board of Directors at least once in every three calendar months. And there must be at least four meetings of the Board of Directors in every year

20.3.2.(ii) Meetings of Creditors.

According to Section 391, the meetings of creditors are held by an order of the court. Sometimes, a compromise or arrangement is proposed between a company and its creditors or any class of creditors. In such cases, the court may order a meeting of creditors or a class of creditors to be called, held and conducted in such manner as the court directs. The court orders such a meeting on the application of the company, or of any creditor or member of the company. In case the company is in liquidation, the application may be filed by the liquidator

20.3.2.(iii) Meetings of debenture-holders.

The meetings of the debenture-holders may be held from time to time in accordance with the provisions contained in the debenture trust deed. Their meetings are usually held when the conditions of the issue of debentures are to be altered. Where a scheme of compromise or arrangement is proposed, the meetings of the debenture-holders may also be held through an order of the court.

20.3.3 One-member Meeting

We know that the quorum must be present for a valid meeting, which is five members in case of a public company, and two members in case of private

company. Thus, a single member cannot constitute a valid meeting. As a matter of fact, the word 'meeting' means the coming together of more then one persons. Moreover, Section 174 also states that the members actually present shall be the quorum. Thus, where only one member attends the meeting, the meeting cannot be validly held. This is known as the rule of Sharp V. Dawes as this point was decided in this case which is discussed in the following example.

However, there are certain exceptional circumstances in which a single member present may constitute a quorum, and meeting can be validly held. These are as under:

1. Where one person holds all the shares of a particular class, he alone can constitute a meeting of that class and can pass a resolution by signing it.
2. Where the general meeting is called by an order of the Company Law Board, this Board may give the direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting (Section 167 Explanation).
3. Where the meeting (other than the annual general meeting) is called by an order of the Company Law Board, this Board may give the direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting (Section 186 Explanation).

Check your progress - 2

Note: List out the contents of the statutory report

a) Write your answer in the space given below

b) Check your answer with the ones given at end of this lesson (pp)

20.4 LET US SUM UP

In this lesson, we have briefly touched upon the following points: Meetings are classified as under: (1) General Meetings; (2) Class meetings; (3) Meeting of creditors and debenture holders; (4) Meetings of Directors. General Meetings are meetings of the share-holders. They are further classified into: (1) Statutory meeting**:** This is the first meeting of a public company which is to be held within a period of not less than one month or more than six months from the date on which the company is entitled to commence business 21 days before this meeting, the Board of Directors shall forward a statutory report to every member

of the company containing the prescribed particulars. At the statutory meeting, the Board produces the list showing the names, addresses and occupations of the members of the company. (2) Annual General Meeting**:** Every company shall in each year hold, in addition to any other meeting, a general meeting as its Annual General Meeting. Not more than 15 months shall claps between the date of one annual general meeting and that of the next. The company shall hold its first Annual General Meeting within 18 months from the date of its incorporation. Annual General Meeting shall be called by giving 21 days' prior notice to the effect. It shall be called during busijness hours. T the Annual General Meeting the members shall consider the accounts of the company, appointment of auditors and fixation of their remuneration, declaring a divided and appointing Directors in place of those retiring. (3) Extra-ordinary General Meeting: Any meeting other than statutory and Annual General Meeting is called an Extraordinary General Meeting. All business transacted at this meeting shall be special. It shall be convened by the Board of Directors on the requisition of not les than $1/40^{th}$ of be members holdings paid-up capital of the company. Within 21 days of the deposit of the requisition the Board shall proceed to call a meeting within 45 days from the deposit of the requisition. 21 days notice of such a meeting shall be given.

Class Meetings: These are the meetings of Equity shareholders and Preference shareholders respectively. They are held in case where their rights are sought to be affected. Meetings of creditors and debenture holders**:** These meetings are held generally, in case of winding-up of the company or in case of proposed scheme of arrangement compromise.

Meeting of Board of Directors**:** The meetings of Board of Directors shall be held at leas once in every three months and at least four such meetings shall be held in every year. The quorum of the meeting of the Board of Directors shall be $1/3^{rd}$ of its strength or two Directors, whichever is higher.

The company Law Board may on its own motion or on application of any Director or member of the company, order a meeting of the company to be called.

Essential of a valid meeting: (1) It shall be convened by the Board of Directors. (2) 21 days prior notice in writing is to be given. (3) In case where special business is to be transacted, explanatory statement is to be attached.

Quorum: Five members in case of a public company and two members in case of any other company shall be the quorum for a meeting of the company if the quorum is not present within half an hour from the time appointed for holding the meeting and where such meeting has been called upon requisition of the members, the same shall stand dissolved. In any other case the meeting shall stand adjourned to the same day in the next week at the same time and place.

Chairman of the meeting**:** Members personally present shall elect one of themselves to be the Chairman of the meeting. It poll is demanded, it shall be taken forthwith. The Chairman shall conduct the proceedings at the meeting.

20.5 QUESTIONS FOR DISCUSSION

1. Classify the different types of meetings under the Companies Act and explain the provisions relating to each?
2. What are the essentials to be complied with for a valid meeting?
3. How are the matters in a meeting decided upon?
4. What us a statutory meeting?
5. What is a statutory report and what are its contents?

20.6 MODEL ANSWER TO CHECK YOUR PROGRESS

Check-1 Explain with example "Ordinary business" and "Special business"

In the case of an annual general meeting, the following business is deemed as ordinary business 1.Business relating to the consideration of the accounts, balance sheet and the reports of the Board of directors and auditors, and declaration of dividend, the appointment of directors in place of those retiring , the appointment of auditors and the fixing of their remuneration.

Special business: In the case of an annual general meeting, any business other than the ordinary business, and in the case of any other meeting, asll business, is deemed special. Special businesses are removal of a director, issue of rights and bonus shares and election of a person as director.

Check-2 List out the contents of the statutory report

a) Total shares allotted,

b) Cash received,

c) Abstract of receipts and payments,

d) Directors and auditors details e) Contracts

f) Underwriting of contracts

g) Arrears of calls

h) Commission and brokerage

i) Certification of report and a copy of the report to be sent to the registrar.

20.7 REFERENCES

1. " Company law" -- A.K. Bagrial
2. "Principles of modern company law" – L.C.B. Gower
3. "Business Law" -- M.R. Sreenivasan

LESSON-21

WINDING UP - COMPULSORY WINDING UP BY THE COURT

CONTENTS

21.0 Aims and Objectives

21.1. Introduction

21.1.1 Meaning

21.1.2 Definition of winding up

21.2 Modes of winding up

21.3 Compulsory winding up by the Court

21.3.1. Special resolution by the company

21.3.2. Default in holding statutory meeting

21.3.3. Failure to commence business

21.3.4. Reduction in membership

21.3.5. Inability to pay debt

21.3.6. Just and equitable

21.4 Persons Entitled to apply for winding up

21.4. 1. Petition by the company.

21.4.2. Petition by the creditors

21.4.3. Petition by the contributories

21.4.3. Petition by the contributories

21.4.3. Petition by the contributories

21.4.4. Petition by the registrar

21.4.5. Petition by any person authorized by the central government

21.5 Legal provisions applicable to compulsory winding up

21.5.1. Commencement of winding up

21.5.2. Powers of the court on the presentation of the petition

21.5.3. Consequences of winding up order.

21.5.4. Procedure for compulsory winding up.

21.5.5. Appointment of official liquidator.

21.5.6. Statement of affairs

21.5.7. Report by Official Liquidator

21.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning of meeting, Requisites of Valid Meeting and types of meeting. In this lesson we discuss the meaning of winding up of a company and Modes of winding up. After going through this lesson, you will able to

1. Know the meaning of winding up of a company
2. Understand the various Modes up winding up

21.1. INTRODUCTION

The term 'winding up' of a company may be defined as the proceedings by which a company is dissolved (i.e. put to an end). In this section , we discuss the meaning and definition of winding up of company.

21.1.1 Meaning

Winding up is the process of putting an end to the life of the company. And during this process, the assets of the company are disposed of the debts of the company are paid off out of the realised assets or from the contribution of its members. If any surplus is left, it is distributed among the members in proportion to their rights in the company. The winding up of the company is also called the 'liquidation' of the company. The process of winding up begins after the court passes the order for winding up. And till such order is passed there cannot be any winding up in fact.

21.1.2 Definition of winding up

According to Prof. Gowar defines, "Winding up of a company is the process whereby its life is ended and its property is administered for the benefit of its creditors and members. And 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".

It may be noted that the company is not dissolved immediately on the commencement of the winding up proceedings. As a matter of fact, the winding up of a company precedes its dissolution i.e. the winding up is the prior stage and the dissolution, the next. On the dissolution, the company is no more in existence, and its name is struck off by the Registrar from the register of companies. But on the winding up, company's name is not struck off from the register. Thus, in between the winding up and dissolution, the legal status of the company continues and it can be sued in a Court of Law.

21.2 MODES OF WINDING UP

In this section, we discuss the modes of winding under the following three heads, namely:

1. Compulsory winding up by the court.
2. Voluntary winding up without the intervention of the court.
3. Voluntary winding up with the intervention of the court i.e. under the supervision of the court.

21.3 COMPULSORY WINDING UP BY THE COURT

The winding up of a company by an order of the court is called the compulsory winding up. Section 433 of the Companies Act contains the cases in which the company may be would up by the court. The court may wound up the company on a petition submitted to it on any of the following grounds:

21.3.1. Special resolution by the company [Section 433 (a)]

Some-times, the company passes a special resolution to the effect that the company be wound up by the court. In such case, the court may order the winding up of the company on a (i.e. application) presented to it by company or contributory.

It may be noted that the passing of special resolution by the company itself is a ground for presenting a petition to the court. And no other ground (or reason) is required for presenting the petition. Thus, a winding up petition under this clause is maintainable simply if the company passes a special resolution that it be wound up by the court. However, the court is not bound to order the wind up of the company. It his discretionary power in this regards, and may refuse to wind up the company, when it is opposed to public interest or company's interest. A winding up petition under this clause can be presented by the company or the contributory.

21.3.2. Default in holding statutory meeting [Section 433 (b)]

We know that the company must hold the statutory meeting within 6 months from the date on which the company is entitled to commence its business. And before the holding of the meeting, the statutory report by the directors must also be delivered to the registrar for registration (Section 165). If default is made in delivering the statutory report to the Registrar, or in holding the statutory meeting, the court may order the winding up of the company on a petition presented to it by the Registrar or contributory. However, the court is not bound to order the winding up of the company. Instead of making a winding up order, the court may also direct that the statutory report be delivered to the court may

also direct that the statutory report be delivered to the registrar, or that the statutory meeting be held [Section 443 (3)].

A winding up petition under this clause can be presented by the Registrar of Companies or the contributory (i.e. shareholder).A private company is neither required to hold a statutory meeting nor to deliver a statutory report to the Registrar. A petition for winding up of a private company is, therefore, not maintainable under this clause [Sec (1978) 48 Company Cases, Page 672 (Madras)].

21.3.3. Failure to commence business [Section 433 (c)]

Sometimes, the company fails to commence the business within one year from its incorporation, or suspends its business for the whole year. In such cases, the court may order the winding up of the company on a petition presented to it by the Registrar or contributory. However the court will exercise its power only when there is a fair indication that there is no intention to carry on the business, or that it is not possible for the company to carry on its business.

A winding up petition under their clause can be presented by the Registrar of companies or contributory (i.e. shareholder).

It is, however, important to note that where the suspension of business is due to temporary causes and is sufficiently accounted for (i.e. explained), the court may refuse the winding up.

Similarly, where the suspension of business is due to depression in trade, and the company has the intention to continue its business when trade prospectus improves, the winding up is generally refused by the court.

Note. Sometimes, a company has many businesses. In such cases, it can not be wound up if it has suspended or cased to carry on one of the several businesses. As a matter of fact, the suspension must be of the entire business and not of a part of it.

21.3.4. Reduction in membership [section 433 (d)]

We know that a public company must have at least seven members, and a private company at least tow. If the membership of any company is reduced below this limit, the court many order the winding up of the company.

A winding up petition, under this clause, can be presented by the Registrar of Companies or contributory (a member i.e. shareholder who presents a winding up petition is called contributory on the presentation of the petition).If the company carries on its business with reduced members for more than 6 months, the members will be personally liable for the payment of company's debts contracted during that time (Section 45).

21.3.5. Inability to pay debt [Section 433 (e)]

Sometimes, the company is unable to pay its debts. In such cases, the court may order the winding up of the company.

The term 'debt' here means a definite sum of money which is due and immediately (i.e. presently) payable by the company. A conditional liability (i.e. amount payable upon some condition) is not a debt unless the condition has happened.

The term 'inability to pay' here means company's inability to pay its current liabilities. In other words, company's inability to pay its liabilities (i.e. claims) as and when they arise in the ordinary course of business. Thus, inability to pay debts is to be taken in the commercial sense. The test of 'inability to pay debts', therefore, is whether the company can pay its existing liabilities, a petition for winding up is maintainable even if it may have very valuable assets not presently realisable. The Companies Act recognises the following three cases in which a company shall be deemed to be unable to pay its debts [Section 434]:

(a) It a creditor to whom the company owes a sum exceeding Rs.500, has served on the company a demand notice for the payment of his amount. And the company has for three weeks thereafter neglected to pay the amount, or has otherwise neglected to satisfy his claim by compromise etc.

(b) If a creditor of the company obtains a decree from the court for the payment of his debts by the company, and the execution issued on the decree in favour of the creditor is returned unsatisfied in whole or in part.

(c) If it is proved to the satisfaction of the court that the company is unable to pay its debts.

It is important to note that under clause (a) above, a winging up petition can be filed against the company only if the company owes Rs.500 or more to a creditor. There is no such condition as to amount in respect of clause (b). The unsatisfied execution of a decree for any amount, however, small, amounts to inability to pay debts. The case of commercial insolvency (i.e. where a company is not in a position to meet its current liabilities) are covered under clause (c). In company the time of three weeks, the day on which notice is dispatched and the day on which it is served should both be excluded.

A notice of demand giving less than three weeks time dose not makes the demand ineffective. It only postpones the right of action to a date after the expiry of three weeks. In execution proceedings, a person against whom a decree is passed is ordered to pay the amount for which decree is passed. In fact, by way of execution proceedings, a practical shape is given to a decree i.e. a court's final order in which a person is held liable to pay.

A creditor who has obtained a money decree against the company is not bound to initiate execution proceedings in order to bring his case under clause (b) for the purpose of winding up. He may also give a statutory notice to the company

as required under clause (a) above if the amount of the decree is Rs. 500 or more, and may file a winding up petition if the company neglects to pay.

A winding up petition on the ground of company's inability to pay can be filed by the creditor, contributory or Registrar of companies.

Above, we have noted the cases where the winding up of a company may be allowed by the court on the ground of company's inability to pay debts. However, in the following cases, a winding up order will not be made by the court:

(a) Where the debt it not presently payable by the company.

(b) Where the debt is not a definite (i.e. certain) amount, and includes unliquidated damages.

(c) Where the debt has become time-barred on the date of petition. A 'time barred debt' is that which cannot be recovered due to the expiry of limitation period within which it should have been recovered.

(d) Where the debt is bona fide (i.e. honestly) disputed by the company. In other words, when there is a bona fide and reasonable dispute about the debt. In such cases, there will be valid and genuine excuse for non-payment of the debts. However, if the dispute is not real but is raised by the company for the sake of avoiding payment or raising a controversy on flimsy (or false) grounds, the winding up order may be passed by the court.

(e) Where there is a bona fide counter claim put forward by the company. The 'counter claim' means the claim (i.e. amount) which the company has to recover from the creditor who has presented the petition. In such cases also, there will be a valid excuse for non-payment of the debts.

21.3.6. Just and equitable [Section 433 (f)]

Sometimes, the court is of the opinion that it is just and equitable that the company should be wound up. In such cases, the court may order the winding up of the company. This clause gives a very wide discretionary power to the court to order the winding up whenever it appears desirable. The words 'just and equitable' are not to be interpreted as covering the cases of like cases of like nature as discussed above. Under this clause, the court may order winding up on any ground. However, there must be some strong ground for winding up of the company. The court may give due winding up on any ground. However, there must be some strong ground for winding up of the company. The court may give due weight to the interest of the company, its employees, creditors and shareholders. The interest of general public should also be considered. The court may refuse to make an order of winding up if it is of the opinion that some other remedy is available to the petitioner, and instead of pursuing other remedy, is available to the petitioner, and instead of pursuing other remedy, he is acting unreasonable in seeking the winding up of the company.

A winding up petition on 'just and equitable' ground can be filed by a contributory, Registrar of companies or by a person authorised by the Central Government.

Following are some of the circumstances in which the courts have ordered winding up on 'just and equitable' grounds:

(a) Complete deadlock in the management of the company. Sometimes, there is complete deadlock in the management of the company. In such cases, the court may order the winding up of the company on just an equitable ground. The 'deadlock' in company's management occurs where the directors lose confidence in each other and disagree on each and every matter.

(b) Failure of company's main object. Sometimes, the main object of the company fails to materialize. In such cases, the court may order the winding up of the company on just and equitable grounds.

Similarly, where the only business of a company was life insurance business, it was ordered to be wound up on just and equitable ground when the life insurance business was taken over by the central Government [See Re Hindustan Co-operative Society Ltd, (1961) 31 Company Cases 193].

However, a winding up order is not passed on the basis of a temporary difficulty which does not make it impossible for the company to carry out its objects.

(c) Recurring losses. Sometimes, it is not possible for the company to carry on the business except at losses i.e. there is no reasonable hope of trading at a profit. In such cases, the court may order the winding up of the company on just and equitable grounds.

However, a winding up order is not passed by the court on the ground that the company has made losses in the current year and is likely to make further losses. As a matter of fact, a mere apprehension on the part of shareholders that losses will occur in future is no ground for winding up. To obtain a winding up order from the court, it must be shown that there is no reasonable prospect of earning profit.

(d) Aggressive or oppressive policy of majority shareholders. Sometimes, the majority shareholders adopt an aggressive or oppressive policy towards the minority shareholders. In such cases, the court may order the winding up of the company on 'just and equitable' ground.

(e) In corporation of company for fraudulent or illegal purpose. Sometimes, the company is incorporated for fraudulent or illegal purposes. In such cases, the court may order the winding up of the company on just and equitable ground.

Similarly a company which has ceased to carry on its authorized business and is engaged in illegal business is liable to be wound up on just and equitable ground.

21.4 PERSONS ENTITLED TO APPLY FOR WINDING UP

We have discussed, in the last article, the grounds on which the court may order the winding up of the company on a petition presented to it. The petition for winding up of a company may be presented to the court by any of the following persons (Section 439):

21.4. 1. Petition by the company. The company may itself present a petition in the court for its winding up. However, the company can do so when the ground for winding up is that the company has passed a special resolution that it be wound up.

We know that a company being an artificial person, cannot act personally. Actions on its behalf are taken by its agents (i.e. director). However, a winding up petition by a person on behalf of the company is valid only when the decision to file the petition is taken by the company at its general meeting. If no such decision is taken, then the winding up petition is not valid i.e. not maintainable.

Note. A company may present a winding up petition on any of the grounds mentioned in clauses (a) to (f) of Section 433 discussed in the last article. A special resolution resolution enables the company to present the winding up petition under clause (a) But such a resolution is not necessary where the company bases the winding up petition on any of the grounds mentioned in clauses (b) to (f). [See State of Madras Electric Tramsway Ltd., (1955) 2 MLJ 640]

21.4.2. Petition by the creditors. The creditors of a company may present a petition in the court for winding up of the company. The petition may be presented by any creditor (or creditors). The creditors may present the petition on the ground that the company is unable to pay its debts.

The expression 'creditors' means any person who has pecuniary (i.e. monetary) claim against the company, and includes the following persons:

(a) A contingent (or prospective) creditor. He is a person whose claim is not immediately due. A guarantor of company's debt, and the holder of a bill of exchange not yet due is a contingent creditor. It is, however, important to note that a winding up petition filed by a contingent or prospective creditor shall not be admitted unless the leave (i.e. permission) of the court is obtained for the same.

(b) A secured creditor. He is a person who is having security (i.e. charge on company's assets) for the repayment of his dues. He can apply for the winding up of the company even without giving up his security.

(c) A debenture-holder. He is a person who holds the debentures of a company and has all the ownership rights in respect of debentures e.g., right to get payment of interest or debt amount directly from the company.

(d) A trustee for debenture-holders. He is a person who holds the debentures of the company for the benefit of the debenture-holders, and is given all the rights of ownership in respect of the debentures e.g., right to receive interest etc. directly from the company.

(e) The Central or State Government or a local authority to whom any public charge i.e. tax etc. is due by the company.

In case of a winding up petition by the creditor, it is his duty to prove that he is fact a creditor i.e. the company owes a debt to him and he is entitled to recover the same.

Sometimes, the debt is disputed by the company, and the creditor threatens the company to file a winding up petition. In such cases, the company may obtain a court order restraining the creditor from bringing a threatened winding up petition.

Note. As regards the injunction to restrain a creditor from filing a threatened petition, the Calcutta High Court has differed on the point. It has held that creditor's right to present a winding up petition is a statutory right and not one arising out of contract. Therefore, a creditor cannot be restrained from filing a proposed petition [Re Chhayabani pvi. Ltd. (1981) 51 Company Cases 369].

21.4.3. Petition by the contributories. The term 'contributory' may be defined as every person who is liable to contribute to the assets of a company in the even of its being wound up. Thus, on the commencement of the winding up of a company, its shareholders are called contributories. (Sections 426, 428). It will be interesting to know that the holders of fully paid up shares are also included in the term 'contributory' though their liability is nil.

The contributories of a company may present a petition in the court for winding up of the company. The petition may be presented by any contributory or contributories. Any contributory may present a winding up petition where the ground for winding up is that the number of members is reduced below the statutory limit. But when the petition is on any other grounds, than only the following contributories shall be entitled to present the petition:

(a) Any contributory to whom the shares were originally allotted; or

(b) Any contributory who has been the registered holder of the shares for at least 6 months out of the 18 months before the commencement of the winding up; or

(c) Any contributory on whom the shares were devolved through the death of the former holder of shares.

The purpose of above clauses restricting contributory's right to file a winding up petition is to prevent a person from buying shares of a company with the sole intention of becoming eligible for bringing the winding up of the company.

It may, however, be noted that in the case of a legal representative of a deceased shareholder, it is not necessary for his winding up petition that the shares should have been held by him in his own name for 6 months during the 18

months before the filing of the winding up petition. This requirement is only for the transferee of shares (i.e. to whom the shares are transferred in a normal way).

21.4.4. Petition by the registrar. The Registrar of Companies may also present a petition in the court for winding up of the company. The Registrar may present for winding up on all the grounds discussed in Art. 20.3 except one, namely, that the company has passed a special resolution that it be wound up.

It may, however, be noted that before making a petition on any of the above grounds the Registrar must obtain the previous sanction of the Central Government. And the Central government shall not give its sanction unless an opportunity has been given to the company to make its representations.

It is important to note that after obtaining the sanction of the Central Government, the winding up petition must be filed by the Registrar within reasonable time. If there is unreasonable delay in presenting the petition, the court will not recognize the sanction as valid.

21.4.5. Petition by any person authorized by the central government. The Central Government may authorize any person to present a petition in the court for winding up of the company. Sometimes, it appears to the central Government from the report of inspectors appointed to investigate the affairs of the company that the business of the company has been conducted for fraudulent or unlawful purposes. In such cases, the Central Government may authorize any person to present a petition for the winding up of the company on the ground that it is just and equitable that it should be wound up [Sections 439 (1) (f), 243]. The Registrar may also be authorized by the Central Government to present a winding up petition.

21.5 LEGAL PROVISIONS APPLICABLE TO COMPULSORY WINDING UP

The legal provisions applicable to the compulsory winding up, as contained in the Companies Act, may be discussed under the following heads:

21.5.1. Commencement of winding up. The winding up of the company shall be deemed to commence from the time of the presentation of the petition, and not from the date of the winding up order by the court. But where before the presentation of winding up petition to the court, the company passes a resolution for the voluntary winding up of the company, the winding up shall be deemed to have commenced from the time of the passing of the resolution (Section 441). The date of commencement of winding up is important for various matters such as liability of past' members, avoidance of fraudulent preferences etc.

21.5.2. Powers of the court on the presentation of the petition. On receipt of the petition for winding up of a company, the court has the following powers:

(a) Stay of proceedings against the company. Sometimes, at the time of winding up petition, certain legal proceedings are pending against the company. In such cases, before making the winding up order, the court may stay the further proceedings on such terms as it thinks fit. The application for the stay of legal proceedings may be made by the company, or any creditor or contributory (Section 442).

It may be noted that where any suit or proceeding is pending in the Supreme Court or in any High Court, the application for stay is to be made to the concerned court in which suit or proceeding is pending. And where such proceedings are pending in any other court, the application is to be made to the court which has the jurisdiction to wind up the company.

(b) Making order on the petition. On hearing a winding up petition, the court may exercise any of the following powers (Section 443)

i) It may dismiss the petition with or without costs,

i) It may adjourn the hearing of the petition,

ii) It may make any interim order as it thinks fit.

v) It may make an order for winding up of the company with or without costs.

v) It may make any order as it thinks fit.

21.5.3. Consequences of winding up order. The consequences of winding up order are contained in Sections 444 to 447 of the Companies Act, which may be summed up as under:

(a). On the making of the winding up order, the court must immediately send the intimation of the winding up order to the Official Liquidator and the Registrar (Section 444).

(b). On the making of the winding up order, the certified copy of the order must be filed with the Registrar within 30 days from the date of the making of the order. The duty to file it is of the petitioner and of the company (Section 445).

(c). The winding up order shall be deemed to be a notice of discharge to the officers and employees of the company. This is so because the employment being conditional on the continued existence of the company, it ceases when the company is wound up. But where the business of the company is continued, the order shall not be considered a notice of discharge [Section 445(3)].

(d). The winding up order shall operate in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor and contributory {Section 447).

(e). After a winding up order has been made, no suit or other legal proceeding shall be commenced against the company except with the leave (permission) of the court. And if any suit or legal proceeding is pending at the date of the order, it shall not be proceeded with except with the permission of the court (Section 446).

21.5.4. Procedure for compulsory winding up.

The winding up proceedings are conducted by an official to be known as the Official Liquidator. Thereafter, the procedure involves the appointment of Official Liquidator, and the conduct of proceedings by him

21.5.5. Appointment of official liquidator.

An Official Liquidator is an officer who helps the court in conducting and completing the winding up proceedings. For the purpose of winding up of a company by the court, the Central Government shall appoint an Official Liquidator who shall be attached to each High Court. Depending upon the 'Work, the Official Liquidator may be appointed either as a whole-time or a part-time officer. In case of District Courts, the Official Receiver appointed for insolvency purpose shall be the Official Liquidator. , And if there is no Official Receiver, the Central Government may appoint the Official Liquidator who shall be attached to the District Court (Section 448).

As soon as the winding up order is made, the Official Liquidator becomes a liquidator of the company for conducting the winding up proceedings (Section 449). It may be noted that only the Official Liquidator can act as the liquidator of the company. And the court has no power to appoint any other private person as the liquidator of the company.

On the presentation of the winding up petition and before the making of a winding up order, the court may appoint the Official Liquidator to act as the Provisional Liquidator of the company. The powers of the Provisional Liquidator shall be the same as of Official Liquidator unless the court orders otherwise. As soon as the winding-up order is made, the Provisional Liquidator becomes the liquidator of the company and ceases to be a Provisional Liquidator (Section 450)

It shall be the duty of the liquidator to conduct the proceedings in winding up the company. And he shall perform such duties in reference to winding up as the court may impose upon him (Section 451).

21.5.6. Statement of affairs. On the making of the winding up order by the court, or on the appointment of the Official Liquidator as the provisional liquidator, a statement as to the affairs of the company must be made out and submitted to the Official Liquidator (Section 454)The statement of affairs should contain the following particulars :

(a) The assets of the company stating separately the cash balance in hand and at bank.

(b) The debts and liabilities of the company.

(c) The names, residences and occupations of company's creditors stating separately the amount of secured and unsecured debts. And also the particulars of the securities given to the secured creditors.

(d) The debts due to the company along with the amount likely to be realised. And the names and addresses of the persons from whom they are due.

(e) Such further or other information as may be required by the Official Liquidator.

Note. The statement of affairs should be in the prescribed form and verified by an affidavit. It must be submitted to the Official Liquidator within 21 days of the date of winding up, or within 21 days of the date of appointment of the provisional liquidator, as the case may be. However, for special reasons, this period may be extended by the Official Liquidator or by the court upto the maximum of 3 months from that date. The statement of affairs must be submitted and verified by the director, manager, secretary or other chief officer of the company, or by such other persons as the Official Liquidator, subject to the directions of the court, may require.

21.5.7. Report by Official Liquidator. After receiving the statement of affairs, as soon as practicable, the Official Liquidator is required to submit a preliminary report to the court showing following information (Section 455):

(a) The amount of issued, subscribed and paid up capital of the company. And the estimated amount of the assets and liabilities.

(b) Where the company has failed, the causes of the failure.

(c) Whether in his opinion, further enquiry is desirable as to any matter relating to the promotion, formation or failure of the company or the conduct of its business.

The report must be submitted to the court within 6 months from the date of the order of winding up. And where this period is extended, within the extended period

Dissolution of a Company

The dissolution puts an end to the existence of the company. And the Registrar then strikes off company's name from the Register of Companies. The company is dissolved by an order of the court. The court shall make an order of dissolution in any of the following cases (Section 481)

1. When the affairs of the company have been completely wound up.
2. When the court is of the opinion that the liquidator cannot proceed with the winding up of the company for want of funds and assets or for any other reason.
3. When the court is of the opinion that it is just and reason able to dissolve the company.

On the making of the order of dissolution, the company stands dissolved from the date of the order. Within 30 days of the order, the liquidator must forward a copy of the order to the Registrar who shall record the same in his books. If the liquidator makes a default in forwarding a copy, he shall be punishable with fine unto Rs. 50 for every day during which the default continues.

It will be interesting to know that the liquidator or any other interested person may also apply to the court for an order declaring the dissolution to be void. However, such an application must be made to the court within 2 years of the dissolution. On such application the court may pass an order declaring the dissolution to be void [Section 559]. The effect of such an order is that it makes the dissolution void ab initio i.e.. ineffective from the very beginning and the company revives as if it had never been dissolved. Consequently, all the consequences resulting from the dissolution are avoided.

Within 30 days of the court order, the person on whose application the order was made, must file a copy of the order with the Registrar of Companies who shall register the same. If such person makes a default in filing the copy with the Registrar, he shall be punishable with fine upto Rs. 50 for every day during which the default continues [Section 559 (2)].

LESSON-22

WINDING UP - VOLUNTARY WINDING UP

CONTENTS

22.0 Aims and Objectives

22.1. Introduction

22.1.1 by ordinary resolution

22.1.2.by special resolution

22.2 Kinds of voluntary winding up

22.3. Members' voluntary winding up

22.3.1 Legal provisions applicable to members' voluntary winding up

22.4 Creditors' voluntary winding up

22.4.1 Legal provisions applicable to creditors' voluntary winding up

22.5 Common provisions applicable to both kinds of voluntary winding up

22.6 Winding up with the intervention of the court

22.7 Winding up of unregistered companies

22.7.1 Courts having jurisdiction to wind up companies

22.0 AIMS AND OBJECTIVES

In the previous lesson, we discussed the meaning of meaning of winding up of a company and Compulsory winding up by the court. In this lesson we discuss the meaning of Voluntary winding up of a company and modes of Voluntary winding up . After going through this lesson, you will able to

1. Know the meaning of voluntary winding up of a company
2. Understand the various modes up voluntary winding up

22.1. INTRODUCTION

In the preceding pages we have discussed the compulsory winding up of the company i.e. the winding up by an order of the court. The company may also be wound up without any intervention of the court. And it is called the voluntary winding up. In other, words, the voluntary winding up means the winding up by

the members or creditors themselves without any intervention of the court. Thus, the members and the creditors are left free to settle their affairs without going to the Court of Law. However, they may apply to the court for any directions when necessary. Section 484 of the Companies Act contains the cases in which the company may be voluntarily wound up, which are as under

22.1.1 By ordinary resolution

Sometimes, the article of the company fixes the period for the duration of the company, or provides that the company shall be dissolved on the occurrence of some event. In such cases, when that time expires or that event occurs, the company may pass an ordinary resolution in its general meeting for its voluntary winding up

22.1.2.By special resolution.

The company may, at any time, pass a special resolution that the company be wound up voluntarily. It may be noted that when the company passes a special resolution for its voluntary winding up, no reason is required to be given for the winding up. Under this clause, the company may be wound up even if it is prosperous.

Note. Within 14 days of the passing of a resolution (ordinary or special) for voluntary winding up, the company must give a notice of the resolution by advertisement in the Official Gazette, and also in some newspaper circulating in the district where the registered office of the company is situated (Section 485).

22.2 KINDS OF VOLUNTARY WINDING UP

The voluntary winding up of the company is of two kinds, namely,

1. Members' voluntary winding up
2. Creditors' voluntary winding up

22.3. MEMBERS' VOLUNTARY WINDING UP

It is the winding up in the case of which a 'declaration of solvency' is made and delivered to the Registrar in accordance with the provisions of Companies Act [Section 488 (5)]. The 'declaration of solvency' is the declaration made by the directors stating that the company has no debts, or that it will be in a position to pay its debts in full. The legal provisions relating to the declaration of solvency are contained in Section 488 and may be summed up as under

1. The declaration of solvency has to be made by the majority of directors at a meeting of the Board of Directors, and verified by an affidavit.
2. The directors have to declare in it that they have made a full enquiry into the affairs of the company and have formed the opinion about the following:

(a) That the company has no debts, or

(b) That the company will be able to pay its debts in full within such period as specified in the declaration, but not exceeding 3 years from the commencement of the winding up.

3. The declaration must be made within 5 weeks immediately before the passing of the resolution for winding up, and must be delivered to the Registrar for registration before that date.
4. The declaration must be accompanied by a copy of the report of company's auditors on the profit and loss account, and the balance sheet of the company prepared upto the latest practicable date before the making of the declaration.
5. The declaration must also contain a statement of the assets and liabilities of the company as at the latest practicable date before the making of the declaration.

22.3.1 Legal Provisions Applicable to Members' Voluntary Winding up

After a declaration of solvency, as aforesaid, is made and filed with the Registrar of Companies, and the members pass a resolution for voluntary winding up, the members' voluntary winding up commences from the date of the resolution. The legal provisions applicable to members' voluntary winding up are contained in Sections 490 to 498 of the Companies Act, which may be discussed under the following heads**:**

1. Appointment of liquidators.

The liquidator is appointed to conduct the proceedings of members' voluntary winding up. He is appointed by the company in its general meeting of shareholders for the purpose of winding up the affairs of the company, and for distributing its assets. The company may appoint one or more liquidators as may be necessary (Section 490). Within 10 days of liquidator's appointment, the company must give a notice of the same to the Registrar of Companies (Section 493).

2. Board's powers to cease on appointment of liquidator.

On the appointment of the liquidator, all the powers of the Board of Directors including the powers of managing director, whole-time director and manager, shall come to an end. However, the company in general meeting or the liquidator may sanction the continuance of any power (Section 491).

3. Creditors' meeting in case of insolvency.

Sometimes, the liquidator is of the opinion that the company will not be able to pay its debts in full within the period stated in 'declaration of solvency.' In such cases, the liquidator should immediately summon meeting of the creditors and lay before the meeting a statement of the assets and liabilities of the company. The liquidator should also take such steps where the period specified in the declaration of solvency has expired and the company has not paid its debts in full. In case of default to summon creditors' meeting the liquidator shall be punishable with fine up to Rs. 500 (Section 495).

4. General meeting at the end of year.

Sometimes, the winding up continues for more than one year. In such eases, the liquidator must call a general meeting of the company at the end of the first year, and at the end of each subsequent year. He must also lay before the meeting, an accountof his acts and dealings, and the progress of the winding up during the year. If the liquidator fails to comply with this provision, he shall be punishable with fine upto Rs. 100 for each failure (Section 496).

5.Final meeting and dissolution.

As soon as the affairs of the company are fully wound up, the liquidator must make an account of winding up, showing how the winding up has been conducted, and how the property of the company has been disposed of. There after, he must call a general meeting of the company for the purpose of laying before it the above said account of winding up. This is the final meeting of the company. If the liquidator fails to call this final meeting, he shall be punishable with fine upto Rs. 500 (Section 497). After the holding of the final meeting, the proceedings take place as under:

(a) Within one week after the meeting, the liquidator shall send a copy of the account and of the return of the meeting to the Registrar, and to the Official Liquidator.

(b) On receipt of the account and the return, the Registrar shall register them, and the Official Liquidator shall make a scrutiny of the books and papers of the company. After the scrutiny, the Official Liquidator shall report to the court the result of his scrutiny.

(e) If the report of the Official Liquidator shows that the affairs of the company were not conducted in a manner prejudicial to the interest of its members or to public interest, then the company shall be deemed to be dissolved from the date of the submission of the report to the court.

(d) If the report shows that the affairs of the company were conducted in a manner prejudicial to the interest of its member or its members or to public interest, the court shall direct the Official liquidator to make further investigations of the affairs of the company. And on the receipt of the report of the further investigation, the court may either make an order that the company shall stand dissolved from the date specified in the order, or the court may make such other order as the circumstances of the case permit. If the company fails to pay its debts in full within the time specified in declaration of solvency, then the meetings of creditors shall also be held along with the company' meeting as discussed in points 4 and 5 above (Section 498).

22.4 CREDITORS' VOLUNTARY WINDING UP

It is the winding up in the ease of which a 'declaration of solvency has not been made and delivered to the Registrar [Section 488 (5)]. Thus, the question of creditors' voluntary winding up shall arise where the company is unable to pay its debts in full. As in such a case, the interest of the creditors is involved, they are given the powers to control and supervise the winding up of the company.

22.4.1 Legal Provisions Applicable to Creditors' Voluntary Winding up

The legal provisions applicable to creditors' voluntary winding up are contained in Sections 500 to 509 of the Companies Act, which may be discussed under the following heads:

1. Meeting of creditors. We know that in case of creditors' voluntary winding up, the interest of the creditors is involved. Therefore they should be given an opportunity to know how the assets of the company are realised and distributed. This is possible by calling a meeting of creditors. It may be noted that the company must call a meeting of its creditors in case of creditors' voluntary winding up. The meeting of the creditors may be called on the same day on which the meeting of the company is to be held at which a resolution for voluntary winding up is to be proposed. However, the meeting of the creditors may also be held on the next day following the day of company's meeting.

The meeting of creditors shall be presided over by one of the directors appointed for the purpose by the Board to lay the following before the meeting of creditors:

(a) A full statement of the position of the affairs of the company, and

(b) A list of the creditors of the company and the estimated amount of their claims (Section 500).

Note. The notice of any resolution passed at the meeting of creditors must be given by the company to the Registrar within 10 days of the passing of resolution (Section 501).

2. Appointment of liquidator.

We know that the liquidators appointed for the purpose of winding up the affairs of the company, and for distributing its assets. In case of creditors' voluntary winding up, the liquidator is appointed by nomination made by both the members and creditors at their respective meetings. If the creditors and the members nominate different persons, the person nominated by the creditors shall be the liquidator. However, within 7 days of the nomination made by the creditors, any director, member or creditor of the company may apply to the court for an order that the person nominated by the members should be the liquidator, or that the Official Liquidator or some other person should be appointed as the liquidator (Section 502). It may further be noted that if no person is nominated by the members, the person nominated by the creditors shall be the liquidator.

3.Committee of inspection.

Sometimes, the creditors think fit to appoint a committee of inspection to watch and supervise the proceedings of the liquidator. In such cases, they (creditors) may appoint a committee of inspection at their meeting. And the committee shall not consist of more than five members appointed by the creditors. When a committee of inspection is so appointed by the creditors, the company may also at any general meeting appoint its own members (not exceeding five) to the committee. However, the creditors may not accept all or any of the members appointed by the company. In such eases, the members appointed by the company cannot act as the members of the committee unless the court directs otherwise. If the court thinks fit, it may also appoint other persons to act as the members in place of the person not agreed to by the creditors (Section 503). The committee of inspection shall have the right to inspect the accounts of the liquidator at all reasonable times. The other provisions relating to the proceedings of the committee of inspection shall be the same as in case of the committee of inspection appointed in a compulsory winding up as discussed in above.

4. Board's powers to cease on appointment of liquidator.

On the appointment of the liquidator, all the powers of the Board of Directors shall come to an end. However, the committee of inspection, or if there is no such committee, the creditors in general meeting may sanction the continuance of the Board's powers (Section 505). It may be noted that under this section, the powers of the managing director, whole-time director and manager do not come to an end.

5. Meetings of company and of creditors at the end of year.

Sometimes, the winding up continues for more than one year; In such cases, the liquidator must call a general meeting of the company, and a meeting of the creditors at the end of the first year, and at the end of each subsequent years. He must also lay before both the meetings an account of his acts and dealings, and the progress of the winding up during the year. If the liquidator fails to comply with this provision, he shall be punishable with fine up to Rs. 100 for each failure (Section 508).

6. Final meetings and dissolution.

As soon as the affairs of the company are fully wound up, the liquidator must make an account of winding up, showing how the winding up was conducted and how the property of the company has been disposed of. Thereafter, he must call a meeting of the company, and a meeting of the creditors for the purpose of laying before the meetings the above said account of winding up. These are the final meetings of the company. Other provisions and the procedure to be followed after holding the final meetings are the same as in case of members' voluntary winding up as discussed in final meeting and dissolution (Section 509).

22.5 Common Provisions Applicable to Both Kinds of Voluntary Winding up

We have already discussed in Arts. 20.14 and 20.16, the respective legal provisions applicable to members' voluntary winding up, and to creditors' voluntary winding up. There are certain common provisions which apply to both kinds of voluntary winding up. These provisions are contained in Sections 486, 487 and 511 to 520 of the Companies Act, and may be discussed under the following heads:

1.Commencement of winding up (Section 486).

The voluntary winding up of the company shall be deemed to commence from the time of passing of the resolution for voluntary winding up.

2.Consequences of voluntary winding up (Section 487)

On the commencement of the winding up, the company shall cease to carry on its business. However, it may carry on its business where it is required for the beneficial winding up of such business. Though the company shall stop its business, but the corporate status and corporate powers of the company shall continue until it is dissolved.

3.Distribution of company's property (Section 511)

On the winding up of the company, its assets shall be applied in satisfaction of its liabilities pari passu (i.e. without any preference of one over the other). This is, however, subject to any payments which are to be made on preference basis under the Companies Act. After the satisfaction of the liabilities, the surplus shall be distributed among the members according to their rights and interest in the company.

4.Statement of affairs (Section 511 A)

On the commencement of the winding up of the company, a statement as to the affairs of the company must be made out, and submitted to the liquidator. The statement must be submitted to the liquidator with in 21 days of the commencement of the winding up.

5. Duties and powers of liquidator (Section 512)

The duties and powers of the liquidator in case of voluntary winding up are the same as those of the liquidator in the case of compulsory winding up as discussed in above section. The only difference is that the powers which in case of compulsory winding up can be exercised with the sanction of the court, in case of members' voluntary winding up those can be exercised with the sanction, of special resolution of the company; and in case of creditors' voluntary winding up with the sanction of committee of inspection, and if there is no such committee, with the sanction of meeting of creditors. It may, however, be noted that in case of creditors' voluntary winding up those can also be exercised with the sanction of the court. All other powers of the liquidator are the same as are given to the liquidator in case of compulsory winding up.

In addition to the above powers, the liquidator may also exercise the following powers:

a) The power of the court of setting list of contributories.

b) The power of the court of making calls.

c) The power to call general meetings of the company. He may call the meetings for the purpose of obtaining the sanction of the company, or for any other purpose as he may think fit.

It may, however, be noted that the exercise of powers by the liquidator shall be subject to the control of the court. And any creditor or contributory may apply to the court with respect to the exercise or proposed exercise of liquidator's powers.

6. Court's powers to appoint and remove liquidator (Section515)

If from any cause whatever, there is no liquidator acting, the court may appoint the Official Liquidator or any other person as the liquidator of the company. The court may also remove a liquidator and appoint the Official Liquidator or any other person as the liquidator in place of the removed liquidator.

7. Notice by the liquidator of his appointment (Section 516)

Within 30 days of the appointment of the liquidator, he must publish in the Official Gazette the notice of his appointment. More over, he must also deliver the same to the Registrar for registration.

8. Directions of court (Section 518)

The liquidator or any contributory or creditor may apply to the court to determine any question arising in the winding up of the company. The application may also be made to the court to exercise all or any of the powers which the court may exercise if the company were being wound up by the court.

9. Public examination (Section 519)

Sometimes, the liquidator makes a report to the court stating that in his opinion a fraud has been committed by any person in the promotion or formation of the

company, or by any officer of the company in relation to the company since its formation. In such cases, the court may direct that such person or officer shall appear before the court and be publicly examined.

10.Costs of winding up (Section 520)

All costs, charges and expenses properly incurred in the winding up including the remunerations of liquidator, shall be payable out of the assets of the company in priority to all other claims. However, the priority of secured creditors shall continue.

22.6 WINDING UP WITH THE INTERVENTION OF THE COURT OR WINDING UP UNDER THE SUPERVISION OF THE COURT

The winding up with the intervention of the court is ordered where the voluntary winding up has already commenced. As a matter of fact, it is the voluntary winding up but under the supervision of the court.

At any time after a company has passed a resolution for voluntary winding up, the court may make an order that the voluntary winding up shall continue but subject to the supervision of the court. The order may be made by the court on such terms and conditions as it thinks fit, and the court may also determine the extent of the supervision. The application for court's supervision may be made by creditors, contributories, or by others as the court may think just [Section 522]. Ordinarily, such an order is passed by the court in the following circumstances:

i) When the liquidator appointed under the voluntary winding up is partial or negligent in collecting the assets of the company, or

ii) When the provisions relating to the winding up are not being observed, or

iii) When the resolution for voluntary winding up was obtained by fraud.

It may be noted that a petition for the continuance of voluntary winding up under the supervision of the court shall be considered to be a petition for winding up by the court, and the court shall get the same jurisdiction over the suits and legal proceedings as in case of compulsory winding up (Section 523). The other provisions with respect to the winding up under the supervision of the court may be summed up as under:

1. The court may appoint an additional liquidator. It may also remove any liquidator, and may fill up the vacancy caused by the removal, death or resignation of the liquidator (Section 524).
2. The additional liquidator appointed by the court shall have the same powers and be subject to same obligations as if he had been duly appointed in accordance with the provisions in respect of the appointment of liquidators in a voluntary winding up. How ever, the liquidator's powers shall be subject to the restrictions imposed by the court [Sections 525, 526 (1)].

3. For all purposes, any order made by the court for a winding up under the supervision of the court shall be deemed to be an order of the court made in compulsory winding up. And the court shall get all the powers as it has in case of compulsory winding up [Section 526 (2)]. Thus, basically the winding up remains a voluntary winding up, but it also has the advantages of compulsory winding up. Because the court gets all the powers which it can exercise in a compulsory winding up.

22.7 WINDING UP OF UNREGISTERED COMPANIES

The expression 'unregistered company' is defined in Section 582 of the Companies Act. According to this section, an unregistered company includes any partnership, association, or company consisting of more than seven members at the time when petition for winding up is presented before the court. However, it does not include the following:

a) A railway company incorporated by any Act of Parliament or other Indian Law, or any Act of the British Parliament.

b) A company registered under the Companies Act, 1956.

c) A company registered under any previous company law other than those having registered office in Burma, Aden, or Pakistan before their separation from India. The above definition of an 'unregistered company' as contained in Section 582 states the associations etc. which are to be included in the expression 'unregistered companies', and the associations which are not to be included in it. It is, however, important to note that the scope of Section 582 is wide and not limited to include only specified associations. As a matter of fact, every association of persons consisting of more than seven members (but not more than 10 in case of an association carrying on a banking business, and 20 in case of any other business) is an unregistered company if it is not registered under the Companies Act or any other law for the time being in force in India.

An unregistered company may be wound up under the provisions of the Companies Act, and all the provisions of this Act relating to the winding up are applicable to the winding up of unregistered companies [Section 583 (1)]. However, certain provisions exclusively dealing with the winding up of unregistered companies are contained in Part X (Sections 582 to 590) of the Companies Act. These may be summed up as under :

1. An unregistered company can be wound up only by the court. It can neither be wound up voluntarily nor subject to the supervision of the court [Section 583 (3)].

2. An unregistered company may be wound up in the following circumstances [Section 583 (4)] :

(a) If the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs.

(b) If the company is unable to pay its debts.

(c) If the court is of the opinion that it is just and equitable to wind up the company.

3. Every person shall be considered to be a contributory that is liable to pay any of the following amounts [Section 585 (1)]

a) any debt or liability of the company.

b) any amount for the adjustment of the rights of the members among themselves.

c) any costs, charges and expenses of winding up of the company.

It is important to note that every contributory (past or present) irrespective of the fact when he ceased to be the member shall be liable to contribute to the assets of the company all amount due from him to the company.

4. On the making of the winding up order, any suit or other legal proceeding can be commenced (i.e. filed) against any contributory of the company only with the leave (i.e. permission) of the court [Section 587]. The object of this provision is to prevent a creditor of an unregistered company from filing suit not only against the company but also against the contributory of the company.

22.7.1 Courts Having Jurisdiction to Wind up Companies

The courts having jurisdiction to wind up the company (i.e. the courts in which the winding up petitions can be filed) are specified in Section 10 of the Companies Act. According to this section, the winding up petition can be filed in the High Court which has the jurisdiction (i.e. power) to try the legal proceedings in relation to the place at which the registered office of the company concerned is situated e.g., if the registered office of a company is situated in the area which falls within the territorial jurisdiction of Delhi High Court, the winding up petition in respect of such a company can be filed in the Delhi High Court.

It is important to note that the Central Government may also by notification in the Official Gazette empower any District Court to exercise the powers of winding up of companies. However, in respect of companies having paid up share capital of rupees one lack or more, only the High Courts shall have the jurisdiction to try winding up petitions.

Following are some of the important provisions relating to the jurisdiction of courts in respect of winding up of companies:

1. The High Court, making an order of winding up of a company, may transfer all subsequent proceedings to a District Court subordinate to it. It may also, with the consent of any other High Court, transfer the subsequent proceedings to that High Court or to a District Court subordinate to that High Court [Section 435]. Such an action is taken by the High Court if it thinks fit to do so.

2. The High Court may also withdraw the winding up proceedings pending before a District Court, and transfer the same to itself or to any other District Court [Section 436]. Such an action is taken by the High Court if it appears to .the court that by doing so the winding up proceedings can more conveniently be proceeded with.

3. The High Court may also allow a District Court to continue with the winding up proceedings started by it although it may not be the court in which the proceedings should have been commenced [Section 437].

MODEL QUESTIONS

Answer any FIVE Questions **5 x 20 = 100**

1. Discuss the essential elements of a valid contract.
2. What are remedies available to an aggrieved party in case of breach of contract?
3. Discuss the circumstances under which an offer lapses.
4. Explain the rights and duties of a bailee.
5. Explain the different kinds of company.
6. Explain the provisions of the companies act relating to the alteration of memorandum of association.
7. Classify the different types of meeting under the companies act and explain the provisions relating to each?
8. Discuss briefly the powers, duties and liabilities of a company director?