

# PONDICHERRY UNIVERSITY

(A Central University)

## DIRECTORATE OF DISTANCE EDUCATION

### MASTER OF COMMERCE



M.Com – First Year

Course Code:  
59

Paper Code:  
MCOM1006

**BUSINESS ENVIRONMENT AND LAW**

**DDE – WHERE INNOVATION IS A WAY OF LIFE**

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# **Business Environment and Law**

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## **PAPER – VI BUSINESS ENVIRONMENT AND LAW**

### **UNIT – I**

Dynamics of Business and its Environment - Ethics in Business - Economic Systems and Management Structure - Economic Transition in India: Privatisation, Globalisation and Competition - Economic and Business Development and Environmental Issues.

### **UNIT – II**

Infrastructural Environment: Energy, Power, Transport, Communication - Social; Education, Demographic Issues - Political: Constitution, Electoral Issues, Democracy - Productivity Factors, Human Elements and Issues for Improvement - Total Quality - Management Issues - Global Trends in Business and Management - MNCs - Foreign Capital and Collaboration - Trends in Indian Industry - The Capital Market Scenario - Future Perspective of Indian Industry and Management.

### **UNIT-III**

Law of Contract - Agreement - Offer - Acceptance - Consideration - Capacity of Contract → Contingent Contract - Quasi Contract - Performance - Discharge - Remedies to breach of Contract - Partnership - Sale of Goods - Law of Insurance - Negotiable Instruments - Notes, Bills, Cheques - Crossing - Endorsement - Holder in due course - Holder in value - Contract of Agency.

### **UNIT-IV**

Company - Formation - Memorandum - Articles - Prospectus - Shares - Debentures → Directors - Appointment - Powers and Duties - Meetings - Proceedings - Management → Accounts – Audit Oppression and Mismanagement - Winding up.

### **UNIT-V**

Factory Act – Licensing and Registration of Factories, Health, Safety and Welfare Measures - Industrial Disputes Act: Objects and Scope of the Act, Effects of Industrial Dispute, Administration under the Act - Minimum Wages Act - Workmen Compensation Act.

### **REFERENCES:**

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**Rudder Dutt&Sundaram:** INDIAN ECONOMY; Vikas, New Delhi

**Kapoor, N.D.:** ELEMENTS OF MERCANTILE LAW.

**Maheswari&Maheswari:** MERCANTILE LAW.

**Ramiah:** COMPANY LAW

## UNIT - I

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### **Objectives:**

*After going through this unit, you should be able to:*

- ▶ Understand the importance of the dynamics of business and its environment;
- ▶ Review the impact of technological, political, social and cultural environment on business;
- ▶ Have some insights into the concepts of corporate governance & social responsibility;
- ▶ Reflect on the need and importance of ensuring ethics in business; and
- ▶ Highlight on some of the key issues relating to the economic systems and management structure of business.

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### **Lesson - 1 Business And Its Environment**

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#### **Definition Of Business**

The term business is understood and explained in different ways by different people. For some, business is an activity, for some it is a method of transacting, for some others, it is a method of money making and some people argue that business is an organized activity to achieve certain pre-determined goals or objectives. Dictionary meaning of business is: the act of buying and selling of goods and services, commerce and trade. Based on all these meanings of business, we may define business as: gainful activity through which various elements of society conduct exchanges of the desirable things.

#### **Nature Of Business**

Business may be understood as the organized efforts of enterprise to supply consumers with goods and services for a profit. Businesses vary in size, as measured by the number of employees or by sales volume. But, all businesses share the same purpose to earn profits.

The purpose of business goes beyond earning profit. There are:

- It is an important institution in society.
- Be it for the supply of goods and services
- Creation of job opportunities
- Offer of better quality of life
- Contributing to the economic growth of the country.

Hence, it is understood that the role of business is crucial. Society cannot do without business. It needs no emphasis that business needs society as much.

### **Business Goals**

**Profit** - Making profit is the primary goal of any business enterprise.

**Growth** - Business should grow in all directions over a period of time.

**Power** - Business houses have vast resources at its command. These resources confer enormous economic and political power.

**Employee satisfaction and development** - Business is people. Caring for employee satisfaction and providing for their development has been one of the objectives of enlightened business enterprises.

**Quality products and services** - Persistent quality of products earns brand loyalty, a vital ingredient of success.

**Market leadership** - To earn a niche for oneself in the market, innovation is the key factor.

**Challenging** - Business offers vast scope and poses formidable challenges.

**Joy of creation** - It is through business strategies new ideas and innovations are given a shape and are converted into useful products and services.

**Service to society** - Business is a part of society and has several obligations towards it.

## **Definition Of Business Environment**

“The total of all things external to firms and industries which affect their organization and operation”—**Bayard O. Wheeler**

According to **Arthur M. Weimer**, business environment encompasses the ‘climate’ or set of conditions, economic, social, political or institutional in which business operations are conducted.

## **Types Of Environment**

The business environment poses threats to a firm or offers immense opportunities for potential market exploitation. The business is determined by two factors namely:

1. Micro environment or internal factor or endogenous factor.
2. Macro environment or external factor or exogenous factor.

## **Micro Environment**

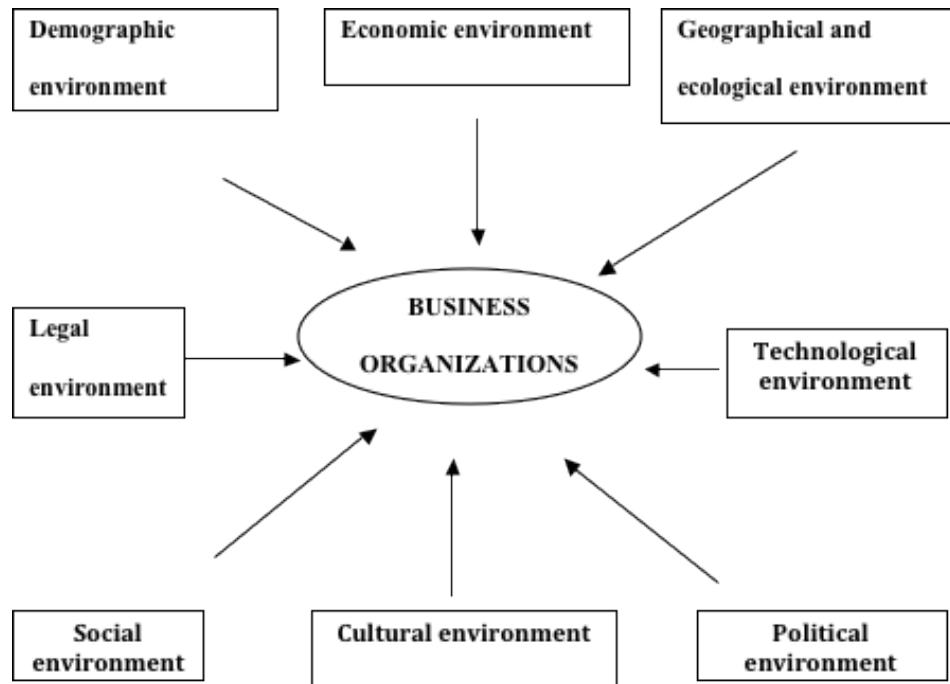
Micro environment relates to internal matters of business such as:

- › Structure of business
- › Size of the business
- › Policy relating to business
- › Product produced

## **Macro Environment Or Business Environment Or External Environment**

- › Demographic environment
- › Economic environment
- › Geographical and ecological environment
- › Legal environment
- › Technological environment
- › Social environment
- › Cultural environment
- › Political environment

## Constituents Of Business Environment



### Demographic Environment

This refers to the size and behaviour of the population in a country. Suppose a country has a huge size of population, then, the country would provide extensive business or marketing opportunities for all types of business organizations. On the other hand, a country with low size of population would force the business organizations to seek external market for their products or services. Similarly, if the population in a country is well - tuned to 'use and throw concept' [like most of the western countries] then there would be limited scope for repair shops. The employment scope in that segment would be almost nothing. But alternatively this would give wide marketing opportunities for manufacturing organizations. On the other hand, if the population is averse to 'use and throw' concept, then the business opportunities would be limited for manufacturing organizations. But the repair shops, self-employed technical persons and spares manufacturers, would have roaring business. Hence, the size and quality of population emerge as vital factors in a business environment.



## **Economic Environment**

There is close relationship between business and its economic environment. Business obtains all its needed inputs from the economic environment and it absorbs the output of business units.

1. Fiscal policy
2. Monetary policy.
3. Foreign policy.

## **Geographical And Ecological Environment**

Geographical environment refers to climatic conditions and natural resources, which determines the manufacturing scope and the nature of the products that could be marketed. For example, a country like kenya has to manufacture more of products based on forest resources, while the gulf countries can produce only crude, japan can have business on fish, fruits, etc., Countries in the tropical region would produce products from largely available geographical resources in that region, organizations in mediterranean countries have a different business scope, scandinavian countries have scope in dairy products and so on. On the other hand, steps towards balanced eco- system are taking place at an alarming rate in the world today. Deforestation and hunting of rare species of animals for food have been prohibited. Hence, while identifying the business opportunities, business organizations have to be conscious of the limitations posed by the geographical and ecological considerations.

## **Legal Environment**

It is well known that every country has a number of legal regulations to ensure that the interests of business organizations do not run counter to national interests. Right from the stage of incorporation of organizations, their listing in stock exchange, redress of customer complaints, payment of tax to government, manufacturing practices, human resources development to pricing of products and services, a number of legal regulations have to be fulfilled. For example, in usa and several western countries, consumer protection is very active, that even a medical practitioner is subjected to huge liabilities in times of deficiency in services. In india and other countries, very rigorous legal provisions are in place to prevent hunting

of rare species. Hence, any organization, which manufactures products based on such species, have to get legal sanctions. In case of failure to honour cheques issued, organizations are now a days made to pay hefty compensations. Hence, the deterrence in terms of legal provisions has become the order of the day. All organizations have to first of all address these provisions become coming in to steam.

### **Technological Environment**

Technology is understood as the systematic application of scientific or other organized knowledge to practical tasks. Technology changes fast and to keep pace with it, businessmen should be ever alert to adopt changed technology in their businesses.

### **Political Environment**

It refers to the influence exerted by the three political institutions viz., Legislature, executive and the judiciary in shaping, directing, developing and controlling business activities. A stable and dynamic political environment is indispensable for business growth.

### **Natural Environment**

Business, an economic pursuit of man, continues to be dictated by nature. To what extent business depends on nature and what is the relationship between the two constitute an interesting study.

### **Social And Cultural Environment**

It refers to people's attitude to work and wealth; role of family, marriage, religion and education; ethical issues and social responsiveness of business. According to geert hofstede, culture is "the collective programming of the mind that distinguishes the members of one category of people from those of another".

## Business Environmental Factors

Sl.No.	Factors	Components
1.	Political	Political System, Political Institutions, Political Environment, Political Ideologies Of Parties, Political Stability, Political Culture Etc.
2.	Government	System Of Government Distribution Of Environment, Power Between National And Local Government, Culture Of Civil Servants, Government Policy On Businesses, Etc.
3.	Legal	Business Related Laws Governing Environment Competition, Consumer Protection, Contractual Obligations, Regulation Of Foreign Participation, Respect For Judiciary Efficiency Of The Same, Etc.
4.	Economic	Size Of The Economy Composition Of The Environment, Economy, Economic Health, Economic Policies – Fiscal Monetary And Entrepreneurial Foreign Capital, Etc.
5.	Technological	Technological Orientations, Research Environment Development, Technology Import And Absorption, Technological Obsolescence, Etc.
6.	Ecological	Natural Resources And Reserves Need For Environment, Protection Of Fragile Zones, Pollution Control Etc.
7.	Geographical	The Geo-Peculiarities Of A Region Like Environment, The Terrain Vegetation Cover Location Attitude, Rainfall, Climate Etc.
8.	Cultural	Cultural Life Of People Rites, Rituals, Environmental Festivals, Heritage Invasion Of Alien Culture Business, Culture Roles, Etc.
9.	Social	Social Practices, Social Classification Environment Like Caste Religion And Community, Social Institutions Like Family, Marriage, Etc.
10.	Demographic	Size Of Population Composition Of Environment, Population, Family Size And Cycle Language Educational Attainments, Entrepreneurial Talents, Etc.

## **Corporate Governance, Social Responsibility And Business Ethics**

### **Corporate Governance**

Corporate failures and widespread dissatisfaction with the way many corporate functions have led to the global realization of the need of a proper system for corporate governance.

Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources.

The aim is to align as nearly as possible the interest of individuals, corporations, and society. The incentive to corporations and to those who own and manage them to adopt internationally accepted governance standards is that these standards will help them to achieve their corporate aims and to attract investment.

The incentive for their adoption by states is that these standards will strengthen the economy and discourage fraud and mismanagement.

### **Relevance**

At least three reasons have trigger off concern in corporate governance in our country.

- ▶ Since 1991, the country has moved into liberalized economy and one of the victims of the market-based economy is transparent fair business practice. Several instances of mismanagement have been alleged, with some well-known and senior executive being hauled up for non-performance and /or non-compliance with legal requirements.
- ▶ Both domestic as well as foreign investors are becoming more demanding in their approach towards the companies in which they have invested their funds. They seek information and want to influence decisions.

- ▶ Interests of non-promoter shareholder and those of small investors are increasingly being undermined. Several mncs have sought to set up 100 percent subsidiaries and transfer their businesses to them .In many cases, there was no thought of consultation with non-promoter shareholders.
- ▶ In this context, some norms of behavior to ensure responsive behavior are of great help. Hence, corporate governance is relevant.

## **Focus**

Corporate governance is concerned with the values, vision and visibility. It is about the value orientation of the organization, ethical norms for its performance, the direction of development and social accomplishment of the organization and the visibility of its performance and practices.

Corporate management is concerned with the efficiency of the resources used, value addition and wealth creation within the broad parameters of the corporate philosophy established by corporate governance.

## **Importance**

- ▶ Studies of firms in india and abroad have shown that markets and investors take notice of well-managed companies, respond positively to them, and reward such companies, with higher valuations. In other words they have a system of good corporate governance.
- ▶ Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection.
- ▶ Corporate governance prevents insider trading.
- ▶ Under corporate governance, corporates are expected to disseminate the material price sensitive information in a timely and proper manner and also ensures that till such information is made public, insiders abstain from transacting in the securities of the company.

- The principle should be 'disclose or desist'. Good corporate governance, besides protecting the interests of shareholders and all other stakeholders, contributes to the efficiency of a business enterprise, to the creation of wealth and to the country's economy.
- Good corporate governance is considered vital from medium and long- term perspectives to enable firms to compete internationally in a sustained way and make them, not only to improve standard of living materially but also to enhance social cohesion.

### **Pre-Requisites**

A system of good corporate governance requires the following:

- A proper system consisting of clearly defined and adequate structure of roles, authority and responsibility.
- Vision, principles and norms, which indicate development path, normative considerations, and guidelines and norms for performance.
- A proper system for guiding, monitoring, reporting and control.
- The two issues - an organization's social responsibility and responsiveness- ultimately depend on the ethical standards of managers.

### **Social Responsibility**

Social responsibility is the obligation of decision-makers to take actions, which protects and improves the welfare of society as a whole along with their own interests. Every decision the businessman takes and every action he contemplates have social implications.

### **Definition Of Social Responsibility**

“Social responsibility refers to the business decisions & actions taken to reasons atleast partially beyond firm's direct economic or technical interest” – **Keith Davis**

## **Arguments For Social Responsibility**

- Business has to respond to the needs and expectations of society.
- Improvement of the social environment benefits both society and business.
- Social responsibility discourages additional governmental regulation and intervention.
- Business has a great deal of power, which should be accompanied by an equal amount of responsibility.
- Internal activities of the enterprise have an impact on the external environment.
- The concept of social responsibility protects interests of stockholders.
- Social responsibility creates a favourable public image.
- Business has the resources to solve some of social problems.
- It is better to prevent social problems through business involvement than to cure them.

## **Arguments Against Social Responsibility**

- Social responsibilities could reduce economic efficiency.
- Social responsibility would create excessive costs for business.
- Weaken international balance of payments
- Business has enough power, and social involvement would further increase its power and influence.
- Business people lack the social skills necessary to deal with the problems of society.
- Business is not really accountable to society.

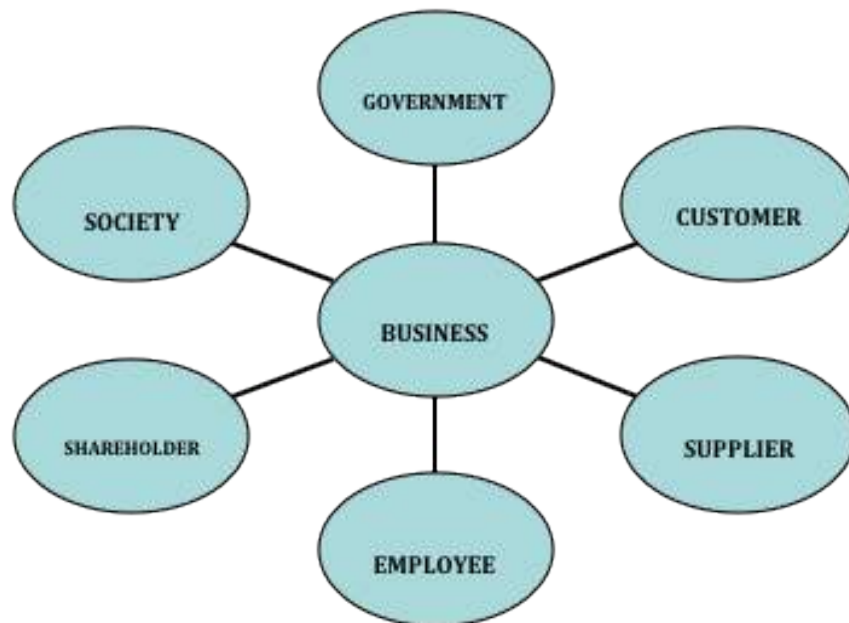
## **Social Stakeholders**

Managers, who are concerned about corporate social responsibility, need to identify various interest groups which may affect the functioning of a business organization and may be affected by its functioning. Business enterprises are primarily responsible to six major groups:

- Shareholders
- Employees
- Customers
- Creditors, suppliers and others
- Society and
- Government.

These groups are called interest groups or social stakeholders. They can be affected for better or worse by the business activities of corporations.

### **Social Responsibility**



### **Social Responsibility Towards Stakeholders**

#### **Customer:**

- Avoid misleading advertisement.
- Avoid misleading name of the product.
- Avoid authorized dealer name for misleading customer.
- Avoid wrong information.
- Avoid exploiting customers.
- Avoid collusive agreements with other firms to exploit customer.



**Employees:**

- Fair wage, bonus & incentives to employees.
- Cordial relation towards employees.
- Providing better working condition.
- Creating opportunities for creative and talent employees.
- Proper training.
- Proper and transparent performance, appraisal and promotion

**Shareholders:**

- Assuring security to their fund
- Proper payment of return on investment(roi)
- Providing correct information about the company.

**Government:**

- The business activities should be law abiding.
- Prompt payment of tax & other duties.
- Abiding by pollution controls.

**Creditors & Suppliers:**

- Maintenance of cordial relationship.
- Timely payment & obligation.
- Providing true & correct picture of financial position

**Society:**

- Preventing monopoly.
- Disposal of waste & effluents.
- Creating employment opportunities.
- Balanced regional rural development.

## **Business Ehtics**

The term ethics commonly refers to the rules or principles that define right and wrong conduct. Business ethics is concerned with truth and justice and has a variety of aspects such as expectations of society, fair competition, advertising, public relations, social responsibilities, consumer autonomy, and corporate behaviour in the home country as well as abroad.

### **Defintion Of Ethics**

Ethics is defined as the “discipline dealing with what is good and bad and with moral duty and obligation”.

### **Types Of Ethics Can Be Classified As**

1. Individual Or Personal Ethics
2. Professional Ethics
3. Business Ethics Or Corporate Ethics

### **Need For Business Ethics**

- Ethics corresponds to basic human needs. It is human trait that man desires to be ethical, not only in his private life but also in his business. These basic ethical needs compel the organizations to be ethic-oriented.
- Values create credibility with public. A company perceived by the public to be ethically and socially responsive will be honoured and respected. The management has credibility with its employees precisely because it has credibility with the public.
- An ethical attitude helps the management make better decisions, because ethics will force a management to take various aspects – economic, social, and ethical in making decisions.
- Value driven companies are sure to be successful in the long run, though they lose money in the short run.
- Ethics is important because the government, law and lawyers cannot do everything to protect society.

## **Ethical Guidelines**

In business, many of ethical guidelines arise from the following value consideration:

- ▶ Is there any unfair gain to the person doing it? An example is a conflict of interest in which manager gains through a purchase contract that he makes with a firm in which he has a secret interest.
- ▶ Is there unfair harm to others? Example: a private disclosure of unfavourable financial information to a shareholder of the firm.
- ▶ How substantial is the unfair gain or harm to others? Example, water pollution in the community and taking part in the civic programme of chlorinating the drinking water.
- ▶ Was the act a personal one or a representative behaviour according to the established practice? Example dismissing an employee on personal dislike is more serious than dismissing him on grounds of poor performance.

## **Approach Of Business Ethics**

### **Moral Management**

Moral management strives to follow ethical principles and precepts, moral managers strive for success, but never violate the parameters of ethical standards. They seek to succeed only within the ideas of fairness and justice.

Moral managers follow the law not only in letter but also in spirit. The moral management approach is likely to be in the best interests of the organization's long run.

### **Amoral Management**

This Approach Is Neither Immoral Nor Moral. It Ignores Ethical Considerations. Amoral Management Is Broadly Categorized Into Two Types – Intentional and unintentional.

- ▶ Intentional amoral managers exclude ethical issues because they think that general ethical standards are not appropriate to business.

- Unintentional amoral managers do not include ethical concerns because they are inattentive or insensitive to the moral implications.

## **Immoral Management**

Immoral management is synonymous with “unethical” practices in business. This kind of management not only ignores concerns, it is actively opposed to ethical behaviour.

## **Codes Of Conduct**

A formal document, that states an organization’s primary values and the ethical rules, expects employees to follow it. The code is helpful in maintaining ethical behaviour among employees.

**Clarence C. Walton** has given models of business conduct. They are as follows

1. **Austre Model:** This business gives exclusive emphasis on ownership interest and profit objective. This type of business will always cost-conscious in every activity. This firm will be conservative in outlook.
2. **The Household Model:** The business gives extension of the benefits to the employees with condescension of paternalism. This type of business is analogous to a family or household consisting of shareholders, management and employees whose benefits will be looked after.
3. **The Vendor Model:** In this type of business, consumer interest, tastes and right would be given first preference and consumer satisfaction would be dominating the organization.
4. **The Investment Model:** This model focuses on the organization as an entity and thus on long term profits and survival. It gives recognition to social investments along with economic investments.
5. **The Civic Model:** This accepts social responsibility and makes a positive commitment to social needs. Its slogan is corporate responsibility.
6. **The Artistic Model:** This model encourages the organization to

become a creative instrument serving the cause of an advanced civilization with a better quality of life. It undertakes creative ideas in its actions not originally contemplated by others.

## **Business Ethics In India**

The people are more concerned about the open unethical practices of the business to exploit the consumer, the employees and the government. In india the open corrupt practices are considered as unethical practices. These unethical practices are looming large in india.

Mr. K.Santhanam who was the chairman of the prevention of corruption committee estimated that 25% of our plan expenditure had been lost because of corrupt practices and inefficiency. Now the percentage would be still larger.

## **Business Unethical Practices:**

### **Towards Customers:**

1. Adulteration.
2. Duplicates.
3. Spurious products.
4. Injurious products.
5. Deceptive advertisement.
6. Deceptive packing and containers.

### **Towards Employees:**

1. Low salaries.
2. Giving low wages after getting discharge of higher amounts.
3. Employing children.
4. Poor working condition.

### **Towards Government And Customers:**

1. Tax evasion.
2. Bribery and corruption to get licenses and quotes.
3. Over invoicing and under invoicing.

4. Pollution.
5. Payment of money to the party in power and indulging in price-hikes and other unethical activities.

### **Tools For Ethical Management**

- ▶ **Top Management Commitment:** Managers can prove their commitment and dedication for work and by acting as role models through their own behaviours.
- ▶ **Ethics Committees:** Appointment of an ethics committee, consisting of internal and external directors is essential for institutionalizing ethical behaviour.
- ▶ **Ethics Audits:** Systematic assessment of conformance to organizational ethical policies, understanding of those policies, and identification of serious deviations requiring remedial action.
- ▶ **Ethics Training:** Ethical training enables managers to integrate employee behavior in ethical arena with major organizational goals.
- ▶ **Ethics Hotline:** A Special telephone line that enables employees to bypass the normal chain of command in reporting their experiences, expectations and problem. The line is usually handled by an executive appointed to help resolve the issues that are reported.

## **Economic Systems**

### **Meaning**

Economic system is a social organism through which people make their living. It is constituted of all those individuals, households, farms, firms, factories, banks and governments, which act and interact to produce and consume goods and services. Individuals and households put their resources (land, labour, capital and skill) to one or more of their alternative uses and make their living; firms buy factors of production and organize them in the process of production, produce goods and services, and sell them to their users to make projects.

Consumers are able to get the goods and services of their requirement; producers are able to produce and sell various kinds of products in appropriate quantities and so on. The system is operated by, what adam smith Called “**Invisible Hands**”, the market forces of demand and supply.

A modern economic system is enormously complex. Millions of people participate and contribute to its working in different capacities – as producers, traders, workers, consumers and financiers and so on. Thousands of people are involved in production and distribution of single commodity. A community, before it reaches its final consumer, passes through a complex process of production and through a number of intermediary hands.

## **Kinds Of Economic Systems**

### **Free Enterprise Economy**

This economic system works on the principle of laissez faire system, i.E., The least interference by the government or any external force. The primary role of the government, if any, is to ensure free working of the economy by removing obstacles to free competition.

A free enterprise economy is characterized as follows:

- ▶ Means of production are privately owned by the people who acquire and possess them
- ▶ Private gains are the main motivating and guiding force for carrying out economic activities
- ▶ Both consumers and firms enjoy the freedom of choice; consumers have the freedom to consume what they want to and firms have the choice to produce what they want to
- ▶ The factory owners enjoy the freedom of occupational choice, i.E., They are free to use their resources in any legal business or occupation;
- ▶ There exists a high degree of competition in both commodity and factor markets and
- ▶ There is least interference by the government in the economic activities of the people; the government is in fact supposed to

limit its traditional functions viz, to defence, police, justice, some financial organizations and public utility services.

### **Government-Controlled Economy**

The government-controlled economies are also called as 'command, centrally planned or socialist economies'. Such economies are, in contradiction to the free enterprise economies, controlled, regulated and managed by the government agencies.

The other features of a pure socialist economy are:

- ▶ Means of production are owned by the society or by the state in the name of the community – private ownership of factors and property is abolished;
- ▶ Social welfare is the guiding factor for economic activities – private gains, motivations and initiatives are absent,
- ▶ Freedom of choice for the consumers is curbed to what society can afford for all, and
- ▶ The role of market forces and competition is eliminated by law.

### **Mixed Economy**

A mixed economy is one in which there exist both government and private economic systems. It is supposed to combine good elements of both free enterprise and socialist economies. A mixed economy is widely known as one, which had both “**Public Sector**” (the government economy) and “**Private Sector**” (the private economy). The private sector has features of a free enterprise economy and the public sector has features of socialist economy. It is important to note here that most economies in the world today are mixed economies.

There are two different forms of the mixed economies.

#### ▶ **Mixed Capitalist Economies**

A mixed capitalist economy is a variant of the free enterprise economic system. To this category fall the highly developed nations like the united states, u.K., France, japan etc. Though these economies have a very



large government sector, their private sectors will work on the principles of the free enterprise system. The government plays a significant role in preserving capitalist mode of production, ensuring a workable competition in factor and product markets, providing infrastructure for promotion of private sector's economic activities.

‣ **Mixed Socialist Economies**

To the category of the mixed socialist economies belong the countries which have adopted “socialist pattern of society and economic planning as he means of growth and social justice (e.G. India) and the former communist countries (e.G. Russia and china) have of late carried out drastic economic reforms and liberalized their economies for private entrepreneurship. The government of these countries takes upon themselves to control and regulate the private sector activities in accordance with the plan objectives.

### **Basic Problems Of An Economy And The Role Of Government**

Whatever the nature of the economic system, all types of economies have been faced with certain common basic problems.

The major economic problems faced by an economy may be classified into two broad groups:

- **Micro-Economic Problems** Called *Basic Problems*, which are related to the working of the constituents of the economic system; and
- **Macro-Economic Problems** related to the growth, stability, and management of the economy as a whole.

The way the basic problems of an economy are solved depends on the nature of the economy. While in a socialist economy they are solved by the government agencies, like central planning authority, in a free enterprise or mixed capitalist economy this task is performed by the price mechanism or market mechanism.

Though free enterprise system is capable of bringing economic growth, it does not ensure a stable, sustained, and balanced growth. It becomes therefore inevitable for the government to intervene fair competition, and help the economy in achieving its goals – efficiency, stability, growth and economic justice.

Now, the question arises as to what should be the appropriate role of the government in economic management of the country or what should be the form, nature and extent of government's interference with market mechanism.

Nevertheless, the economic role of the government can be broadly categorized on the basis of the three economic systems which presently prevail in the world, viz., Capitalist system or free enterprise system, socialist system, and the mixed-economy system.

### **1. Capital Society:**

In this system, the primary role of the government are: (i) to preserve and promote free market mechanism wherever it is possible to ensure a workable competition, (ii) to remove all unnecessary restrictions on the free operation of competitive market, and (iii) to provide playground and rules of the market game through necessary interventions and controls so that free competition can work effectively.

It may be inferred that the government's role in a capitalist society is supposed to be limited to (a) restoration and promotion of necessary conditions for efficient working of free market mechanism; and (b) to enter those areas of production and distribution in which private entrepreneurship is lacking or is inefficient.

### **2. Socialist Economy:**

In contrast with the capitalist system, the role of government in a socialist economy is much more exhaustive. While in the former, the government is supposed to play a limited role in the economic sphere, in the latter,

It exercises comprehensive control on almost all economic activities. In the socialist system, not only there is a complete disregard for free enterprise and market mechanism but also these systems are abolished by law. The private ownership of factors of production is replaced by the state ownership. All economic activities are centrally planned, controlled and regulated by the state. All decisions regarding production resources, allocation, employment, pricing etc., Are centralized in the hands of government or the central planning authority.

### **3. Mixed Economy:**

In this system, a major part of the economy, the *private sector*, is allowed to function on the principles of free enterprise system or free market mechanism within a broad political and economic policy framework. The other part of the economy, the *public sector*, is organized and managed along the socialist pattern. The public sector is created by reserving certain industries, trade, services, and activities for the government control and management. The government prevents by an ordinance the entry of private capital into the industries reserved for the public sector. Another way of creating or expanding the public sector is *nationalization* of existing industries. The promotion, control and management of the public sector industries are the sole responsibility of the state.

Apart from controlling and managing the public sector industries the government controls and regulates the private sector through its industrial, monetary and fiscal policies. If necessary, direct controls are also imposed.

### **Characteristics Of Mixed Economy:**

#### **I. Co-Existence Of Public And Private Sectors:**

In a mixed economy, one will find the existence of both the private and public sectors. In such a system, the government will undertake the responsibility to build and develop certain sectoral activities and leave the other activities for the private initiative. In india, the government announced the adoption of the mixed economy system through its 1948 industrial policy resolution. The government clearly earmarks the industries to be completely under the state control, the industries which are to be owned and controlled by the state as well as the private sector

and industries which are completely left for the private sector. In this way the resolution provided for the simultaneous existence of both private and public sectors.

## **II. State Participation In Economic Development:**

This is the second feature of mixed economy, according to which the state reserves its right to design and decide the type of development to be achieved. In such a set up, the government strives to promote the welfare of the country by ensuring social order, social justice and establishing all the necessary institutions which are required to achieve the desired pattern of growth and development.

## **III. Distribution Of Ownership And Control Of Resources:**

This is the next feature of mixed economy. In this system, the government itself enters the field of production so that the available resources are fully utilized. This will also help to avoid concentration of wealth in the hands of a few and enable distribution of ownership and control of productive activities. As a result there is no scope for exploitation of any group, say labour, by any other group. In this way the weaker section of the community is well protected and taken care of. Only the mixed economy will enable the government to attain the objectives of the directive principles of the Indian constitution.

## **IV. Directing The Investment In Socially Desirable Projects And Channels:**

Mixed economy facilitates the flow of investment into channels which confers the society with several benefits. For example, the Indian government has invested huge amount in several projects to develop the infrastructural facilities. This forms the basis for the development of other sectors. The investment in these infrastructural areas will not come forth from the private sector as the return is nil. Hence, the government in a mixed economic set up provides the thrust by developing the necessary background and strength which will encourage the private sector to invest in profitable opportunities. Thus, the government plays a key role in a mixed economic system.

## **V. Scope For Achieving Balanced Economic Development:**

One left to itself, the private sector would establish its enterprises only in urban or sub-urban areas and that too in already well developed states. This will mean other areas will have no scope for development. But in a mixed economy, the government will itself undertake the initiative to set up industries in backward areas and encourage the private initiative to set up industries in such areas by offering several concessions and exemptions. In the absence of mixed economy, several states in india would have remained industrially backward.

## **VI. Ultimate Control And Regulation In The Hands Of Government:**

This feature of mixed economy clearly spells out that in every activity affecting the economy, the government will be the ultimate authority. Though the private sector is assigned its role to perform, the government will still monitor and control the way in which the private initiative is performing its role. According to the 1948 industrial policy resolution, the government made it clear that the industries already established by the private sector belonging to the category in which new industries will be established by the government alone, the government would undertake the review of the working of these industries in private sector for a decade and if it's found unsatisfactory, they would be taken over by the government. Though this was criticised as a threat to nationalisation, yet through such a provision the government underlines its authority. Similarly in the banking and insurance sectors, the government nationalised banks emphasising its powers to control and regulate any sector.

## **VII. Co-Operation In The Field Of Economic Development:**

According to this feature of mixed economy, the government formulates the design for development and invites the private sector to participate in the development. It clearly spells out the guidelines which would govern such co-operative efforts and the limits of freedom granted to the private sector. In indian case, the government prepares the plans for development and spells out the areas left for the private initiative and the areas will be under state control. Hence, there is scope for the development of private sector, though only according to the design developed by the government.

## **Economic Transition In India: Privatisation And Globalisation**

### **Privatisation**

Privatisation, which has become a universal trend, means transfer of ownership or management of an enterprise from the public sector to the private sector. It also means the withdrawal of the state from an industry or sector, partially or fully. Another dimension of privatisation is opening up of an industry that has been reserved for the public sector to the private sector.

Privatisation is an inevitable historical reaction to the indiscriminate expansion of the state sector and the associated problems. Even in the 'communist' countries it became a vital measure of economic rejuvenation.

### **Ways Of Privatisation**

1. Divestiture or privatisation of ownership through sale of equity.
2. Reprivatisation or denationalisation.
3. Franchising.
4. Contracting
5. Leasing

#### **1. Divestiture**

Allowing the private sector to participate in the equity of government held company or public sector unit is one more form of privatisation. In this case the government widely announces its intention of selling the equities of a public sector unit by inviting the private sector to buy these equities and become partner in the ownership, management and control of the unit.

#### **2. Denationalisation**

Those units which were nationalised in the past, to enable the government to have management and control over them, are handed over to the private sector for continued operation. For example, suppose a

commercial was nationalised by taking it over from a private management, under privatisation, the government voluntarily reduces its hold in the bank by disposing of its ownership equities to the private sector

### **3. Franchising**

The government may provide the technical know-how and the name and brand name may be provided by the private sector. For example, the millions of STD/ISTD telephone booths are owned by the private parties and the telephone link is provided to them by the government. In this case the private parties are franchised to use the telecommunication links provided by the government. Before this, the postal and telegraph departments were completely providing this service.

### **4. Contracting**

Government may contract out its service and make the service available to the common public through private bodies. For example, railways or airways may contract the catering service to an outside hostel or restaurant for a fixed period.

### **5. Leasing**

Leasing of facilities provided by the government is yet another form of privatisation. For example, a shopping complex built by the government may be leased out to private parties for a specified period against the payment of lease rentals.

### **Objects**

The objects are:

- ▶ To improve the performance of psus, so as to lessen the financial burden on taxpayers.
- ▶ To increase the size and dynamism of the private sector, distributing ownership more widely in the population at large.
- ▶ To encourage and to facilitate private sector investments, from both domestic and foreign sources.
- ▶ To generate revenues for the state.

- To reduce the administrative burden on the state.
- Launching and sustaining the transformation of the economy from a command to a market model.

### **Privatisation Routes**

The important ways of privatisation are:

- Divestiture, or privatisation of ownership, through the sales of equity. Denationalization or reprivatisation.
- Contracting – under which government contracts out services to other organizations that produce and deliver them.
- Franchising – authorizing the delivery of certain services in designated geographical areas – is common in utilities and urban transport.
- Government withdrawing from the provision of certain goods and services leaving them wholly or partly to the private sector.
- Privatisation of management uses leases and management contracts
- Liquidation, which can be either formal or informal. Formal liquidation involves the closure of an enterprise and the sale of its assets. Under informal liquidation, a firm retains its legal status even though some or all of its operations may be suspended.

### **Benefits**

The benefits of privatisation may be listed down as follows:

- It reduces the fiscal burden of the state by relieving it of the losses of the soes and reducing the size of the bureaucracy.
- Privatisation of soes enables the government to mop up funds.
- Privatisation helps the state to trim the size of the administrative machinery.
- It enables the government to concentrate more on the essential state functions
- Privatisation helps to accelerate the pace of economic developments as it attracts more resources from the private sector for development.
- It may result in better management of the enterprises.



- Privatisation may also encourage entrepreneurship.
- Privatisation may increase the number of workers and common man who are shareholders. This could make the enterprises subject to more public vigilance.

## **Criticisms**

Some of the important arguments against privatisation are as follows:

- The public sector has been developed with certain noble objectives and privatisation means discarding them in one stroke.
- Privatisation will encourage concentration of economic power to the common detriment.
- If privatisation results in the substitution of the monopoly power of the public enterprises by the monopoly power of private enterprises, it will be very dangerous.
- Privatisation, many a time, results in the acquisition of national firms by foreign firms.
- Privatisation of profitable enterprises, including potentially profitable, means foregoing future streams of income for the government.
- Privatisation of strategic and vital sectors is against national interests.
- There are well managed and ill-managed firms both in the public and private sectors. It is not sector that matters, but the quality and commitment of the management.
- The capital markets of developing countries are not developed enough for efficiently carrying out privatisation.
- Privatisation, in many instances, is a half-hearted measure and therefore it is not properly carried out. As a result, that the expected results may not be achieved.
- In many instance, there are vested interested behind privatisation and it amounts deceiving the nation. In many countries privatisation often has been a “garage sale” to favored individuals and groups.

## **Conditions For Success**

- Privatisation cannot be sustained unless the political leadership is committed to it, and unless it reflects a shift in the preferences of the public arising out of dissatisfaction with the performance of other alternatives.
- Replacement of a government monopoly by a private monopoly may not increase public welfare. There must be a multiplicity of private suppliers and freedom of entry to provide goods and services.
- Public services provided by the private sector must be specific or should have measurable outcome.
- Lack of specificity makes it more difficult to control services provided by the private sector. Service delivery by non-governmental organisations or local governments may be more appropriate under these conditions.
- Consumers should be able to link the benefits they receive from a service to the costs they pay for it, and then they will shop more wisely for difficult services.
- The importance of educating consumers and disseminating information to the public are necessary.
- Privately provided services should be less susceptible to fraud than government services, if they are effective.
- Equity is an important consideration in the delivery of public services. Broadly speaking, the benefits of privatisation can accrue to the capital owner, to the consumer and to the public at large.

## **Privatisation In India**

In India, although there were some isolated cases of privatisation, no definite policy decision was taken until the new economic policy was ushered in. The accumulated losses of many SOEs, including some state transport corporations, are larger than the capital invested in them. Privatisation of certain sectors and enterprises are, therefore, necessary to reduce the budgetary burden on the public, in order to make more resources available for the developmental activities, and to enable the government to concentrate more on the essential and priority areas.

The new industrial policy, which has abolished the public sector monopoly in all but a very few industries, is a significant step towards privatisation. The new policy also proposes privatisation of enterprises by selling shares to mutual funds, workers and the public. The central government has been reviewing the existing portfolio of public investment with a view to offloading public investment.

The disinvestments commission was set up by the government of India in August 1996 for suggesting the modalities for undertaking disinvestments of equities for selecting PSUs. The commission has recommended disinvestments at varying levels for a number of PSUs.

## **Globalisation**

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market.

Foreign investment by Indian firms was very insignificant. With the new economic policy ushered in 1991, there has been a considerable change. Globalization has, in fact, become a buzzword with Indian firms now and many are expanding their overseas business by different strategies.

### **Definition Of Globalization:**

Globalization may be defined as “the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology”.

### **Levels Of Globalization:**

Globalization may be considered at two levels. Viz,

- ▶ Macro level (i.e., Globalization of the world economy) and
- ▶ Micro level (i.e., Globalization of the business and the firm).

Globalization of the world economy is achieved, quite obviously, by globalising the national economies. Globalization of the economies and globalization of business are very much inter-dependent.

## **Reasons For Globalisation**

- The rapid shrinking of time and distance across the globe thank to faster communication, speedier transportation, growing financial flows and rapid technological changes.
- The domestic markets are no longer adequate rich. It is necessary to search for international markets and to set up overseas production facilities.
- Companies may choose for going international market to find political stability, which is relatively good in other countries.
- To get technological and managerial know-how.
- Companies often set up overseas plans to reduce high transportation costs.
- Some companies set up plans overseas so as to be close to their raw materials supply and to the markets for their finished products.
- Other developments also contribute to the increasing international of business.
- The us, canada and mexico have signed the north american free trade agreement (NAFTA), which will remove all barriers to trade among these countries.
- The creation of the world trade organization (WTO) is stimulating increased cross-border trade.

## **Stages Of Globalisation**

There are five different stages in the development of a firm into global corporations.

### **First Stage**

The first stage is the arm's length service activity of essentially domestic company, which moves into new markets overseas by linking up with local dealers and distributors.

### **Second Stage**

In this stage , the company takes over these activities on its own.

### **Third Stage**

In the next stage, the domestic based company begins to carry out its own manufacturing, marketing and sales in the key foreign markets.

### **Fourth Stage**

In the fourth stage, the company moves to a full insider position in these markets, supported by a complete business system including R & D and engineering.

This stage calls on the managers to replicate in a new environment the hardware, systems and operational approaches that have worked so well at home.

### **Fifth Stage**

In the fifth stage, the company moves toward a genuinely global mode of operation.

## **Globalisation Strategies**

The various strategies of transiting a firm into global corporation are as follows:

### **Exporting**

Exporting, the most traditional mode of entering the foreign market is quite a common one even now.

### **Licensing And Franchising**

Under international licensing, a firm in one country (the licensor) permits a firm in another country (the licensee) to use its intellectual property (such as patents, trademarks, copyrights, technology, technical know-how, marketing skill or some other specific skill).

Franchising is “a form of licensing in which a parent company (the franchiser) grants another independent entity (the franchisee) the right to do business in a prescribed manner.

### **Contract Manufacturing**

A company doing international marketing, contracts with firms in foreign countries to manufacture or assemble the products while retaining the responsibilities of marketing the product.

### **Management Contracting**

In a management contract the supplier brings together a package of skills that will provide an integrated service to the client without incurring the risk and benefit of ownership. The arrangement is especially attractive if the contracting firm is given an option to purchase some shares in the managed company within a stated period.

### **Turnkey Contracts**

A turnkey operation is an agreement by the seller to supply a buyer with a facility fully equipped and ready to be operated by the buyer's personnel, who will be trained by the seller.

Turnkey contracts are common in international business in the supply, erection and commissioning of plants, as in the case of oil refineries, steel mills, cement and fertilizer plants etc.

### **Wholly Owned Manufacturing Facilities**

Companies with long term and substantial interest in the foreign market normally establish fully owned manufacturing facilities there. This method demands sufficient financial and managerial resources on the part of the company.

### **Assembly Operations**

A manufacturer, who wants many advantages that are associated with overseas manufacturing facilities and yet does not want to go far, may find it desirable to establish overseas assembly facilities in selected

markets. The establishment of an assembly operation represents a cross between exporting and overseas manufacturing.

### **Joint Ventures**

Any form of association, which implies collaboration for more than a transitory period is a joint venture. Types of joint overseas operations are:

- Sharing of ownership and management in an enterprise
- Licensing / franchising agreements
- Contract manufacturing
- Management contracts

### **Third Country Location**

When there are no commercial transactions between two nations because of political reasons or when direct transactions between two nations are difficult due to political reasons or the like, a firm in one of these nations which wants to enter the other market will have to operate from a third country base. For example, taiwanese entrepreneurs found it easy to enter people's republic of china through bases in hong kong.

### **Mergers And Acquisitions**

Mergers and acquisitions (M & A) have been a very important market entry strategy as well as expansion strategy. A number of indian companies have also used this entry strategy.

### **Strategic Alliance**

This strategy seeks to enhance the long-term competitive advantage of the firm by forming alliance with its competitors, existing or potential in critical areas, instead of competing with each other. Strategic alliance is also sometimes used as a market entry strategy. For example, a firm may enter a foreign market by forming an alliance with a firm in the foreign market.

## **Counter Trade**

Counter trade refers to a variety of unconventional international trade practices which link exchange of goods- directly or indirectly – in an attempt to dispense with currency transactions. Counter trade is a form of international trade in which certain export and import transactions are directly linked with each other and in which import of goods are paid for by export of goods, instead of money payments.

## **Benefits**

The important arguments in favour of globalisation are:

- ▶ Productivity grows more quickly when countries produce goods and services in which they have comparative advantage.
- ▶ Living standards can go up faster.
- ▶ Global competition and imports keep a lid on prices, so inflation is less likely to derail economic growth.
- ▶ An open economy spurs innovation with fresh ideas from abroad.
- ▶ Export jobs often pay more than other jobs.
- ▶ Unfettered capital flows give access to foreign investment and keep interest rates low.

## **Disadvantages**

Following are the cases against globalisation:

- ▶ Millions have lost jobs due to imports or production shifts abroad. Most find new jobs that pay less.
- ▶ Millions of others fear losing their jobs, especially at those companies operating under competitive pressure.
- ▶ Workers face pay cut demands from employers, which often threaten to export jobs.
- ▶ Services and white-collar jobs are increasingly vulnerable to operations moving offshore.
- ▶ Employees can lose their comparative advantage when companies build advanced factories in low-wage countries, making them as productive as those at home.



## **Natural Resources And Economic Development**

### **Natural Resources**

Natural resources include land, water resources, fisheries, mineral resources, forests, marine resources, climate, rainfall and topography. But nature possesses more in its bosom and in order to discover what it hides; man is required to develop techniques of knowing the undiscovered resources. Some times the discovery of the use of a resource can immediately increase its value.

When we talk about the natural resources of a country, we have obviously in mind the extent of the known or discovered natural resources with their present uses. With the growth of the knowledge about the unknown resources and their use, the natural endowment of a country will be materially altered.

Another consideration regarding the nature of natural resources is that some resources; e.G., Land, water, fisheries and forests are renewable and there are others like minerals and mineral oils which are exhaustible and can be used only once. Consequently, careful use of the exhaustible resources and maintenance of the quality of renewable resources like land are a sine qua non in the process of development.

### **Principles Of Resource Development**

The principal objective of resource development is to maximize gross domestic output (GDP) and for this purpose there should be optimum utilization of resources not only in the short period but, in a sustained manner, over the long period. Various guiding principles for resource development are:

- ▶ Economic use of resources to achieve minimum waste
- ▶ Sustained use of economic resources through conservation of renewable resources and economic use of exhaustible resources
- ▶ Multi-purpose use of resources: if a certain resource has a number of uses, it is necessary to have all the uses
- ▶ Integrated planning in the use of natural resources

- Location of industries with a view to reducing transport costs to the minimum
- Abundant supply of energy resources, specially electric power so as to utilize other resources in the best possible manner

### **Land Resources**

The total geographical area of india is about 329 million hectares of which 42 million hectares or 14% of the total reporting area in india is classified as:

- Barren land, such as mountains, deserts, etc. Which cannot be brought under cultivation and
- Area under non-agricultural uses, that is, lands occupied by buildings, roads and railways, rivers and canals, and other lands put to use other than agricultural.
- The rest of the land is put under three major uses, viz., Forests, pastures and agriculture.

### **Forest Resources**

Forests are important natural resources of india. They help control floods and thus they protect the soil against erosion. They supply timber, fuel wood, fodder and a wide range of non-wood products. They are the natural habitat for bio-diversity and repository of genetic wealth. Forests, thus, play an important role in environmental and economic sustainability. Under land utilization pattern, the government of india estimated the total area under forests as 68 million hectares or 22 % of the total geographical area. In our country, forests have generally been undervalued in economic and social terms.

The contribution of the forest sector to GDP was put as 1% in 1996 – 97 (measured at 1980 – 81 prices). A recent estimate puts the gross value of goods and services provided by the forest sector at 2.4% GDP. There is concentration of forests in a few states in assam, madhya pradesh, orissa and a few union territories. Northern india is particularly deficient in forests. There is a need to increase forest areas in the entire country as also to develop them in deficient states.

## **Forest Policy, 1952**

Appreciating the necessity of developing forests, the government of india declared its first forest policy in 1952. According to this policy, it was decided to raise steadily the area under forests to 100 million hectares or 33 % for the country as a whole. The target area was to provide green cover over two thirds of the land area in the hills and mountains. The main objectives of forest policy under the five-year plans were:

- ▶ To increase the productivity of forests
- ▶ To link up forest-development with various forest-based industries and
- ▶ To develop forests as a support to rural economy.

## **New Forest Policy, 1988**

The 1952 forest policy had failed to stop the serious depletion of forest wealth over the years. Accordingly, it became imperative to evolve a new strategy of forest conservation. The government of india announced its new forest policy in december 1988. The important features of this policy are:

### ▶ **Role of tribal in forests recognized**

The new policy enunciates that all agencies responsible for forest management, including forest development corporations should associate tribal people closely in the protection, regeneration and development of forests.

### ▶ **Depletion of forest area and the target for green cover**

The new policy reiterates that green cover should be extended to over two-thirds of that land area in the hills and mountains and that the total forest area in the country should be raised to 100 million hectares or 33 % of the total geographical area in the country.

### ▶ **Discouragement to forest-based industries**

The new forest policy states that no forest based enterprises except at the village or cottage level will be set up in the future, unless it is first cleared, after a careful study of the availability of raw materials.

- ▶ **End the system of private forest contractors**

The new forest policy advocates an end to the system of contractors working the forests. The contractors will be replaced by institutions such as tribal Co-operatives, government corporations, etc.

- ▶ Forest land not to be diverted to non-forest uses

The forest department used to assign forestland to individuals or non-government agencies for the purpose of reforestation.

- ▶ Participatory forest management system

This new strategy involves rural people, particularly women and tribal community who have intimated the knowledge of plant species, their growth characteristics, utility and medicinal value, etc. They also know the specific requirements of fuel, fodder, timber and other non-food products. The adoption of the new strategy has led to several positive outcomes, such as:

- ▶ Change in the attitude and relationships of local communities and forest officials towards each other and the forests
- ▶ Improvement in the condition of forests
- ▶ Reduction in encroachments
- ▶ Increase in the income of local people and
- ▶ Involvement of non-governmental organizations (NGOs) in forest research, tree planting, promotion of productivity, etc.

## **Water Resources**

India is one of the wettest countries of the world but it is not able to hold all the water it receives. Because of deforestation and denudation, a large portion of the monsoon water disappears into the sea as surface runoff. Community resources such as ponds, tanks and rivers are misused and continuously neglected.

Rivers are increasingly getting polluted as urban and industrial wastes are dumped into them. India's water policy has concentrated on gigantic river systems and reservoirs and despite huge investments on them; their productivity continues to be low. They have not helped in controlling or moderating floods.

Nor are they cost effective, or ecologically desirable. Ground water table has gone down dramatically in more intensely cropped areas, clearly indicating the need to increase recharges or to regulate pumping. In some areas, there is serious pollution danger to ground water due to industrial wastes.

India continues to be highly flood-prone and drought-prone but neither the government nor the planning commission has shown sufficient imagination to appreciate the gravity of the situation and make necessary correction to india's water policy.

## **Fisheries**

India is the sixth largest producer of fish in the world and perhaps, second largest in inland fish production. Fisheries sector plays important role in the socio-economic development of india, generating employment for a large coastal population – about one million fishermen draw their livelihood from fisheries, but they generally live on the verge of extreme poverty. It is not only an important source of direct employment but generates employment in downstream industries. It is estimated that about six million people are employed in the fisheries sector.

Fisheries help in raising nutritional levels, augmenting food supply and earning foreign exchange. The contribution of the fisheries sector to gross domestic product (at current prices) has increased from rs. 1,230 Crores to rs. 32,060 Crores between 1980-1981 and 2001-2002. Fisheries contribute about 1.21 % Of india's GDP. Broadly, fishery resources of india are either inland or marine. The principal rivers and their tributaries, canals, ponds, lakes, reservoirs comprise the inland fisheries. The five-year plans assign high priority to the development of fisheries because of the necessity to raise the nutritional levels of protein deficient indian diet and to earn much needed foreign exchange.

The fisheries programmes have emphasized family-based labour, intensive inland and brackish water fisheries and improving the harvesting from seas by stimulating the growth of country boats, mechanized boats and deep sea trawlers.

## Mineral Resources

The development and management resources play a major role in the industrial growth of a nation. Coal and iron, for instance, are the basic minerals needed for the growth of iron and steel industry, which in turn, is vitally necessary for the country's development. Similarly, there are other minerals like mica and manganese, copper, lead and zinc, which are of economic importance.

Then we have mineral fuels like petroleum, coal, thorium and uranium, which are of national importance. Thorium and uranium, the atomic energy minerals, promise to be tremendous source of power. Besides these, we have a number of minor minerals with varying degrees of utility to the country.

The reserves of india in respect of minerals essential for basic industries viz., Coal and iron are ample. But there is a fairly long list of vital minerals like copper, tin, lead, zinc, nickel, cobalt and sulphur and most of all petroleum which india lacks.

The government of india amended the mines and minerals (regulated and development) act, 1957 in january 1994 and announced a new mineral policy:

- ▶ Throwing open the mining sector to the private sector including direct foreign investment,
- ▶ Empowering the states to grant prospecting licenses/mines leases without prior approval of the central government (except in a few cases)
- ▶ Removing the restrictions on equity holding by foreign nationals in a mining company
- ▶ The major objectives and the strategies of the new mineral policy are as follows:
  - ▶ To explore for identification of mineral wealth on land and off-shore
  - ▶ To develop mineral resources taking into account the national and strategic considerations
  - ▶ To minimize adverse effects of mineral development on the forests, environment and ecology through appropriate protective measures

- To promote foreign trade in minerals
- To promote research and development in minerals

## **Economic Development And Environmental Issues**

Ecologists and environmentalists believe that one principal reason for the existence of the environmental problem stems from the emphasis on the growth by the industrialized nations. They point out that economic growth has been made possible only at the expense of the environment.

Ecologists postulate that growth rates were so high, because of the fantastic increase in population and demands of the society. Increased production and consumption had unscrupulously released wastes and pollutants into the environment without consideration of their effects.

Fast growth has resulted in the destruction of the environment, the impairment in the quality of elemental environmental services, the deterioration of air quality and the contamination of seas, rivers, lakes, etc. These were not taken into account in economic calculations. The loss and deterioration of important environmental goods went relatively unnoticed. In short, the social costs of growth were not included in economic analyses.

Economists who analyze in a straight jacket always contend that sustained economic growth increases human welfare. These economists base their arguments on international companies in terms of the value of goods and services produced in the economy. To put in shortly, they compare gross national product (GNP) in terms of dollar value to assess the economic growth of nations. Countries feel highly satisfied if their gnp graph shows an ascending tendency, year after year and they proclaim that they are forward.

But, the measurement of economic growth in terms of output of goods and services (GNP) is rather faulty. It takes into consideration the national product only. It does not consider the national disproduct in the process of production. Billions of dollars worth of cigarettes produced in the economy have been brought under the calculation of GNP per year. It does not take into consideration the external cost, the pollution it creates, the diseases it spreads in the society among smokers and silent smokers.

These are the disproducts of the nation. Edward F. Denison considers that air and water pollution and also the solid wastes generated in the process of production as the real costs of economic growth. He has suggested that value of the deterioration to environment by these real costs should be deducted from NNP to contain a better. In this context, Samuelson's NEW (Net Economic Welfare) is worth considering as very appropriate, whereby the national disproducts are deducted from the national product. Measure of output.

The role of environment and the need for maintaining the quality of the environment have emerged recently as important issue and has assumed greater importance in the context of several ecological disasters in many parts of the globe in recent times.

Barry Commoner has analyzed the interaction of three major factors influencing environmental impact. They are:

- ▶ Population factor
- ▶ Per capita availability of goods
- ▶ Pollution per unit of economic good.

The environmental impact (ei) is given as follows

$$EI = \text{Population} * \frac{\text{Economic Good}}{\text{Population}} * \frac{\text{Pollutant}}{\text{Economic Good}}$$

This enables us to estimate the contributions of the three factors to the environmental impact, viz., The size of the population, per capita production or consumption; and the pollutant generated per unit of production or consumption.

Thus, environmental impact represents the environmental cost of a given economic process. By the economic process, agencies external to the eco- system is produced and which tends to degrade its capacity for self-adjustment.



According to Kenneth Boulding, *“the world is finite and the resources are scarce”*. Man out of greed exploits this earth, as if its resources are limitless, to enrich himself in his pursuit of economic growth. If this is continued by man who is too much enterprising, soon *“we will have a plundered planet”*.

### **Self Assessment Questions:**

1. What is business? How does business of today differ from that of earlier?
2. What are business objectives?
3. Explain business environment.
4. “Firms which systematically analyse and diagnose the environment are more effective than those which don’t”. Elucidate.
5. Sketch organizational arrangement for environment analysis. Give its limitations.
6. Define corporate governance. Why is it assuming greater relevance now a day?
7. Explain the factors influencing corporate governance.
8. Why is social responsibility important for business?
9. List out the arguments for and against social responsibility.
10. What are the practical problems that confront social action programmes? How do you overcome them?
11. What do you understand by ethics? Why is ethics important for business?
12. State and explain the sources of business ethics.
13. How is ethics managed in a business unit?
14. State the difficulties involved in ethical decision-making. Bring out the guidelines, which help in ethical decision-making.
15. What is an economic system? What are the basic problems of an economic system?
16. What are the features of a mixed economic system?
17. “The fundamental economic problem of an economy is the problem of choice”. Discuss.
18. Explain the role of government in solving problems aroused out of different economic systems.
19. Define privatisation and trace the history of privatisation.
20. Explain the different routes of making privatisation.
21. Give your arguments for and against privatisation.

22. “There is a need for exercising caution and restraint while privatising psu’s”. Comment.
23. Bring out the nature and causes of globalization of business.
24. Explain the stages involved in the economic transition of globalisation.
25. Evaluate the impact of globalisation on indian economy.
26. List out the strategies used for globalising a business.
27. Natural resources are the wealth of a country’s economy. Discuss.
28. Explain the different kinds of natural wealth discovered and undiscovered in india.
29. Evaluate our government policies towards management of natural resources.
30. Appraise the impact of economic development on various kinds of environmental issues.

### **Key Words**

- **Micro environment:** the microenvironment refers to the forces that are close to the company and affect its ability to serve its customers. It includes the company itself, its suppliers, marketing intermediaries, customer markets, competitors, and publics.
- **Macro environment:** the macro environment refers to all forces that are part of the larger society and affect the microenvironment. It includes concepts such as demography, economy, natural forces, technology, politics, and culture.
- **Privatization:** it is the incidence or process of transferring ownership of a business, enterprise, agency, public service or property from the public sector to the private sector or to private non-profit organizations.
- **Business ethics:** it is a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and entire organizations.
- **Globalization:** it has to do with processes of international integration arising from increasing human connectivity and interchange of worldviews, products, ideas, and other aspects of culture.

- ▶ **Economic system:** an economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community. These agencies are joined by lines of trade and exchange along which goods, money etc. Are continuously flowing

### **Further Readings**

1. David Needle., *Business In Context: An Introduction To Business And Its Environment (Revised Edition)*, Thomas Rennie, 2004.
2. David P. Baron, *Business And Its Environment*, Pearson Education, 2006.
3. Thomas Childs Cochran And Harold I. Sharlin, *Business And Its Environment: Essays For Thomas C. Cochran*, Greenwood Press, 1983.

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## UNIT - II

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### Objectives:

*The major purpose of this unit is to enable you to:*

- Define what is meant by infrastructure and its need and importance to build the economy;
- Identify the critical elements of infrastructure development;
- Understand the global trends in business and management;
- Analyse the role of MNCs in the developing countries; and
- Examine the current trends in Indian industry and also the capital market scenario

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### Lesson - 1 Infrastructure Of The Economy

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#### Infrastructure

Adequate quantity, quality and reliability of infrastructure are the key to the growth of any economy. Infrastructure facilities often referred to as economic and social overheads – consists of:

- Irrigation: including flood control and command area development
- Energy: coal, electricity, oil and non-conventional sources
- Transport: railways, roads, shipping and civil aviation
- Communications:
- Posts and telegraphs, telephones, telecommunications, etc
- Banking, finance, and insurance
- Science and technology
- Social overheads: health and hygiene and education.

#### Energy

Energy is the most important determinant of a country's economic growth. In fact, per capita consumption of energy is taken as an indicator of a country's prosperity. Energy is created through several sources. The sources are conventional and non-conventional. The first shall include commercial and non-commercial sources of energy.

Commercial energy is so-called as it commands a price and the user are expected to pay it for its use. Non-commercial energy commands no price and the user can take it as a free goods gifted by nature. Non – conventional energy is a recent discovery and its use is confined to limited pockets in our country.

Confining to the commercial energy, it may be stated that coal is the main source, accounting for 67 % of the total energy consumed in the country. The government has initiated several steps to improve the supply of coal. Private sector participation is allowed in coal mining. Imports of cooking coal under the open general license (OGL) are being allowed and the import tariff has been slashed from 85% to 35 %.

Power has been a bugbear of our economy. Lack of sufficient power supply has checked the growth of industries all over the country. The government has announced a package of incentives to attract private investments. The package includes the reduction of import duties on power equipment to 20%; a five-year tax holiday for new power projects; a guaranteed 16% rate of return on paid up and subscribed capital; and the provision of counter guarantee by the central government.

As part of the ongoing economic reforms, the government has allowed imports and distribution of certain petroleum products like domestic lpg and kerosene by the private sector at market prices to promote new investments and to improve operational efficiency. The ongc has already disinvested 2% of its equity and proposes to offload 18 % more in domestic and foreign markets.

Private and foreign companies are now allowed to invest in oil exploration and production in joint-venture with ONGC or OIL, (ONGC has already tied up with reliance and enron) and also in refining of petroleum products. The domestic market in lubricants has been opened up to foreign collaborations.

## **Strengths, Weaknesses And Remedies Of Power**

### **Strengths**

- ▶ Elaborate organizational framework for the growth of electricity has been provided by the electricity (supply) act, 1948
- ▶ Power and responsibilities has nearly been divided between central and states. Former confines itself to planning, co-ordination and regulation. Latter looks after generation and distribution.
- ▶ Vast network of generation, transmission and distribution facilities are spanning the length and breadth of the country.
- ▶ Joint venture among states in power generation
- ▶ Numerous amendments to permit private participation in power generation.

### **Weaknesses**

- ▶ Very low plant load factors
- ▶ Declining share of hydro-power
- ▶ Too much subsidy burden on state electricity boards
- ▶ Incompetent and corrupt electricity boards
- ▶ Frequent and heavy load-shedding
- ▶ Capital intensive but starved of funds
- ▶ Heavy losses during transmission and distribution

### **Remedies**

- ▶ Formulate unambiguous guidelines for private sector investment and ensure speedy clearance
- ▶ Expedite formulation of guidelines for private participation in transmission and distribution
- ▶ Create autonomous regulatory authorities at the central and state levels.
- ▶ Corporatise sebs with separate generation, transmission, and distribution segments.
- ▶ Set cost-based pricing for each consumer group, building in per-determined tariff increases

## **Transport**

Transport sector includes railways, roads, shipping and civil aviation. The Indian railways have a long history. They consist of an extensive network spread over 62,462 kms- comprising broad gauge (36,824 kms), meter gauge (20,653kms) and narrow gauge (3,985kms). Electrified networks with 11,793 kms account for 18.8 % Of the total route kilometer age.

The thrust areas are identified for the eight-plan periods include replacement and renewal of averaged assets; argumentation of terminal and rolling stock capacities, gauge conversion and electrification. Railways can claim for having connected most of the country with the conversion of gauges and creating more routes.

The last few years have been particularly good for railways because of the addition of more than 500 new trains, which include the deluxe trains like rajdhani and shatabdi. A little known distinction of the railways is their achievements abroad. Among the psus of the railway ministry are the Rail India Technical and Economic Services Ltd (RITES) And The Indian Railway Construction Company Ltd (IRCON). RITES consultancy expertise is internationally recognized.

It has completed important assignments in railway systems in Africa, the middle east, Vietnam and Nepal. Ircon too has undertaken construction projects in Turkey, Saudi Arabia, Malaysia, Indonesia and Bangladesh. Another feather in the cap of the railways is the 760 km long Konkan railway.

## **Strengths, Weakness And Remedies Of Railways**

### **Strengths**

- ▶ Historical advantage – 85% of track being inherited from the British
- ▶ Largest in Asia and fourth largest in the world
- ▶ Substantial electrified tracks
- ▶ Competitive advantage in project consultancy and construction
- ▶ Agenda of national integration



## **Weakness**

- Ever increasing traffic load
- Inadequate finance
- Low productivity
- Low speed of goods as well as passenger trains
- Poor service to the passengers
- Absence of suitable transportation policy
- Too many social objectives

## **Remedies**

- Corporatise with detailed terms of reference approved by the parliament
- Unbundle disparate operations like transportation of freight and passengers and equipment-manufacture
- Corporatise all manufacturing units and privatise them gradually
- Commercialise passenger services by abolishing all free travel, and privatise ticket-checking
- Phase out cross-subsidisation of passenger fares, through freight charge, so as to reflect real costs
- Make commercial use of railway property by selling or leasing it, to the private sector

## **Road Transport**

In order to improve the road transport system, the government announced several measures. Private participation has been allowed in the construction and maintenance of roads. In addition, road transport has been declared as an industry, which enables it to borrow finance from financial institutions. National highway act is to be amended so as to enable the levy of a toll on road users.

MRTP act is also to be amended to enable large firms to enter the road transport sector. The Road Development Plan for 1981 – 2001 envisages the construction of 2212000 kms of rural roads. But viewing against the backdrop of the resource crunch, this plan appeared to be unimplementable.

## **Strengths, Weaknesses And Remedies Of Road Transport**

### **Strengths**

- One of the worlds largest, stretching for almost 201 million across the country
- Relatively low vehicle density per km.
- Ease the burden of railways

### **Problems**

- Only 1.6% Of road strength is occupied by national highways, 5.86% By state highways and 92.54%By district and village roads. Except the national highways, the condition of other roads is pathetic.
- Several missing links, unbridged river crossings, weak culverts and inadequate road pavement enroute.
- Remote parts of the country are still not connected
- Veritable death traps
- Lack of adequate finance
- Increasing pollution

### **Remedies**

- Allocate additional resources for upgrading and widening existing national and state highways.
- Create a highway development fund as an extra-budgetary development fund for funding highways
- Set up a financing mechanism for funding road construction, using the toll system for cost recovery
- Encourage private sector participation in highways by institutionalising build-operate – transfer schemes.
- Earmark a proportion of the state's levies on vehicle and fuels for road maintenance.
- Amend the loans to allow for right of way in land acquisition for laying roads.

## **Sea Transport**

The government has recently approved a scheme, which envisages voluntary cargo support of the shippers to indian shipping lines, up to 40% of the value of linear cargo transacted in the foreign trade in a phased manner. To reap the benefits of the scheme, SCI has beefed up its customer services cell to attend to the requirements of shippers on a priority basis.

Steps have been initiated by the government to frame guidelines for indian shipping companies as per the international safety management (ISM) code, which was adopted by the international maritime organization (IMO) in november 1993. Under the ism code, which will be applicable to passenger ships and tankers by july 1998 and for other vessels by july 2002, shipping companies are required to provide special training to on shore staff and the crew on board. There are eleven major ports and 139 operable minor ports located along the 5560 km long coastline of the country.

The phenomenal growth of our merchant navy from a modest base of 0.2M GRT in 1947 to 6.3 M GRT has placed our country 17th among the maritime nations of the world. Today, our shipping industry can boast of a modern versatile and technically superior fleet with an average of 13 years as against the world average of 17 years and is well equipped to compete in the international markets.

## **Strengths, Weakness And Remedies Of Shipping**

### **Strengths**

- ▶ Long coastline of over 5700 kms and almost the whole of foreign trade passing across the seas.
- ▶ Largest merchants shipping fleet among the developing countries and 14th in the world in shipping tonnage
- ▶ Skilled and competent managerial and ship board personnel
- ▶ Huge potential in the make of india becoming one of the signatories of the WTO. There will be considerable increase in sea-borne trade.

## **Weaknesses**

- ▶ Limited cargo handling capacities of ports
- ▶ Challenge from containerisation which is highly prevalent in advanced countries
- ▶ Fund starving
- ▶ Undue hardships to ship owners due to conversion of fob items into cif, which has been introduced because of decanalisation.

## **Remedies**

- ▶ Amend the Major Port Trust Act, 1963, to allow private sector bot projects at the 11 major ports
- ▶ Raise the capital expenditure ceiling of the port trust boards from rs.5 Crore to rs.200Crore.
- ▶ Abolish the need for pib approvals for private projects that do not need port trust investment
- ▶ Unbundle activities like cargo handling and warehousing into profit centers.
- ▶ Allow port-based businesses to create captive facilities for themselves under the BOT system
- ▶ Initiate restraining programmes to reduce labour resistance to private sector participation.

## **Civil Aviation**

Civil aviation has three functional sub sectors; operational, infrastructural and regulatory-cum-developmental. On the operational side, indian airlines limited, vayudoot (which functions as a separate identifiable division of indian airlines limited) and private airlines (scheduled and non-scheduled) provide domestic air services. Air india limited and indian airlines limited are domestic airlines, which provide international air services. Pawan hans limited provides helicopter support services, primarily to the petroleum sector.

Infrastructural facilities are provided by the International Airports Authority of India (IAAI) and the National Airports Authority (NAA). These two authorities are being merged to form a single authority viz. Airports authority of india as a result of the enactment of the airports

authority of india act, 1994. The regulatory and developmental functions are looked after by the ministry of civil aviation and the offices of the directorate general of civil aviation. The air corporation act, 1953, was repealed on march 1, 1994, ending the monopoly of indian airlines, air india and vayudoot over scheduled air transport services. Six private operators, who were hitherto operating as air taxis, have since been granted scheduled airlines status.

Indian airlines has also geared itself since june 1993 to the challenging task of adopting itself to a competitive environment. Several measures have been taken, mainly centered on making the organization adopt a marketing approach to decision-making and considerably to improve the quality of its product. It has improved its passenger facilities both on board and on the ground, on time performance; flight safety measures and has also increased employee participation to provide better services.

## **Communications**

The communication system comprises posts and telegraphs, telecommunication systems, broadcasting, television and information services. By providing necessary information about the markets and also supplying necessary motivation, the communication system helps to bring buyers and sellers together effectively and helps to accelerate the growth of the economy. Accordingly, the modern communication system has become an integral part of the development process.

### **Importance Of Communication**

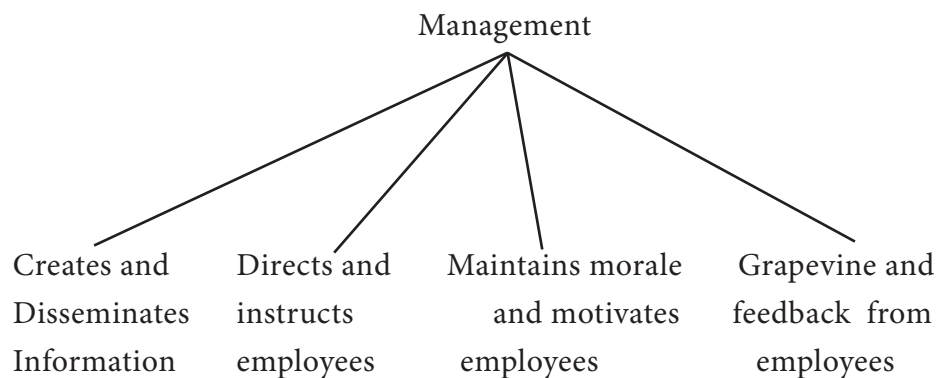
With the development of science and technology, the need for the importance of communication is felt and consequently the social behaviour of human mankind is also transformed to a larger extent. The pressure of work and other social and personal commitments keep people in tight schedules leaving no time for casual talk or gossiping in private life. Whereas, in business circles, stiff competition of trade, liberal import of goods, development of new businesses by foreign corporate houses, indigenous giants, NRI's investment, easy availability of bank loans, heavy transactions in the stock market, etc., Make business people to keep track of the development worldwide in order to keep abreast of business

information on hourly basis. It involves interpretation of communication between people continuously which in turn results into refined decision-making of the business people.

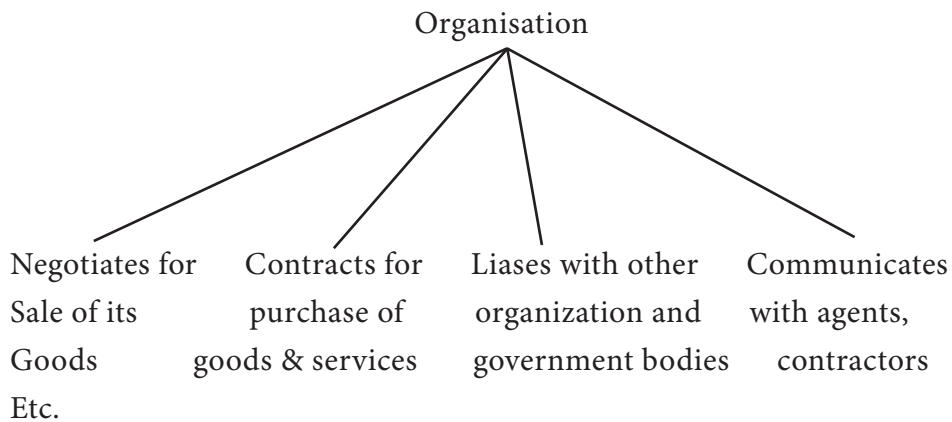
In the modern professional organizations a great deal of importance is attached to devising and maintaining an efficient system of communication. Research shows that 70% to 80% of the total working time of professional and top ranking officials of corporate offices is spent on communication. In india, out of total time spent on communication, 64.14% Is on communicating in english as against 27.22% In hindi and 8.64% In regional languages. Thus the role of english in business communication is predominant and it continues to be in the first place always.

Communication performs a number of functions and plays a major role in an organization.

### **Internal Communication**



## External Communication



## Postal System In India

Since 1950-51, the postal network has been expanded throughout the country, and in recent years, with special emphasis on the rural, hilly and remote tribal areas. The postal department has given a new thrust to its programme of modernisation for providing new value added services to customers. This includes:

- ▶ A programme of computerised services of such postal operations as mail processing, savings of bank and material management
- ▶ Introduction of metro channel service linking 6 metros
- ▶ Introduction of raidhani channel linking delhi with most of the state capitals and
- ▶ A business channel with exclusive treatment to pin coded business mail

In recent years, there has been a healthy growth in many lines of postal activity, such as speed post traffic, postal life insurance, extensive of postal life insurance and post office savings banks to rural areas, etc.

## Indian Telegraphs

Indian telegraph is one of the oldest government-owned public utility organisations in the world. A number of telegraph offices has been increased from 8,200 in 1951 to over 30,000 now. All these facilities: the

phonogram service for sending and receiving telegram by telephone, telex service to send and receive printed message directly from one centre to another, the tremendous expansion of telephone facilities and direct trunk dialing – are available to the general public.

### **Telecommunications**

Telecommunication is a vital input for global competition and for india's success in the international markets. It is important not only because of its role in bringing the benefits of communication to every corner of india but also in serving the new policy objectives of improving the global competitiveness of the indian economy and stimulating and attracting foreign direct investment. There has been phenomenal growth in the telecommunication sector after 1995.

There has been a shift in importance towards the private sector and towards wireless telephony with falling tariff rates for cellular phones. There has also been a phenomenal increase in the number of cellular subscribers. Cellular telephony has become the most preferred mode of communication among the indian public.

### **Strengths, Weaknesses And Remedies Of Telecommunication**

#### **Strength**

- ▶ Huge potential for expansion
- ▶ Rapid growth in the last couple of years with annual growth of 13 % between 1984 and 1994 and 20 % thereafter.
- ▶ Relatively high density with 7.97 Phones per 100 towns people ahead of china and indonesia
- ▶ High technology – 66 % of exchanges are digital

#### **Weaknesses**

- ▶ Waiting period to get new connections
- ▶ Poor maintenance 218 faults for 100 lines every year
- ▶ Privatisation efforts are not successful



## **Remedies**

- ▶ Accelerate the clearance process for private sector entry into basic telecom services
- ▶ Offer incentives to private telecom companies for meeting connection and low-fault targets
- ▶ Resolve disputes between private operators and the DOT over long distance connections immediately
- ▶ Convert the DOT into a holding corporation, with its subsidiaries operating services in different circles
- ▶ Replace the Indian Telegraph Act, 1885 with a new act incorporating the impact of technology changes.

## **Recent Developments In Telecom Sector**

- ▶ Large number of villages are now covered through wireless in local loop (WLL)
- ▶ The national internet backbone (NIB) was commissioned
- ▶ Since long distance (national and international) has been opened up to competition, long distance tariffs have come down.
- ▶ To enhance telecom services in rural and remote areas, the telecom department has issued guidelines for implementing universal service obligation (USO)
- ▶ According to the new telecom policy every village in India is expected to be provided with one public telephone.

## **Education, Science And Technology**

Science and technology are ideas and the means with which man seeks to change his environment. While science represents “accumulation of knowledge”, technology represents “refinement in tools”. Over last two hundred years or so, science and technology have helped to improve the quality of human life. For rapid economic progress, the application of science and technology (S and T) to agriculture, industry, transports and to all other economic and non-economic activities has become essential.

Jawaharlal Nehru believed in the spread of science of scientific temper. He was responsible for the setting up of a chain of national laboratories devoted to basic and applied research which develops

indigenous technology and processes and helps industrial enterprises in solving their technological problems. The Council of Scientific and Industrial Research (CSIR) as well as the department of atomic energy was set up. The Indian Council of Agricultural Research (ICAR) was strengthened. The department of space technology, the Indian Space Research Organization (ISRO) etc., Arrived later. In 1958 the science policy resolution was adopted to provide positive incentives for the development and utilization of s and t in nation building activities. The major aims of this policy were:

- ▶ To foster, promote and sustain by appropriate means the cultivation in science and scientific research in all its aspects – pure, applied and educational
- ▶ To ensure an adequate supply within the country of research scientists of higher quality and recognize their work as an important component of the strength of the nation
- ▶ To encourage and initiate with all possible speed programmes for training of scientific and technical personnel on a scale adequate to fulfill the country's needs in regard to scientific and education, agriculture, industry and defence
- ▶ To ensure for the people of the country all the benefits that can accrue from the acquisition and application of scientific knowledge.

The indian government has been giving special support to s and t since independence and the large network of national laboratories and universities have been training a strong cadre of scientists, engineers, technologists, etc. Public and private sector organizations have established over 600 in-house research and development (R&D) laboratories to meet their internal technological requirements. The rapid growth of engineering consultancy organizations to provide design and consultancy services and act, as the bridge between research institutions and industry, is really commendable. India's stock of technical man-power has been growing at the rate of about 9 percent per year for the last 20 years and is now estimated to be about 2.5 Million. After usa, india today ranks second in the world as regards qualified science and technology man-power.

Science and technology (S&T) has made a phenomenal impact over the world in shaping the lifestyle of the common man. If India has to really forge ahead in the coming decade, S&T must play a pivotal role in all the important tasks that lie ahead of us. Hence, the deployment of S&T as an effective instrument of growth and change becomes an imperative strategy. In order to derive maximum output from meager resources, S&T and the associated methodology must be brought into the main theme of economic planning in the agricultural, industrial and services sectors.

### **Measures To Promote Science & Technology**

Following are the measures necessary to promote science & technology

#### **Education For The Knowledge Economy**

Producing knowledge intensive, technologically sophisticated, higher value goods and services are not possible without a trained management cadre and labour force with the appropriate mix of technical and vocational skills. Among other things, this requires:

- ▶ Scientists with the skills needed to conduct appropriate R&D
- ▶ Engineers and skilled craftsmen to evaluate technology and adopt it for use in the enterprise,
- ▶ Skilled technicians who will actually utilize the technology in the production process

Vocational, secondary and tertiary education must all contribute to turning out graduates with the necessary skills. Moreover, since the skills required by today's labour market may not be the same as those that will be required in the future, a process of life long learning must be built into the education system. And at all levels and life-cycle stages, the education system must work with the private sector to understand and respond to its needs.

## **Technology Acquisition And Diffusion (Using Existing Knowledge To Improve The Competitiveness)**

Most of the knowledge that developing countries need to boost productivity and value added, in both high tech and traditional sectors, has already been invented. The problem is that this existing knowledge is not always being employed in world bank client countries. Therefore, a third, related aspect of capacity building involves enhancing the private sector's ability existing technology, to improve and develop it for particular needs of local enterprises and incorporate it into local production processes. In other words, this aspect of capacity building would focus on helping the private sector absorb and utilizes better technology that is already in use elsewhere in the world.

### **Science & Technology Policy Making Capacity**

National policy makers need to have the capacity to understand the challenges and opportunities flowing from the global economy and to devise appropriate policies. Meeting these challenges will require concerted action by education institutions, R&D institutes, the private sector and the national government. It will also require close links and co-operation between each of these actors.

### **Science And Technology Manpower Development And Employment**

While a number of steps have been taken by the government to increase employment opportunities the number of scientists would fall far short of the rate at which S&T persons are needed in the country. Some of the strategies for the creation of jobs and for retaining S&T personnel are:

- Motivating S&T personnel to capture the full potential of self-employment
- Creating awareness about entrepreneurship leading to self-employment among the college and school students
- Introducing greater capital investment in the areas where the outlay per work place is minimal
- Restructuring government policies to minimize import of goods
- Creating entrepreneurship development cells in all Science / Engineering/IITs and other academic institutions by the concerned

central /state agencies

- ▶ Introducing automated techniques selectively from the viewpoint of safety, reduction of drudgery, improvements in productivity / efficiency, etc.
- ▶ Examining export strategy to enable the country to pay for imports through exports and thereby simultaneously generating greater employment
- ▶ Encouraging the establishment of sophisticated industries in the emerging areas of technology as also encouraging the service sectors requiring inputs from high technology so that highly trained s&t personnel could be retained and gainfully employed
- ▶ Maintaining centers of excellence in various branches of science and technology to retain highly trained persons within the country
- ▶ Providing proper working atmosphere and adequate amenities (e.g. Housing in urban areas) to S&Tt personnel

## **Demographic Issues And Human Development**

### **Study Of Human Resource**

The study of human resource is vital from the point of view of economic welfare. It is particularly important because human beings are not only instruments of production but also ends in themselves. It is necessary to know in quantitative terms the number of people living in a country at a particular time, the rate at which they are growing and the composition and distribution of population.

### **The Theory Of Demographic Transition**

The theory of “demographic transition” postulates a three-stage sequence of birth and death rate as typically associated with economic development.

#### **First Stage Of Demographic Transition:**

According to this theory death rates are high in the first stage of an agrarian economy on account of poor diets, primitive sanitation and absence of effective medical aid.

### **Second Stage Of Demographic Transition:**

Rise in income levels enables the people to improve their diet. Economic development also brings about all round improvement including the improvement in transport, which makes the supply of food regular. These entire factors tend to reduce death rate. Thus in the second stage, birth rate remains high but death rate begins to decline rapidly. This accelerates the growth of population. High birth rate and falling death rate contribute to the growth of the average size of the family in the second stage.

### **Third Stage Of Demographic Transition:**

With the growth of industrialization, population tends to shift away from rural areas towards industrial and commercial centers. One of the features of economic development is typically increasing urbanization, and children are usually more of a burden and less of an asset in an urban setting than in a rural. The consciousness to maintain reasonable standard of living tends to reduce the size of family in an industrialized economy; since the death rate is already low, this is possible only if birth rate falls. Thus, the characteristics of the third stage are low birth rate, low death rate, small family size and low growth rate of population.

These three stages reveal the transformation of a primitive high birth and high death rate economy into a low birth and low death rate economy. When an economy shifts from the first stage to the second stage of demographic transition, an imbalance is created in the economy as a result of falling death rate but relatively stable birth rate. The second stage of demographic evolution has, therefore, been termed as the stage of population explosion. This stage is the most hazardous period for a developing economy. The decline in death rate in the second stage therefore creates an imbalance, which requires a period of transition for adjustment. Thus, the theory is termed as the theory of demographic transition. During the period of transition the demographic factors get out of harmony. A new constellation of demographic forces is brought about which changes the character of society; birth and death rate becomes balanced at a lower level as a result of which growth rate of population also declines.

## Size And Growth Rate Of Population In India

India today possesses about 2.4 Percent of the total land area of the world but she has to support about 17 percent of the world population. At the beginning of this century india's population was 236 million and according to 2001 census, the population of india is 1,027 million.

A study of growth rate of india's population falls into four phases:

1891-1921: Stagnant population

1921-1951: Steady growth

1951-1981: Rapid high growth

1981-2001: High growth with definite signs of slowing down

During the first phase of 30 years (1891-1921), the population of india grew from 236 million in 1891 to 251 million in 1921 i.E., Just by 15 million.

### Growth Of Population In India (1901-2001)

Censes Period	Population (In Millions)	Compound Annual Growth Rate
1891-1921	251	0.19
1921-1951	361	1.22
1951-1981	683	2.15
1984-1991	844	2.11
1991-2001	1027	1.93

**Source:** Census Of India 2001, Series 1, Paper 1 Of 2001, Provisional Population Totals.

During the second phase of 30 years (1921 to 1951) the population of india grew from 251 million in 1921 to 361 million in 1951 i.E. By 110 million. During the third phase of 30 years (1951-1981), the population of india grew from 361 million in 1951 to 683 million in 1981. In other words, there was a record growth of population by 332 million in a period of 30 years. During 1981 to 2001, india entered the fourth phase of high population growth with definite signs of slowing down. Total population increased from 683 million in 1981 to 1,027 million in 2001 indicating an increase of 50.4 % During the 20 years period.

However, the second decade (1991-2001) of this phase registered a decline (1.93%) in the annual average rate of growth. This is a welcome trend, which should be strengthened.

## Human Development In India

### Measures of human development

Economic Growth Contributes Most To Poverty Reduction When It Expands The Employment, Productivity And Wages Of Poor People And When Public Resources Are Channeled To Promoting Human Development. A Virtuous Cycle Of Economic Growth And Human Development Arise When Growth Is Labour Using And Employment Generating And When Human Skills And Health Improve Rapidly.

Income, clearly, is only one option that people would like to have, though an important one. But it is not the sum total of their lives. Income is also a means, with which human development meets the end. Ever since the publication of the human development report 1990, efforts have been made to devise and further refine measures of human developments. Three measures have been developed. They are human development index (HDI), gender related development index (GDI) and human poverty index (HPI).

### Comparison Of Human Development Indices (2002)

#### Some Selected Countries

	Human Development (HDI)	Gender Related Development Index (GDI)	Human Poverty Index (HPI)	Income Poverty Line US \$ I A Day 1993 PPP 1990 – 2002
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#### High Human Development

1	Norway	0.956	0.955	7.1	4.3*
4	Canada	0.943	0.941	12.2	7.4*
8	United States	0.939	0.936	15.8	13.6*
9	Japan	0.938	0.932	11.1	...
12	United Kingdom	0.936	0.934	14.8	15.7*
28	South Korea	0.888	0.882	...	<2.0
53	Mexico	0.802	0.792	9.1	9.9



### Medium Human Development

57	Russian Fed	0.795	0.794	...	...
59	Malaysia	0.793	0.786	10.9	<2
68	Venezuela	0.778	0.770	8.5	15.0
72	Brazil	0.775	0.768	11.5	8.2
77	Saudi Arabia	0.768	0.739	15.8	...
83	Philippine	0.753	0.751	15.0	14.6
94	China	0.745	0.741	13.2	16.6
96	Sri Lanka	0.741	0.738	18.2	6.6
101	Iran	0.732	0.713	16.4	<2
111	Indonesia	0.692	0.685	17.8	7.5
112	Vietnam	0.961	0.689	20.0	17.7
120	Egypt	0.953	0.634	30.9	3.1
127	India	0.595	0.572	31.4	34.7
138	Bangladesh	0.509	0.499	42.2	36.0

### Low Human Development

142	Pakistan	0.497	0.471	41.9	13.4
151	Nigeria	0.466	0.458	35.1	70.2
176	Niger	0.292	0.278	61.4	61.4

\*For 1994 – 95 using \$ 11 a day (1994 PPP US \$)

**Note:** countries have been arranged in the descending order on the basis of HDI

**Source: Compiled From UNDP, Human Development Report 2004.**

### Human Development Index

Hdi measures the average achievement in three basic dimensions of human development:

- A long and healthy life as measured by life expectancy at birth
- Knowledge as measured by the adult literacy rate (with two third weight) and the combined primary, secondary and tertiary gross enrolment ratio (with one third weight)
- A decent standard of living as measured by GDP per capita (PPP US \$)

Before calculating hdi, an index for each of the three dimensions is created,

The hdi is calculated as a simple average of the dimension indices. The table indicates human development index for 2002 for selected countries as reported in HDR 2004. Countries have been grouped under three categories:

- ▶ Countries in the HDI range 0.8 And above are in the high human development group
- ▶ Countries in the HDI range 0.5 To 0.8 Are in the range of medium human development group
- ▶ Countries in the HDI range less than 0.5 Are in the low human development group

The data has been collected for 177 countries. Among them 55 countries were in the high human development range, 86 countries were in medium human development range and 36 countries were in low human development range. India, which was at no.138 In hdi in 1994, has improved its position to no.127 In 2002.

### **Gender Related Development Index (GDI)**

While hdi measures average achievement, the GDI adjusts the average achievement to reflect the inequalities between men and women. The three components used for the purpose are:

- ▶ Female life expectancy
- ▶ Female adult literacy and gross enrolment ratio
- ▶ Female per capita income

If gender inequalities were not penalized, the value of GDI and hdi would be the same, but if gender inequalities exist, the value of GDI would be lower than that of HDI. The greater the difference between hdi and gdi, the greater is the gender inequality.

From the table (refer GDI column) it may be noted that near gender equality exists in Norway, Canada, United States, United Kingdom, Japan, Mexico, Russian Federation, Malaysia, Venezuela, Philippines, Sri Lanka, China, Vietnam and Indonesia. Countries which indicate higher gender inequality are Saudi Arabia, Pakistan, Iran , India , Egypt and Nigeria.

## **Human Poverty Index (HPI)**

Human development report 1997 introduced the concept of human poverty index, which concentrates on deprivation in three essential elements of human life already reflected in HDI – longevity, knowledge and a decent living standard. The first deprivation is vulnerability to death at a relatively early age and is represented in the HPI by the percentage of people expected to die before age 40. The second deprivation is related to knowledge and is measured by the percentage of adults who are illiterate. The third deprivation relates to a decent standard of living, in particular, overall provisioning. This is represented by a composite of three variables – the percentage of people of people with access to:

- ▶ Health services
- ▶ To safe water
- ▶ The percentage of malnourished children under five.

It may be noted that in the case of nigeria, 70.2 % Of the population suffers from income poverty, but HPI index is 35.1 %. However, in the case of bangladesh, the situation is totally reversed – HPI 42.2, But income poor population is 36 %. In case of india, proportion of population below international income poverty line is 34.7 %, But human poverty index is 31.4.

## **United Nations Millennium Declaration For 2015**

### ***To Promote HDI:***

- ▶ To halve the proportion of the world's people living on less than \$1 a day
- ▶ To halve the proportion of the world's people suffering from hunger
- ▶ To halve the proportion of the world's people without access to safe drinking water
- ▶ To achieve universal completion of primary schooling
- ▶ To achieve gender equality in access to education
- ▶ To reduce maternal mortality ratios by three quarters
- ▶ To reduce under-five mortality rates by two thirds
- ▶ To halt and begin to reverse the spread of HIV/AIDS, malaria and other major diseases.

## Human Development Index For Variuos States In India

Major State – Wise Human Development In India (HDI)

Rank	State	Value Of HDI
1	Kerala	62.78(1)
2	Maharashtra	55.49(2)
3	Punjab	54.86(3)
4	Tamil Nadu	51.11(4)
5	Haryana	50.56(5)
6	Gujarat	47.82(6)
7	Karnataka	46.83(7)
8	West Bengal	45.37(8)
9	Andhra Pradesh	41.28(9)
10	Assam	39.48(10)
11	Madhya Pradesh	36.71(11)
12	Orissa	37.25(12)
13	Rajasthan	37.11(13)
14	Uttar Pradesh	35.51(14)
15	Bihar	34.05(15)

**Note:** 1. States have been arranged on the basis of UNFPA studying the descending order of HDI

2. Figures in brackets indicate respective state-wise ranks

**Source:** UNFPA, India: Towards Population And Development Goals, OUP, 1997

Many of india's states can be compared with medium-size countries. It would, therefore, be appropriate to construct human development index (HDI) for various states so as to understand the difference in HDI among them. The unfpa published a report on human developments in india in a book entitled "India; towards population and development goals" in 1997. The range of HDI values in unfpa study varies from 62.8 For the top most Kerala to 34 for Bihar. In this study, the variation is from 59.7 In case of Kerala to 34.1 For Madhya Pradesh.

## **Progress Of Human Development In India**

The basic purpose of planning in india is to widen people's choices and improve the well being of the people. In this context, human development was the key issue so that people could lead a long and healthy life, they could acquire knowledge so as to have a better vertical mobility in life and last, but not the least, to achieve a decent standard of living of all. It would be, therefore, appropriate to examine the progress of human development in india.

India has been categorized by the human development report 2001 as a medium human development country. The human development index has risen gradually from 0.406 In 1975 to 0.510 In 1990 and stands at 0.590 In 2001. In fact, it can take quite long for india to cross the mark of 0.8 In hdi to join the rank of high hdi countries.

A major impediment to progress in human development is the very fast growth of population experienced in india. India's population increases from 620.7 Million in 1975 to 1,033 million in 2001 giving a growth rate of 20 % per annum during the period (1975-2001), which is fairly high. It is expected that the growth rate of population during 2000-2015 will come down to 1.3 %. This would provide a welcome relief to push forward the process of human development. Urbanization is considered to be a factor, which promotes human development.

The share of urban population, which was 21.3 % In 1975, has reached a level of 27.8 %In 2001, but by 2015, urban population would reach the level of 32.2 %. This would certainly help to enlarge human development because it has been observed that urban areas are better looked after in terms of education and health facilities. Another healthy feature of likely demographic transition is the proportion of children or population under age 15, whose proportion stood at 33.7 % In 2001 but likely to decline to 27.7 % By 2015.

This will imply decreasing population pressures far below in future which would also help in releasing resources to improve human development. It would be quite useful to consider factors related with the education of the population that are likely to promote human development. The most important factor is adult literacy rate, which was 58 % in 2001.

The share of india in the world's illiterate population is 33.3 %. The information technology revolution has been necessitated an increase in proportion of tertiary students in science, maths and engineering to be steeped up. Their proportion was only 25% during 1994 – 97 in india. India has to bring about a shift to meet the challenging demands of the new economy.

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## Lesson - 2 Global Trends In Business And Management

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### International Relations

In modern times no state can afford to live in isolation. It has to cultivate relations with other states of the world out of sheer necessity. Just as no individual can live outside the society, similarly, no state can live outside the international community. Therefore, international relationship is as much a product of necessity as social existence itself. With the industrial revolution the world shrank and the distances were reduced.

As a result the regional and local problems began to assume world character. With this regional relations were transformed into international relations. The term international relations has been interpreted and defined in two senses- narrow and broad. In the narrow sense it is confined to the study of *“official relations conducted by authorized leaders of the state”*.

By emphasizing official relations, the relations between businessmen, scientists, etc., Of the various countries are excluded from the scope of international relations. In the broader sense international relations include *“all intercourse among states and all movements of people, goods and ideas across national frontiers”*.

### Types Of Relations

Usually two types of relations exist between states – **co-operative and oppositional**.

- ▶ **Cooperative relations** – they are usually non-political and involve no power.
- ▶ **Oppositional relations:** the oppositional relations imply conflict among groups and demand use of power.

International relations include study of the both. At initial stages international relations studied only diplomatic history as conditioned by the happening of the past, but soon even to study of international law was included in its scope.

With establishment of the league of nations, the study of international institutions was also included in its fold. Thus after world war i it came to study the diplomatic history, international law and the league organization.

After world war ii, its field was further widened and study of military science and regional areas was also included in it. The psychological study through personality and background analysis also gained prominence. Thus at present international relations have become very extensive.

### **International Relations Approaches**

Broadly speaking there are two approaches for the study of international relations.

- **The classical approach** considers the substance more important
- **Scientific approach attaches** more importance to method and technique.

### **Types Of Classical Approach**

The prominent amongst the classical approach are

#### **1. Historical approach**

Under it diplomacy and inter-relations of a particular period are studied. This approach is not possible in modern world, though it has the advantage of giving the students a deep understanding of the problems in their correct prescriptive.

#### **2. International organization approach**

It studies the behavior of various states in the international organization to determine the attitude of a particular power. This theory does not take into account the activities of a state outside the international organization.



### 3. International law approach

It considers the international law as the key to the interpretation of international relations. This approach, however, ignored the internal politics as a factor in determining the attitude of a power in the international sphere.

### Types Of Scientific Approach

The prominent scientific or modern approaches are

- ▶ **Behavior approach** is based on psychology and tries to analyze international relations as strife between various national characters.
- ▶ Karl Detsch developed **quantitative theory** and developed certain measurable indices of community development.
- ▶ **Decision-making approach** of Richard C. Snyder emphasized the need of probing the minds of the decision makers. While probing their minds both internal and external settings were to be taken into account.
- ▶ **The systems theory** developed by Kaplan holds that a theory of international politics normally cannot predict individual actions because the interaction problem is very complex.
- ▶ **Equilibrium theory** of international relations and institutions was developed by Liska. He holds that the states seek to secure the best attainable position of equilibrium, and this is desirable.
- ▶ **Power approach or realist theory** it tries to understand international relations in terms of state interests and holds that the statesmen are guided by interests rather than ideology, or motives.

### Multinational Corporations

The dynamics of the business environment fostered by the drastic political changes in the erstwhile communist and socialist countries and the economic liberalization across the world have enormously expanded the opportunities for the multinational corporations, also known by such names *as international corporation, transnational corporation, global corporation (or firm, company or enterprise) etc.*

The rapidity with which the MNC's are growing is indicated by the fact that while according to the world investment report 1997, there were about 45000 mnc's with some 280000 affiliates. According to the world investment report 2001, there were over 63,000 of them with about 822,000 affiliates.

Only less than 12 % of these affiliates were in the developed countries. China was host to about 3.64 Lakh of the affiliates (i.E., More than 44% of the total) compared to more than 1400 in india. The MNC's accounts for a significant share of the world's industrial investment, production, employment and trade.

### **Definition And Meaning**

“A corporation that controls production facilities in more than one country, such facilities having been acquired through the process of foreign direct investment, firms that participate in international business, however large they may be, solely by exporting or by licensing technology are not multinational enterprises.”

The various benchmarks sometimes used to define “multi nationality” are that the company must:

- ▶ Produce (rather than just distribute) abroad as well as in the headquarters country
- ▶ Operate in a certain minimum number of nations (six for example)
- ▶ Derive some minimum percentage of its income from foreign operations (e.G., 25%)
- ▶ Have a certain minimum ratio of foreign to total number of employees, or of foreign total value of assets
- ▶ Possess a management team with geo-centric orientations.
- ▶ Directly control foreign investments (as opposed simply to holding shares in foreign companies).

### **Merits Of MNC**

The important arguments in favour of the mncs are mentioned below:

- ▶ MNCs help to increase the investment level and thereby the income and employment in host country.

- ▶ The transnational corporation has become vehicles for the transfer technology, especially to the developing countries.
- ▶ They also kindle a managerial revolution in the host countries through professional management and the employment of highly sophisticated management techniques.
- ▶ The MNCs enable the host countries to increase their exports and decrease their import requirements.
- ▶ They work to equalize the cost of factors of production around the world.
- ▶ MNC provide an efficient means of integrating national economies.
- ▶ The enormous resources of the multinational enterprises enable them to have very efficient research and development systems. Thus, they make a commendable contribution to inventions and innovations.
- ▶ MNC also stimulate domestic enterprise because to support their own operations, the mncs may encourage and assist domestic suppliers.
- ▶ MNC help increase competition and break monopolies.

### **Demerits Of MNC**

The various cases against mncs are:

- ▶ The MNCs technology is designed for worldwide profit maximization, not the development needs of poor countries.
- ▶ Through their power and flexibility, mncs can evade or undermine national economic autonomy and control, and their activities may be inimical to the national interests
- ▶ MNCs may destroy competition and acquire monopoly powers.
- ▶ The tremendous power of the global corporations poses the risk that they may threaten the sovereignty of the nations in which they do business.
- ▶ MNCs retard growth of employment in the home country.
- ▶ The transnational corporations cause fast depletion of some of the non-renewable natural resources in the host country. They have also been accused of the environmental problems.
- ▶ The transfer pricing enables mncs to avoid taxes by manipulating prices on intra-company transactions

- › The MNC undermine local culture and traditions; change the consumption habits for their benefits against the long-term interests of the local community.

### **Perspective**

Future holds out an enormous scope for the growth of MNCs. The changes in the economic environment in a large number of countries indicate this. A united nation's report described several developments that points to a rapidly changing context for economic growth, along with a growing role transnational corporations in that process. These include:

- › Increasing emphasis on the market forces and a growing role for the private sector in nearly all developing countries.
- › Rapidly changing technologies that are transforming the nature of organization and location of international production.
- › The globalization of firms and industries.
- › The rise of services to constitute the largest single sector in the world economy and
- › Regional economic integration, which involves both the world's largest economies as well as selected developing countries.

### **Multinationals In India**

The inflow of foreign funds through MNCs in india is showing an upward trend in recent years. 1991 Onwards, the government of india has taken several steps to attract foreign investments and entry of the MNCs, such as:

- › Abolition of industrial licensing
- › Removal of restriction on investment under the mrtpMRTTP act
- › Liberalization of policy and procedure for transfer of technology, import off capital goods, etc
- › Existing companies are allowed to raise foreign equity up to 51%
- › Provisions of the FERA have been relaxed. As a result, companies with more than 40% foreign equity can operate like any other indian company.
- › Foreign companies are permitted to use their trade in domestic markets.

During the nineties, there has been an increasing trend of foreign investments in India. The government approved 666 foreign collaborations in 1990. This number has become more than double to 1520 by 1992. At present, the USA is the largest investor in India, followed by Switzerland, Japan and UK. Foreign investment has largely been concentrated in sectors such as fuel and oil refineries, power chemicals and electrical equipments and electronics.

### **The Rise Of Indian Multinationals**

After liberalization of Indian market in 1991 and in its due course, Indian MNC is flying high not only over the Indian sky but globally. Though it took almost a decade when many Indian firms have slowly and surely embarked on the global path and led to the emergence of the Indian Multinational Companies. With each passing day, Indian businesses are acquiring companies abroad, becoming worldwide popular suppliers and are recruiting staff across national boundaries. While Asian Paints is painting the world red, Tata is rolling out Indicas from Birmingham and Sundaram Fasteners nails home the fact that the Indian company is an entity to be reckoned with.

Some facts:

- ▶ **Tata Motors** sells its passenger-car Indica in the UK through a marketing alliance with Rover and has acquired a Daewoo Commercial vehicles unit giving it access to markets in Korea and China.
- ▶ **INFOSYS** has 25,634 employees including 600 from 33 nationalities other than Indian. It has 30 marketing offices across the world and 26 global software development centers in the US, Canada, Australia, the UK and Japan.
- ▶ **Ranbaxy** is the ninth largest generics company in the world. An impressive
  - ▶ 76 % Of its revenues come from overseas.
- ▶ **Dr.Reddy's Laboratories** became the first Asia Pacific pharmaceutical company outside Japan to list on the New York stock exchange in 2001
- ▶ **Asian Paints** are among the 10 largest decorative paints makers in the world and have been manufacturing facilities across 24 countries.

- ▶ Small auto components company **Bharat Forge** is now the world's second largest forging maker. It became the world's second largest forgings manufacturer after acquiring Carl Dan Peddinghaus, a German forgings company, last year. Its workforce includes Japanese, German, American and Chinese people. It has 31 customers across the world and only 31 percent of its turnover comes from India.
- ▶ About 80% of revenues for Tata Consultancy Services come from outside India. It raised in Asia's second – biggest tech IPO this year and India's largest IPO ever.
- ▶ Sundaram Fasteners is not merely a nuts and bolts company. It believes in thinking out of the box. Probably that is why it decided to acquire a plant in China. The plant in Jiaxin city in the Haiyan economic zone has ensured one fact; that its customers who were earlier buying Sundaram products in Europe and the US, did not have to go far from home to access the product.

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## Lesson - 3 Foreign Capital And Collaboration

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### Foreign Capital

Most countries of the world which embarked on the road to economic development have to depend on foreign capital to some extent. The degree of dependence, however, is varied with the extent to which domestic resources could be mobilized, the state of the domestic economy in respect of technical progress, the attitude of the respective governments, etc. But the fact cannot be denied that foreign capital contributes in many important ways to the process of economic growth and industrialization.

### Need For Foreign Capital

The need for foreign capital for a developing country like India can arise on account of the following reasons:

- ▶ Domestic capital is inadequate for purposes of economic growth.
- ▶ For want of experience, domestic capital and entrepreneurship may not flow into certain lines of production.
- ▶ There may be potential savings in a developing economy like India but this may come forward only at a higher level of economic activity.
- ▶ It may be difficult to mobilize domestic savings for the financing of projects that are badly needed for economic development.
- ▶ Foreign capital brings with it other scarce productive factors, such as technical know-how, business experience and knowledge.

### Trends In Indian Industry

The different forms of foreign investments in India are:

#### *Direct Foreign Investment -*

Foreign capital can enter India in the form of direct investments.

### ***Foreign Collaboration***

Joint participation of foreign and domestic capital: there are three types of foreign collaborations – joint participation between private parties, between foreign firms and Indian government and between foreign governments and Indian government.

### ***Inter-Government Loans***

Since the Second World War, there has been a growing tendency towards direct inter-government loans and grants.

### ***Loans from International Institutions***

International Monetary Fund (IMF), Aid India Consortium, Asian Development Bank (ADB) and the World Bank have been the major sources of external assistance to India.

### **External Commercial Borrowing (ECB)**

Export credit agencies like the US Exim bank, the Japanese Exim Bank, and ECGC of the UK etc. to obtain commercial borrowing from the capital market.

The Government of India liberalized its policy towards foreign investment in 1991 to permit automatic approval for foreign investment up to 51 percent equity in 34 industries. The Foreign Investment Promotion Board (FIPB) was also set up to process applications in cases not covered by automatic approval. During 1992-93 several additional measures were taken to encourage direct foreign investment, portfolio investment, NRI investment, etc.

### **Foreign Collaboration**

During the early phase of the planning era, the national policy towards foreign capital did recognize the need for foreign capital, but decided not to permit it a dominant position. Consequently foreign collaborations had to keep their equity within the ceiling of 49 % and allow the Indian counterpart a majority stake. Moreover, foreign collaborations were to be permitted in priority areas, more especially those in which we had not developed our capabilities.



But in an overall sense, our policy towards foreign collaborations remained restrictive and selective. Consequently, during 1961-70 a total of 2,475 foreign collaborations were approved and during the next decade (1971 – 80) another 3, 041 collaborations were sanctioned.

It was only during the eighties that government relaxed its policy towards foreign collaborations. This was done specifically in respect of investors from Oil Exporting Developing countries with well-defined package exemptions. This was followed by Technology Policy Statement (TPS) in January 1983. The objective of the policy was to acquire imported technology and ensure that it was of the latest type appropriate to the requirements and resources of the country.

### **Foreign Investments By Countries**

Technical collaborations were allowed on financial criteria i.e. royalty or lump sum payment or a combination of both. These relaxations resulted in a larger inflow of foreign direct investment and consequently, the number of approvals during the decade (1981 – 90) reached a record figure of 7,436 involving a total investment of Rs1, 274 crores.

Country-wise analysis of foreign collaboration reveals that USA was at the top accounting for nearly Rs.322.7 crores of investment. This was one fourth of the total foreign collaboration approvals. This was followed by Federal Republic of Germany (17.2%), Japan, UK, Italy, France and Switzerland. Five countries USA, West Germany, Japan, UK and Italy accounted for nearly 63% of total approved foreign investment. Even Non-Resident Indians (NRIs) contributed about Rs.113 crores accounted for 8.9 % of total investment.

### **Foreign Investment By Industries**

An industry-wise analysis of foreign collaboration approvals reveals that electrical and electronic (including telecommunications) accounted for 22% of the total approval, indicating highest priority to this sector, followed by industrial machinery 15.5%. Foreign collaboration in chemicals (other than fertilizers) was third in importance. By and large it may be stated that the priority sector accounted for about 70% of total approvals. It implies that foreign collaborations approvals were more or less in conformity with the general climate towards foreign capital in the country at that time.

## **Financial And Technical Collaborations**

Foreign collaborations are of two types:

- ▶ **Technical approvals** involving payments for technology
- ▶ **Financial approvals** involving equity capital of an existing or new undertaking.

Upto Rs.600 crores the Industry Ministry accords approval on the advice of Foreign Investment Promotion Board (FIPB), but larger projects over these limits are approved by Cabinet Committee on Foreign Investment (CCFI).

### **Sources Reveal:**

- ▶ Financial collaborations were just 20.1% during 1981 – 1985, their share improved to 28.8 % during 1985 – 90 but rose sharply to 72 % during 1991- 1997.
- ▶ The amount of approved investment also increased sharply from Rs.899 crores during 1985 – 90 to Rs.1, 73,510 crores in August 1998.

Obviously there is a shift from technical approvals to financial approvals during the post liberalization phase. However, Government has been successful in attracting more foreign investment in the post liberalization phase as compared to the earlier period.

## **Takeovers And Implementation Of Foreign Collaborations**

Indian entrepreneur seems to have lost its bargaining power and well known Indian brands have been taken over by TNCs. It needs to be emphasized that takeovers do not add to new production capacities. On the contrary, there are likely to add to higher outflow of foreign exchange. In foreign collaborations, transfer of superior technology has not been the main consideration.

### **Some Recent Takeovers**

- ▶ ICI (UK) attempted to take over Asian paints.
- ▶ Hindustan lever took over Tomco.

- Premier automobiles transferred two of its plants to Peugeot.
- Transfer of Lakme's brand to a 50:50 joint venture with the Levers.
- TVS Suzuki takes up Hero Honda.
- Whirlpool took over TVS Whirlpool.
- Suzuki's attempt to gain majority control in Maruti Udyog.
- Bridgestone increasing its stake from 51% to 74 % in joint venture with ACC.
- Bausch & Lomb increasing its share in Indian venture to 69%.
- Henkel increasing its share to 70%.
- Blue star edged out of Motorola Blue Star and Hewlett Packard India.
- Shriram's share got reduced in Shriram Honda Power.
- Once the Indian partners transferred the units, they neither had the money nor the marketing network with them.

### **Fdi And The Indian Stock Market**

- Stock market is an ideal form of organization, which by providing easy liquidity encourages the public to invest, and this brings out the latent surplus in the economy.
- For this purpose, the shares of good promising companies should be listed on the market. During the 70's and 80's, a good number of blue chip TNC scripts got listed. Notable among them were: Abbot Labs, Burroughs Wellcome, E.Merck, Eskayef, Fulford, Hoechst, May & Baker, Organon, Parke Davis and Wyeth.
- The chief objective of offering shares to the public by the affiliates could not be to raise fresh capital from the public, but was only a strategy of diluting foreign equity without reducing their foreign parent's quantum of investment.
- In the post-liberalization period, the policy was reversed. At the first available opportunity, many foreign affiliates raised foreign equity to majority levels.
- While raising share of foreign equity to majority level, most TNCs indicate a tendency to avoid the stock market. TNCs are side-stepping the stock market and they sell off the existing units to locals and promote Wholly-Owned-Subsidiaries (WOS) or transfer certain divisions / products to Wholly-Owned-Subsidiaries of the parent company.

- ▶ The number of technical collaborations declined from 629 in 1997 – 1998 to only 299 in 2003 – 2004. There was a tendency to convert purely technology transfer arrangements later into financial collaboration by buying the equity share of the concerns.

### **Foreign Capital And Collaboration – A Critical Assessment**

- ▶ Transfer of technology can be affected with more investment being made by technologically advanced MNCs. But, there are aspects of foreign direct investment which seriously impinge on people's welfare and national sovereignty.
- ▶ Nearly half of the Foreign Investment is in the nature of portfolio investment, which only strengthens speculative trading in shares. This only underlines the fact that MNCs are able to manipulate the stock market to suit their goals.
- ▶ Foreign direct investment is catering to the needs of the upper middle and affluent classes. Consequently, there is an utter neglect of the wage goods sector.
- ▶ Portfolio investment made in India is in the nature of hot money, which may take to flight, if the market signals indicate any adverse trends. Thus, it would be a mistake to treat portfolio investment as a stable factor in our growth.
- ▶ A larger inflow of foreign direct investment, more so in the financial sector, will lead to building of reserves, which in turn will expand domestic money supply. Consequently, inflationary trend of prices gets strengthened in the process.
- ▶ MNCs after their entry are rapidly increasing their shareholding in Indian companies. This has resulted in a number of takeovers by the MNCs and thus, the process of Indianisation of the corporate sector has been totally reversed.

### **Self Assessment Questions:**

1. Outline the present status of infrastructural facilities in our country.
2. Point out the constraints which inhibit the rapid growth of infrastructural facilities.
3. Bring out the role of infrastructure in the growth of a country.

4. Bring out the strengths, problems and remedies for different areas of infrastructure.
5. List out the recent developments in Telecom sector.
6. Evaluate the significance of S & T in economic growth suggests suitable measures to promote S & T.
7. Explain the theory of Demographic Transition.
8. Examine the trend of population growth and its implications on economic growth.
9. State the importance of Human Development. What are the measures to assess human development?
10. 'Gender Related Development is important to achieve overall human development', Comment and highlight the extent of gender equality in India.
11. Evaluate the Human Development across the state in India. Give reasons for the variation among the states.
12. What do you understand by International Relations? Why is IR important in today's environment?
13. Explain the different approaches of International Relations management.
14. Evaluate the role played by MNCs in developing countries.
15. What is Multinational Corporation? Explain its characteristics.
16. Outline the major MNCs in India. Also, the rise of Indian Multinationals at global.
17. Describe the need of foreign capital for economic growth.
18. What are the forms of foreign capital? List the major investing foreign countries in India.
19. Explain the concept Financial and technical collaborations.
20. Why should have collaborations? Explain the various strategies of collaborations.
21. Critically examine the impact of FDI on Indian stock market.
22. Examine the relationship between FDI flows and liquidity and volatility of stock market.
23. Trace out the growing significance and major forms of takeover in India.
24. Outline the trade and pattern of industrialization in India.
25. Examine the concept of leaders in drafting the long term plans to promote industrial growth in our country.
26. Examine the growth and future perspective of Indian industries.

27. What is 'Geopolitical Dimension'? Give its relevance in today's global environment.
28. Describe the need and emergence of new dimension of business environment, 'geopolitical transformation'.

### **Key Words**

- ▶ Demographic transition (DT) refers to the transition from high birth and death rates to low birth and death rates as a country develops from a pre-industrial to an industrialized economic system.
- ▶ Human development is a concept within the scope of the study of the human condition, specifically international development, relating to international and economic development.
- ▶ International Relations (I.R.) although the two terms are not perfectly synonymous) is the study of relationships between countries, including the roles of states, Inter-Governmental Organizations (IGOs), International Nongovernmental Organizations (INGOs), Non-Governmental Organizations (NGOs) and Multinational Corporations (MNCs).
- ▶ Multinational Corporation: A Multinational Corporation (MNC) or Multinational Enterprise (MNE) is a corporation enterprise that manages production or delivers services in more than one country.
- ▶ Foreign direct investment (FDI) is investment directly into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.
- ▶ Subsidiary Company: A subsidiary company, subsidiary, or daughter company is a company that is completely or partly owned and wholly controlled by another company that owns more than half of the subsidiary's stock.
- ▶ The International Monetary Fund (IMF) is an international organization that was created on July 22, 1944 at the Bretton Woods Conference and came into existence on December 27, 1945 when 29 countries signed the Articles of Agreement.

## Further Readings

1. Don Mayer, Daniel Warner, George Siedel and Jethro K. Lieberman, *Business Law and the Legal Environment*, Palgrave Macmillan publishing, New York, 2011.

2. Jane P. Mallor, A. James Barnes, L. Thomas Bowers and Arlen W Langvardt, *Business Law: The Ethical, Global and E-Commerce Environment*, McGraw-Hill/Irwin, 2004.

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## UNIT - III

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### Objectives:

*The primary aim of this unit is to enable you to:*

- ▶ Understand the role of Government in regulating the economic and business activities;
- ▶ Have adequate insights into the concept of law of contract and its various essential elements;
- ▶ Explain the performance, discharge and remedies of breach of contract;
- ▶ Know the principles of Partnership and Sale of Goods and their related provisions;
- ▶ Describe the legal provisions relating to Law of Insurance and Negotiable Instruments

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### Lesson - 1 Law Of Contract (Indian Contract Act 1872)

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Most of the business transactions are based on promises to be performed at a later date. These promises whether made by businessmen or by others create certain rights and obligations and if these rights and obligations are not enforceable, the business world would be paralysed. It is with the enforcement of these promises that the law of contract is concerned. The contract Act does not lay down the list of obligations that would be enforceable by law but lays down the rules subject to which rights or duties created by the parties would be enforced. The parties to the contract can make whatever rules they want, if these rules are not inconsistent with the provisions of the Act, they would be enforced by courts of law.

**Meaning:** Sec.2 (h) “An agreement enforceable by law is a contract.” Therefore, a contract has two important elements, one is the agreement, and the other is the obligation which is enforceable by law.

**Agreement:** Agreement is the outcome of the consensus between the parties who enter into a contract, i.e., the promise made between them, represents concurrence of their minds. (Sec.13). these would not be an agreement if the parties do agree but not on the same thing in the same sense, i.e., consensus is not sufficient. There has to be **consensus ad idem**. Sec.2 (e) defines an agreement as “Every promise or every set of promises forming consideration for each other”. A proposal when accepted becomes a promise.

**Example:** A received Rs.10, 000 from B and promises to supply him 10 bags of rice after 10 days. It is a promise. It shall be a set of promises if A promises to supply 10 bags of rice after 10 days and B promises to pay him Rs.10, 000 after the rice is supplied. Thus, Agreement = Offer + Acceptance.

**Offer (Proposal):** Offer [(proposal) (Sec.2 (a))] “When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal”.

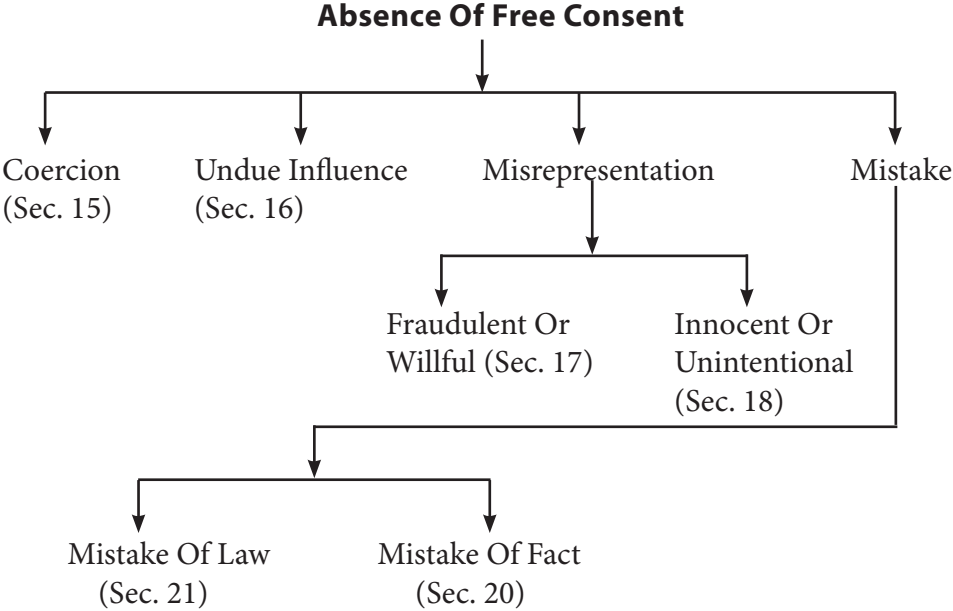
**Acceptance:** Acceptance has been defined u/s (Sec.2 (b)) as “When the person to whom the proposal is made, signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise”.

**Example:** A lost his Cell Phone and announced that anybody who brought his cell phone back home would receive Rs.500 as reward. B heard the announcement and brought the Cell Phone back home. He is said to have accepted the proposal by doing the act required by A and hence he can recover the reward.

**Promisor:** A person who makes the promise is called the ‘**Promisor**’ or ‘**Offeror**’. And the person to whom the proposal is made is known as ‘**Promisee**’ or ‘**Offeree**.’ In case an agreement is a set of promises, then a person becomes a **promisor** and **promisee**. Thus if there is an offer, acceptance and consensus ad idem between the parties, there is an agreement. However, this agreement does not become a contract unless there is a corresponding obligation, i.e., enforceability at law.

**Obligation (Sec.10):** It is the legal duty of a person to carry out what he has promised to do or not to do. All agreements are contracts if they are made by the free consent of the parties competent to enter into contract, for a lawful consideration and with a lawful object and not hereby expressly declared to be void. Therefore, a person becomes legally bound to do what he has promised to do only if the following conditions are fulfilled.

1. **Capacity of the Parties:** Only those persons who are competent to enter into a contract can create valid obligations. A minor, a lunatic, a drunkard etc., suffer from flaw in capacity to Contract and therefore the contract made with them can't be enforced against them.
2. **Free Consent:** Absence of consent does not create a legal obligation. For an agreement to become a contract the parties to an agreement should give their consent to the agreement out of their own free will. It should not be induced by coercion, undue influence, fraud, misrepresentation, etc.



3. **Lawful Consideration and Object:** Consideration means something in return, i.e., 'quid pro quo.' E.g. A promises to give his bike to B for no money, here, there is no consideration, hence no obligation. Without consideration a promise can't be enforceable by law. However, consideration need not be in money or in kind. It may be of an act, abstinence, a promise to do, or not to do something. But consideration should be lawful.

4. Example: A promises to pay a sum of money to B if B smuggles the object proposed by A. In this case, there is no lawful object.
5. Intention to create Legal Relationship: Social obligation can't bring legal relationship. For example: Father promised his son to pay Rs.100 per day for pocket expenses, however, later on, did not pay the said amount. Therefore, if the parties do not intend to be bound by law at the time they make promises, nothing can bind them to their promises, later on.
6. Possibility of Performance: Example: A promised B that he would make The Sun rises in the West if B pays him Rs.1 lakh. And B agreed to it, this agreement does not create any legal obligation as it would not be enforceable by law.
7. Meaning should be certain: Example: A agrees to sell B's horse. There is nothing whatever to show which horse is intended. The agreement is void for uncertainty.
8. Legal Formalities (If required): An agreement to make a gift for natural love and affection should not only be in writing but registered also (Sec. 25). In the absence of any such specific requirement an oral agreement is as enforceable as a written agreement.
9. Agreements not Declared Void: Indian Contract Act has specifically declared some agreements to be not enforceable at law e.g. Agreements in restraint of trade, Agreements in restraint of marriage, wagering agreements etc. Thus the law of Contract is not the whole law of Agreements. It is the law of those agreements which create obligations.

### **Kinds Of Contracts**

1. **Valid Contract:** It is an agreement which fulfils all the essentials of enforceability and can be enforced by either of the parties at the courts of law.
2. **Voidable contract:** Sec 2(i) lays down that "An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a Voidable Contract." This arises where the consent of one of the parties to the contract is not free. Ex., A, at the point of pistol makes B agree to sell his bicycle for Rs.500. Here B's consent is not free.

Circumstances in which a contract is voidable are:

#### (A) At the conception

1. Consent caused by fraud (Sec.14, 17 and 19)
2. Consent caused by coercion (Sec. 14, 15 and 19)
3. Consent caused by misrepresentation (Sec. 14, 18 and 19)
4. Consent caused by undue influence (Sec. 14, 16 and 19A)
5. When one party induces another to enter into an agreement the object of which is unlawful though it is not known to the other party.

(B) By Subsequent Default

1. Where offer of performance is not accepted (Sec. 38)
2. When one party prevents performance of reciprocal promise (Sec. 53)
3. When a party fails to perform at the time fixed, if time is the essence of the contract (Sec. 55)

Consequences of Rescission of Voidable Contract

When a voidable contract is rescinded?

- A. As regards the party at whose option the contract is voidable, if he has received any benefit from another party to such contract, he must restore such benefit so far as may be, to the person from whom it has been received. The benefit must have been received under the contract and not otherwise. Security for performance is not the benefit received under the contract.
- B. As regards the other party, he need not perform his promise.
3. **Void Contract:** [Sec 2(j)] "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable" E.g A agrees to sell his car to B for Rs.10, 000. All essentials of a contract are fulfilled. If A refuses to sell his car, B can go to the court and the court would enforce A's promise. But if, before the delivery the car is destroyed by Tsunami, the court cannot enforce anything and hence this contract becomes unenforceable i.e void. Thus, void contract is one which was a valid contract when it was made but becomes void later on. Those agreements which are *void ab initio* (from the very beginning) are called Void Agreements and those which become void later on are called Void Contracts.

Following circumstances will transform a valid contract into a void contract.

- A. **Contingent contract:** A contingent contract to do or not to do something on the happening of an uncertain future event becomes void, when the event becomes impossible (Sec 32).
- B. **Repudiation of a voidable contract:** When a voidable contract is rescinded by the party at whose option it is voidable, the contract becomes void.
- C. **Subsequent impossibility (Sec. 56):** A contract which becomes impossible to perform, after it is made, becomes void.
- D. **Subsequent illegality (Sec. 56):** A contract becomes void if it becomes illegal after it is made.

Consequences of a Void Contract: Sec. 65 lays down that when a contract becomes void, the party who has received any advantage under such agreement should restore it or make compensation for it to the party from whom he received it.

4. **Void Agreement:** An agreement not enforceable by law is called a void agreement. If any of the essentials of obligations (enforceability), other than free consent, is missing the agreement cannot be enforced at Courts of Law.

### **Invalidating Causes**

In the following circumstances an agreement is void ab initio.

- i. If a party to the contract is incompetent to contract (Sec.10, 11 & 12)
  - ii. If the agreement is without consideration (Sec. 10, 25) barring certain exceptions.
  - iii. If the consideration or object is unlawful (Sec. 23)
  - iv. If the meaning of the contract is uncertain (Sec. 29)
  - v. If the agreement is to do an impossible act (Sec. 56)
  - vi. If both the parties enter into an agreement under a mistake as to the essential matter of fact (Sec. 20). There is no consensus ad idem.
  - vii. If both the parties are under a mistake as to foreign law (Sec. 21)
  - viii. If the agreement is in restraint of marriage of a person other than a minor (Sec. 26)
  - ix. If the agreement is in restraint of trade (Sec. 27) barring certain exceptions.
  - x. If the agreements is in restraint of legal proceedings (Sec. 28)
  - xi. If the agreement is by way of wager (Sec. 30)
5. **Illegal Agreement:** An illegal agreement is one which is forbidden by law i.e. it is entered into with the intention of violating the law. Example: A agrees to steal furniture for B for a consideration of Rs. 1, 00,000. It is illegal and therefore it is void. It also attracts the penal provisions of the law it is violating.

While all illegal agreements are void, all void agreements are not illegal. Parties to an illegal agreement cannot get any help or protection from law courts.

6. **Unlawful Agreements:** (Sec. 23). In simple words an agreement may be unlawful because it is:
  - a. **Immoral** – i.e. contrary to sound and positive morality as recognized by law, e.g. cohabitation.
  - b. **Opposed Public Policy** – i.e. contrary to the welfare of the State as tending to interfere with the civil or judicial administration, or with individual liberty of citizens, e.g. bribing a public servant.
  - c. **Illegal** – i.e. contrary to positive law, being forbidden either by statutes law or common law;  
Hence a line of demarcation needs to be drawn between illegal and unlawful agreements.

7. **Unenforceable Contract:** Contracts which have all the essentials of enforceability but cannot be enforced due to certain technicalities like insufficiency of stamp, etc. are termed as unenforceable contracts.
8. **Express Contract:** It is one where the intention of parties is stated in words either written or spoken. Example: A goes to B's shop and asks him to supply 10 boxes @ Rs.20 per box. B tells him that he is ready to supply the boxes at the mentioned rate. This is an Express Contract. The same intention of the parties may be expressed in writing signed by both the parties.
9. **Implied Contract:** The evidence of an implied contract is to be deduced from the acts or conduct of the parties. No exchange of words either written or spoken takes place, but the manifestation of their intentions is inferred from their respective acts or conduct.
10. **Quasi Contracts:** These are those obligations which are imposed by the Contract Act and do not arise from a consensus between the parties. Example: A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. B is bound to pay A for them; the obligation is imposed by law.
11. **An Executed Contract:** It is one where both the parties to a contract have discharged their respective responsibilities by performing them. All transactions of Cash sales are the examples of Executed Contracts.
12. **An Executory Contract:** It is one where one or both the parties are yet to perform their respective promises. It is partly Executed and partly Executory.
13. **Unilateral Contract:** It is one where at the time when the contract is made one party has already performed his obligation and the obligation on the part of the other party only, is outstanding. Example: A goes to a bus stand ticket counter and buys a ticket for journey. A has performed his duty under the contract i.e., to pay the scheduled fare. But the bus authority is yet to perform his promise i.e., of carrying him from one point to another. This is a Unilateral Contract.
14. **Bilateral Contract:** As against Unilateral Contract, a Bilateral Contract is one where at the time of entering into the contract both the parties to the contract are yet to perform their respective promises.

## Offer And Acceptance

As seen earlier the first step in making a contract starts with making an offer. We shall, therefore, discuss as to what constitutes a 'lawful offer'.

## Offer Or Proposal

'Offer' and 'Proposal' are synonymous terms. According to sec. 2(a), "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 person making the proposal is called the "**Promisor**" and the person to whom the offer is made is called the "**Promisee**" [Sec.2 (c)] Example: A offers to pay Rs.100 to B if B washes his cloths. A is the promisor and B is the promisee for the promise to pay Rs.100. A is the promisee and B is the promisor for washing his clothes. It is important to note that the offer must be made with the object of obtaining the assent of the other party.

### Rules Regarding A Lawful Offer

A valid offer must be in conformity with the following rules:

1. **Terms of an offer should be definite or should be capable of being made definite.**
2. **Offer should be made with an intention to create legal relationship:** In the absence of such intention no obligation can arise. Absence of such intention may be express or implied.

**Example:** Where A proposes to sell his 'Television' to B for Rs.10000 but tells him that the breach of promise by either party would not create legal rights, no binding contract would arise in that case even if the agreement is in writing.

3. **There is no valid offer where:**
  - i. **It is mere statement of intention:**

**Example:** A gives an advertisement in the television that he would dispose of his building by auction on 5th June at 8 a.m. in the lawns of his bungalow. B, who saw this advertisement, travels a distance of 200 kilometers and reaches A's bungalow at the given time and date and finds that auction has been cancelled. A cannot be held liable because his advertisement to hold auction did not constitute an offer; it was merely an intention to hold an auction where bids would be received.

- ii. **It is an invitation to offer:**

Where A puts his building to public auction he is inviting offers from the bidders and he accepts the offer by falling the hammer or by any other customary method. The actual offer is the bid made at the auction and the auctioneer accepts it.

4. **Offer must be communicated :** The offer must be brought to the knowledge of the person to whom it is made. If an offer is not communicated to the offeree, the latter cannot accept it.



5. **Offer should not contain a term the non-compliance of which would amount to acceptance.**

**Example:** A writes to B “I shall buy your furniture for Rs, 10,000, if you do not reply I shall assume that you have accepted my offer. This is not a valid offer.

6. **Offer may be express or implied:** An offer is express when it is stated in words, written or spoken.
7. **An offer may be general or specific:** When an offer is made to a specific person it is called a specific offer and it can be accepted only by that person but when an offer is addressed to an uncertain body of individuals i.e. the world at large, it is a general offer and can be accepted by any member of the general public by fulfilling the condition laid down in the offer.

### **Lapse Of An Offer**

An offer once made cannot be continued for ever. Liability of the party making the proposal cannot be continued for all times to come. An offer becomes invalid i.e. comes to an end in the following circumstances.

1. **When the stipulated or reasonable time has expired: Example:** A offers to sell his modern table to B for Rs. 5000 and tells him that B must communicate his acceptance within three days. On fourth day B brings Rs.5000 to buy the table. A refuses. A is not bound because the offer has lapsed on the third day.
2. **Where the offer becomes illegal after it is made: Example:** X of Mumbai offers to buy Peanuts from Y of Chennai. Next day Central Government prohibits inter-state transfer of Peanuts. The offer lapses by subsequent illegality.
3. **Where the offerer or offeree dies or becomes insane before the offer is accepted: Example:** A offers to sell his cow to B. Before B could accept the offer, A dies. B cannot accept the offer.
4. **Where the offeree does not accept the offer in the mode the offerer had prescribed: Example:** A writes to B that he wants to sell his furniture to B for Rs.10,000. He also writes to B that if B wants to buy the furniture, he (B) should send him (A) a telegram accepting the offer. B writes a letter to A accepting the offer. If A keeps silence over it, this is a valid acceptance. But if A informs B that he is not treating this letter as acceptance because the offer has not been accepted by a telegram, then this letter would not result in acceptance.
5. **An offer lapses by counter offer by the offeree: Example:** A tells B, “I want to buy your land for Rs. 10,000”. B says, “I shall sell my land for Rs.15,000.” A refuses to buy it for Rs. 15,000. Then B insists that

A should buy it for Rs. 10,000. A refuses to do so. A is not bound by his offer because the statement of B that 'I shall sell my land for Rs. 15,000' is not acceptance of A's offer but a counter offer. When a counter offer is made the original offer lapses and there is nothing for the offeree to accept. But an enquiry should not be mistaken for a counter offer.

**6. An offer comes to an end when the offerer revokes his offer before it is accepted.**

**Tender (standing offer):** A tender is an offer made in response to an invitation to offer. The party inviting tenders may require a definite quantity of goods or services to be supplied, in that event the person who responds to that invitation is said to have made a definite offer and would become bound by it if it is accepted.

**ACCEPTANCE:** "When the person to whom the proposal is made signifies his assent thereto the proposal is said to be accepted. A proposal once accepted becomes a contract." Where two parties make offers to each other with identical terms, without knowing each other's offer. These offers are called 'CROSS OFFERS'.

**Who can accept?:** Where an offer is made to a specified person, only that specified person can accept it and nobody else. But where the offer is made to an uncertain body of persons, anybody can accept the offer.

### **Rules Regarding Acceptance**

1. Acceptance must be absolute and unqualified: The offeree must accept unconditionally all the terms of the offer without any change in any of them.
2. **The Acceptance must be expressed in some usual and reasonable manner, unless the proposal prescribes a manner in which it is to be accepted**
3. **Acceptance by performing conditions or receiving consideration: Example:** A offers to pay Rs. 100 to B, if B throws the ring ball into the basket in first attempt. B immediately throws the ball into the basket in first attempt. By the performance of this condition B is said to have accepted the offer."
4. **Acceptance must be communicated:** Unless acceptance is communicated it would not turn the offer into a contract. However, if the offeree posts the acceptance but it does not reach the offerer, it would be deemed to be communicated. But the offerer cannot frame his offer in such a way that the silence of the offeree would become his acceptance.

5. **Acceptance should be given within stipulated time and before the offer is revoked:** If the offer lapses before acceptance is given, the acceptance would not result into a contract. But where no time limit is stipulated the offer should be accepted within a reasonable time.
6. **Where an offeree accepts an offer knowing that it has been made by the offeror under a mistake, the contract is not binding upon the offeror.**

### **Consensus Ad Idem**

According to sec. 13, “Two or more persons are said to consent when they agree upon the same thing in the same sense”. But where the circumstances lead one party to believe that the other would have understood the terms of the agreement, law may imply unenforceable agreement. Because it is not what a party thinks in his mind but what he expresses or does that binds him to the contract.

### **Communication Of Offer And Acceptance**

Problem of communication arises when the parties to the contract are not face to face with each other. It arises in the following cases:

**(A) Contracts through Telephones: (B) Contracts through Post:** Offer and acceptance are generally made through letters and telegrams, Advertisements, notices, circulars, etc., are also used to make an offer. The rules of communication regarding them are as follows:

(1) **“The communication of a proposal is complete** When it comes to the knowledge of the person to whom it is made...” (sec. 4)

(2) **“...The communication of an acceptance is complete**

- i. as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of acceptor; and
- ii. as against the acceptor, when it comes to the knowledge of the proposer...” (Sec.4)

From the above, it is clear that an offer may be revoked at any time before the acceptance is put in course of transmission to the proposer.

### **Revocation Of Proposal And Acceptance**

“A proposal may be revoked at any time before that communication of its acceptance is complete as against the proposer, but not afterwards.”

## **Communication Of Revocation**

“The communication of a revocation is complete... As against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it as against the person to whom it is made, when it comes to his knowledge.”

## **Agreement to Agree in Future**

Agreement to enter into an agreement upon terms to be settled afterwards between the parties is a contradiction in terms. It is absurd to say that a man enters into an agreement till the terms of agreement are settled; until those terms are settled, he is perfectly at liberty to retire from the bargain”.

## **Consideration And Competence To Contract**

Consideration is one of the elements of obligation. An agreement becomes enforceable only if it is supported by consideration. (Sec. 10) “All agreements are contracts if they are made... for a lawful consideration...” It clearly shows that consideration is an important pre-requisite of a valid contract. (Sec.25) “An agreement made without consideration is void...” Hence the rule is “No Consideration, No Contract.”

## **Essentials Of Consideration**

### **(A) Based on Definition**

An analysis of the above definition reveals the following essentials of consideration.

1. Consideration must move at the desire of the promisor
2. It may move from promisee or from any other person on behalf of promisee.

### **Stranger to Contract**

It is a general rule that a person, who is not a party to a contract, cannot sue on the contract even though the contract is for his benefit i.e. unless there is privity of contract, the relationship is not enforceable.

3. Consideration may be past, present or future
4. Consideration must be real and not illusory
5. Consideration may consist of an act, abstinence or promise
- 6.

### **(B) Based on other provisions**

In addition to the above essentials of consideration that emerge from the definition, the others are as follows:

1. Consideration must be lawful: (Sec. 10) “All agreements are contracts, if they are made for a lawful consideration” The consideration of an agreement is unlawful, if (i) it is forbidden by law, or (ii) it is of such a nature that, if permitted, it would defeat the provisions of any law, or (iii) it is fraudulent or (iv) it involves or implies injury to the person or property of another or (v) the court regards it as immoral or opposed to public policy (Sec. 23).
2. Consideration need not be adequate to the value of the promise: (Sec. 25) “An agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate, but the inadequacy of the consideration may be taken into account by the court in determining the question whether the consent of the promisor was freely given.”

### **Exceptions to the Rule of Consideration**

(Sec. 25) In the following cases the agreement would be enforceable even though they are made without consideration.

#### **(1) Love and affection:**

An agreement without consideration is enforceable, if

- a. it is made out of love and affection;
- b. the love and affection is natural because the parties are so related to each other;
- c. the agreement is in writing;
- d. the agreement is registered under law.

**(2) Compensation for voluntary services:** “If it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do.”

**(3) Promise to pay a time barred debt:** If it is a promise, made in writing and signed by the debtor or his agent to pay wholly or in part a debt which is barred by the limitation.

**(4) Contract of Agency:** Sec. 185 provides “No consideration is necessary to create an agency.”

**(5) Gift already Made:** (Sec. 25) “Nothing in this Section shall affect the validity, as between the donor and donee, of any gift actually made.”

### **Unlawful Agreements**

According to the Indian Contract Act (Sec. 23), “The consideration or object of an agreement is lawful, unless it is forbidden by law; or is of such a nature that, if permitted, it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another; or the court regards it as immoral, or opposed to public policy.

Let us see the provisions of Sec. 23 which make an agreement unlawful.

1. **Forbidden by law:** If the object of the agreement or the consideration of the agreement is the doing of an act which is forbidden by law, the agreement is void.
2. **If it is of such a nature that, if permitted, it would defeat the provisions of any law:** i.e. it would indirectly lead to a violation of the law.
3. **If it is fraudulent:** Any agreement whose object is to defraud others is void.
4. **If it involves or implies injury to the person or property of another:**
5. **If the Court regards it as immoral.**
6. **If the Court regards it as opposed to public policy:** The following agreements have been held to be against public policy:
  - a. Trading with Enemy:
  - b. Agreements for stifling prosecution: An agreement to suppress criminal charge is void because if a person has committed a crime, public policy requires that he should be prosecuted.
  - c. Agreements interfering with the Course of Justice: An agreement entered into with the object of exercising improper influence on judges or officers of justice is bad in law as opposed to public policy.
  - d. Agreements tending to an abuse of legal process: There may be two types of agreements under this head, one is Maintenance and the other is Champerty.
  - e. Agreement to vary the period of limitation: An agreement that reduces or increases the period of limitation as laid down by the law of limitation is opposed to public policy.
  - f. Traffic in Public Offices: An agreement whereby an appointment to a public office is procured for monetary consideration is against public policy because it would cause corruption in administration of the State.
  - g. Agreement creating an interest opposed to duty
  - h. Agreements restraining personal freedom
  - i. Agreements opposed to parental rights and duties: Father is supposed to be the guardian of his children and in the absence of the father their mother acquires this right as well as responsibility and this right cannot be bartered away.
  - j. Marriage Brokerage Agreements: Agreement to pay reward to a person for negotiating marriage is opposed to public policy.

The following agreements are also opposed to public policy.

- i. Agreements in restraint of marriage.
- ii. Agreements in restraint of trade.
- iii. Agreements in restraint of legal proceedings.

## Competence To Contract

Competence to contract is one of the essential elements of enforceability of an agreement. According to Sec. 10 'All agreements are contracts if they are made by... the parties competent to Contract.....As regards the meaning of competence, Sec.11 of the Contract Act states that "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.

The following persons are incapable of entering into a contract:

1. A person who has not attained the age of majority i.e. A person who is still a **MINOR**.
2. A Person who is not of sound mind i.e. A person of **unsound mind**.
3. A Person who is **disqualified by any other law** to which he is subject (i.e., other disqualifications.)

## Minor

A minor is a person who has not completed 18 years of age on the date of the contract. But in the following two cases the minority would continue up to the completion of 21 years of age:

- ▶ Where a guardian to the person or property of a minor is appointed by the court.
- ▶ When the minor is under the guardianship of the court of Wards, i.e. Minor's property is looked after by the Court of Wards.

## Rules Relating To An Agreement With A Minor

1. **Agreement is void ab initio** : According to Sec. 10, an agreement made by a person incompetent to contract is void. Hence an agreement made by a minor is void. The agreement is void ab initio i.e. Void from the very beginning.However, Sec. 68 of the Contract Act lays down "if a person, incapable of entering into a contract or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.
2. **Minor can be a promisee**: An agreement is void as against a minor but a minor can derive benefit under a contract. The privilege of minority is available to the minor only. Other person cannot avoid the contract because the promisee is a minor. Thus the minor can enforce the agreement against the other party.

3. **A Minor's Agreement cannot be ratified** : Since an agreement with a minor is void ab initio, i.e. It does not exist in the eyes of law, it cannot be ratified by a minor after completing the age of majority.
4. **No Compensation is payable by a minor:** Though an agreement with a minor is void, the minor would not be called upon to refund any benefit which he has received, under such an agreement (i.e. Sec. 64 and Sec. 65 would not apply to a minor).
5. **The rule of estoppel does not apply to a minor** i.e. A minor can misrepresent his age and enter into an agreement and can still plead infancy to avoid that agreement.
6. **No recovering back the money paid:** Where an infant has paid money under a void or voidable contract he cannot recover it, unless there has been a total failure of consideration.
7. **A minor can be sued in tort.** If what the infant has done lies right outside the terms of the contract, the infant can be made liable.
8. **Agency.** A minor acting as an agent cannot be held liable even for those acts for which other agents would incur personal liability.
9. **Negotiable Instrument:** A minor can also make and deliver negotiable instruments and can negotiate them making all other persons except himself liable on them.
10. **Partnership:** An agreement with a minor is void. But a minor can be admitted into the benefits of partnership with the consent of all the partners (Partnership Act). This means that the losses of the firm can be recovered only from his share in the firm but unlike other partners his personal property would not be liable for firm's losses.
11. **Insolvency:** A minor cannot be adjudicated insolvent.
12. **Joint Agreement:** Where a minor and another person make a joint promise, the promisee cannot enforce the agreement against the minor but he can enforce it against the other person.
13. **Guardianship:** Though an agreement made by a minor is void but an agreement made by the guardian of a minor is binding on the minor if it is for the benefit of the minor.
14. **Minor's Parents:** Agreements made by a minor are not enforceable against his parents, even through they are for the necessities supplied to the minor.

### **Persons Of Unsound Mind**

According to Sec.11 only a person of sound mind can make a contract. Sec. 12 further defines the term sound mind in these words, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interest...". Thus two essentials of 'Sound Mind' emerge from this definition:



(1) Capacity to understand: and (2) Capacity to make a rational judgment

There must be free and full consent of the parties so as to bind them to the contract. Consent is an act of reason accompanied by deliberations. It is due to the absence of rational and deliberate consent that conveyance and contracts of persons of unsound mind are deemed to be invalid. A person of unsound mind may be divided into two broad categories:

**1. Idiots:** An Idiot is one who has lost mental powers completely, i.e., his brain has not developed enough to enable him, at all to understand the contract or of forming a rational judgment of its effects upon his interest. Hence an agreement with him is always void. However, he can be sued for necessities of life supplied to him or to anybody dependent upon him.

**2. Lunatic:** Lunacy arises from the illness of the brain or mental or bodies distress. The essential element of lunacy is that the mental powers of the lunatic are so deranged that he cannot make a rational judgment of any subject the period of lunacy.

### **Effects of agreements made by persons of unsound mind**

An agreement made with a person who is suffering from lunacy at the time of entering into the contract, is void (Sec. 10).

### **Other Disqualifications**

1. **Alien Enemy :** A citizen of a foreign country is known as an alien.
2. **Foreign sovereigns and their Ambassadors.** Foreign sovereigns and their Ambassadors in India can enter into contracts with Indian citizens and can sue them in Indian courts but no suit can be filed against them in local courts unless the permission of the Central Government to this effect has been obtained.
3. **Corporation:** A corporation is an artificial person created by law. Being a legal person only, it cannot act by itself. It has to act through some agent. Its contractual capacity suffers from the following limitations:  
(a) Natural Limitation: (b) Legal Limitation:
4. **Insolvents:** When a person is adjudged insolvent, he loses contractual powers over his property.
5. **Convicts:** A person against whom a sentence of imprisonment is passed loses the capacity to contract.
6. **Married women:** A married woman used to suffer from certain disabilities with regard to making of contracts under English Law before 1935. A woman, married or single, in Indian Law, is under no disability as regard, entering into contracts with regard to the property that belongs to her (e.g. Stridhan of a married women). Her contracts can be enforced against her husband's property if he has

failed to provide necessaries of life to her and the contract relates to necessaries of life.

### **Free Consent**

“The term free consent consists of two requirements viz.: (i) There should be consent: and (ii) Consent should be free.

**Consent:** The term consent is defined by Sec. 13 as “Two or more persons are said to consent when they agree upon the same thing in the same sense”

**Free Consent:** “Consent is said to be free when it is not caused by: (1) Coercion, as defined in section 15, or: (2) Undue influence as defined in section 16, or: (3) Fraud, as defined in section 17, or: (4) Misrepresentation, as defined in section 18, or: (5) Mistake subject to the provisions of sections 20, 21 and 22. Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake.” (Sec.14)

### **Coercion**

“**Coercion** is the committing or threatening to commit any act, forbidden by the Indian Penal Code or the unlawful detaining or threatening to detain any property, to the prejudice of any person whatever, with the intention of causing any person to enter into agreement.”(Sec.15)

- ▶ Coercion is **committing any act** forbidden by the Indian Penal Code with the intention of causing any person to enter into an agreement.
- ▶ Coercion is the **threatening to commit any act** forbidden by the Indian Penal Code, with the intention of causing any person to enter into an agreement.
- ▶ Coercion is the **Unlawful detaining** of any property to the prejudice of any person, whatever, with the intention of causing any person to enter into an agreement.
- ▶ Coercion is the **threatening to detain**, unlawfully, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

**Effect of Coercion:** Sec, 19 states “When consent to an agreement is caused by coercion... the agreement is a contract voidable at the option of the party whose consent was so caused” i.e. The aggrieved party at its option, may set aside the contract or may insist that the contract shall performed. Sec. 72 further states, “A person to whom money has been paid, or anything delivered... under coercion, must repay or return it.”

**Undue Influence** [Sec. 16 (1)] “A Contract is said to be induced by ‘undue influence’ where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.” Three conditions should be fulfilled:

- ▶ The relation between the contracting parties should be such that one party is in a position to dominate the will of the other; and
- ▶ Such party has used that dominant position to enter into a contract with the latter; and
- ▶ Such party has obtained an unfair advantage over the other.

**Effect of Undue Influence:** [Sec. 19 (A)] “When consent to an agreement is caused by undue influence the agreement is a contract voidable at the option of the party whose consent was so caused.

**Pardanashin Women:** A pardanashin woman is susceptible to undue influence and therefore, the law throws around her a “Special cloak of protection” i.e. Where such a woman signs a sale, mortgage, gift or release, the person obtaining her signatures has to prove that the transaction was not only explained to her but also that she had understood the transaction and that no undue influence was exercised on her.

### **Difference Between Coercion And Undue Influence**

S.No.	Coercion	Undue Influence
1.	The consent is obtained under the threat of an offence.	The consent is obtained by a person who is in a position to dominate the will of another.
2.	Coercion is mainly of a physical character. It involves mostly use of physical or violent force.	Undue influence involves use of moral force or mental pressure to obtain the consent.
3.	There must be intention of causing physical harm to any person to enter into an agreement.	Here the influencing party uses its position to obtain an unfair advantage over the other party.
4.	It involves a criminal act.	It involves unlawful act.

## **Fraud**

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

- The suggestion, as a fact, of that which is not true by one who does not believe it to be true;
- The active concealment of a fact by one, having knowledge and belief of the fact;
- A promise made without any intention of performing it;
- Any other act fitted to deceive;
- Any such act or omission as the law specially declares to be fraudulent (Sec. 17)

**Can silence be Fraudulent?** (Sec. 17) “silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud unless the circumstances of the case are such that regard being had to them it is the duty of the person keeping silence to speak or unless his silence is in itself equivalent to speech.”

Exception: Silence would amount to Fraud if

- a. It is the duty of the person keeping silence to speak. These are called *uberrimae fidei* contracts;
- b. His silence is, in itself, equivalent to speech:

## **Effect of Fraud**

- Where Fraud is the cause of the contract:(i)Voidable Contract:(ii) Damages
- Where Fraud is not the cause of contract: An attempt at deceit, which does not deceive, is no fraud.

## **Misrepresentation**

Misrepresentation, better known as ‘Innocent misrepresentation’ has been defined by Sec. 18 as: “Misrepresentation means and includes-

- a. The positive assertion in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
- b. Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of any one claiming under him;
- c. Causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement”.

### **Effect Of Misrepresentation**

“When consent to an agreement is caused by... misrepresentation, the agreement is a contract voidable at the option of the party whose consent is so caused.

### **Distinction Between Fraud And Misrepresentation**

**Fraud:** Intention to deceive that there is no intention to deceive, fraud to recover damages not available in case of misrepresentation.

**Misrepresentation:** the aggrieved party loses the right to rescind the contract if it could discover the truth with ordinary diligence. In Fraud, this exception does not apply.

### **Mistake**

Salmond has described these contracts as “error in Causa”. As “error in consensus” i.e. There is no ‘consensus ad idem’; because of some misunderstanding, called ‘**Mistake**’, parties do not agree upon the same thing in the same sense. According to Indian Contract Act, Mistake is of two types, (1) Mistake as to law and (2) Mistake as to fact.

**Mistake Of Law** (Sec. 21): “A contract is not voidable because it was caused by a mistake as to any law in force in India, but a mistake as to a law not in force in India has the same effect as mistake of fact.” The reason of this rule lies in the legal maxim “ Ignorance of law is no excuse”.

**Mistake Of Fact:** (Sec 20:) “Where both the parties to an agreement are under a mistake as to a matter of fact, essential to the agreement, the agreement is void”. **Essentials: (1) Mistake must be mutual; (2) Mistake must relate to a fact; (3) Fact should be essential:**

**Type of Mistakes:** Mistake of fact can be divided into the following categories:

- A. **Bilateral Mistakes:** (1) Mistake as to the subject Matter: (i) Mistake regarding existence of subject matter: (ii) Mistake regarding identity of the subject matter i.e. The two parties understand different things to be the subject matter: (iii) Mistake regarding quantity of subject matter: (iv) Mistake regarding title of the subject matter: Where both the parties believe that the seller has the right to sell the goods but unknown to both, the seller has no title to the goods. (v) Mistake regarding the price of the subject matter. (vi) Mistake regarding the quality of the subject matter. (2) Mistake as to the possibility of performance of the agreement: if both the parties to the agreement believe that the agreement is capable of being performed though it is not, the agreement is void.
- B. **Unilateral Mistake:** In the following circumstances, even unilateral mistake will make the contract voidable.
1. **Mistake as to the nature of transaction:** This is an exception to the rule that mistake must be mutual. When one of the parties to a contract, without any fault of his own, is made to commit a mistake as to the nature of transaction the agreement would be void.
  2. **Mistake as to the person contracted with:** When the identity of the person is essential to the contract and a mistake is committed regarding that, the contract can be avoided.

## **Void Agreements**

Following are those contracts, which may not lack any of the essentials, discussed so far, still the law has specifically declared them void, they are:

1. **Agreement In Restraint Of Marriage**
2. **Agreement In Restraint Of Trade**

### **Following agreements are not in Restraint of Trade**

- i. Restraint during the term of service
- ii. Agreements which promote business and do not restrain it
- iii. Trade Combinations

### **3. Agreement In Restraint Of Legal Proceedings**

(Sec. 28) “Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent”.

**Exceptions-Arbitration Agreements:** An agreement to refer all future as well as present disputes in connection with a contract, to arbitration is valid.

- **Uncertain Agreements:** (Sec. 29) “Agreements the meaning of which is not certain or capable of being made certain, are void.”
- **Agreement By Way Of Wager:**(Sec. 30) “Agreements by way of wager are void, and no suit shall be brought for recovering anything alleged to be won on any wager, or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made.

## **Agreements Collateral To Wagering**

### **Agreements**

However transactions collateral or incidental to a wagering agreement are not void as per Sec. 30. **Lotteries:** A lottery is a game of chance and is a wagering agreement. **Cross-ward Puzzles:** Cross-word puzzles are of two types:

- One in which any person solving the puzzle would be awarded, therefore it is a game of skill and not of chance and is not a wagering agreement.
- The other type of cross-word puzzle is one in which the prize would be awarded to that competitor whose solution corresponds to the solution kept with the editor of the newspaper.

### **Contingent Contracts**

(Sec. 31) “A contingent contract is a contract to do or not to do something, if some event, collateral to such contract does or does not happen”. Thus it is a contract, the performance of which is dependent upon, the happening or non-happening of an uncertain event, collateral to such contract.

**Example:** X contracts to pay Y Rs.30,000, in consideration of Y paying Rs. 100 monthly premium, if Y’s factory is burnt. This is a contingent contract.

**Example:** A agrees to pay B a sum of money if B marries C. Contracts of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts.

### **Rules Relating To Contingent Contracts**

1. Contingent on the act of party to the contract: If the performance of the promise is contingent upon the pleasure and will of the promisor, it is not a contract at all.
2. Contingent upon the act of a third party: where the performance of a contract is conditional upon the act of a third party, it is a valid contract.
3. Contingent on the happening of an event: (Sec.32) “Contingent contracts to do or not to do anything, if an uncertain future event happens cannot be enforced by law unless and until that event has happened”.
4. Contracts contingent on the non-happening of an event: (Sec.33) “Contingent contracts to do or not to do anything, if an uncertain future event does not happen, can be enforced when the happening of that event becomes impossible, and not before”.
5. Contracts contingent on the happening or not happening of a specified



event within fixed time (Sec.35). “Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time, becomes void if at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible”.

6. Contracts contingent on impossible event: (Sec. 36-)“Contingent agreement to do or not to do anything if an impossible event happens, are void, whether the impossibility is known or not to the parties to the agreement at the time when it is made.”

### **Difference Between A Contingent Contract And Wagering Agreement**

The main points of distinction between the two are as under:

- ▶ A contingent contract is a valid contract but wagering agreement is absolutely void.
- ▶ Parties have real interest in the occurrence but non-occurrence of the event e.g., insurable interest in the property insured. Parties are not interested in the occurrence of the event except for the winning or losing the bet amount.
- ▶ Future uncertain event is merely collateral: uncertain event is the sole determining factor of the agreement.

### **Quasi Contracts**

A quasi contract is an obligation or a right created by law. A quasi contract is based on the principle that no person can enrich himself unjustly, at the expense of another. If he obtains a benefit which under the circumstances he ought, equitably to pay for it, the law would compel him to make the payment even though there is no contract requiring payment.

Following relations created by law, resemble those created by contract:

- ▶ **Necessaries Supplied To A Person Incapable Of Contracting:** Example: X supplies Y, a lunatic, with necessaries suitable to his conditions in life. X is entitled to be reimbursed from Y’s property.
- ▶ **Payment Of Money Due By Another:** (Sec.69) “A person, who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other.”

- ▶ **Non-Gratuitous Act For Another's Benefit:** (Sec.70) "Where a person lawfully does anything for another person or delivers anything to him not to do so gratuitously and such other person enjoys the benefits, thereof the latter is bound to make compensation to the former in respect of, or to restore the thing so due or delivered". Example: A Businessman leaves goods at B's house with the intention of persuading B to buy them. B treats the goods as his own. He is bound to pay A for them.
- ▶ **Finder Of Lost Goods:** (Sec. 71) "A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee."
- ▶ **Money Paid By Mistake Or Under Coercion:** (Sec.72) "A person to whom money has been paid or anything delivered by mistake or under coercion must repay or return it". Example: X and Y jointly owe Rs. 1000 to Z. X alone pays the amount to Z and Y, not knowing the fact pays Rs.1000 over again to Z. Z is bound to repay the amount to Y.
- ▶ **Suit Upon Quantum Meruit:** The phrase 'Quantum Meruit' means as much as earned or 'in proportion to the work done'. This is a general rule, usually invoked where there is no agreement to pay for the work done.(Sec. 70)

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## Lesson – 2 Performance And Discharge Of Contracts

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‘Performance of Contracts’ refers to the fulfillment of their respective legal obligations, created under the contract, by both the parties. It is a natural and normal mode of discharging a contract. The various aspects relating to performance are discussed below:

### A. Actual Performance

“The parties to a contract must either perform, or offer to perform their respective promises, unless such performance is dispensed with or excused under the provisions of this Act or any other law...”

Example: X bought goods from Y and promised to pay Rs.1000 to Y on 10th June. X went to Y on 10th June to give Rs.1000 in cash but Y did not accept it. Though X may not be discharged from the payment of Rs.1000, he would not be liable to pay interest thereon from 10th June onwards.

For a tender to become legally valid it must fulfill the following conditions:

- i. **It should be unconditional** (Sec. 38): The promisor while offering to perform his promise must do it unconditionally.
- ii. **Offer must not be of a part only** (Sec. 38): The offer must be of whole payment or performance. A creditor is not bound to accept less than what is actually due and would not lose his right to interest on that portion.
- iii. **Proper time and place** (Sec. 38): The offer must be made at a proper time and place.
- iv. **Able and willing** (Sec. 38): “It must be made... under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person by whom it is made is able and willing there and then to do the whole of what he is bound by his promise to do.”
- v. **Reasonable opportunity** (Sec. 38): “...If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that thing offered is the thing which the promisor is bound by this promise to deliver. Thus, buyer must have reasonable opportunity to ascertain that the goods offered are contracted for.

- vi. **Tender of money:** A tender of money must be in legal tender money, and not in any foreign currency, promissory note or cheque'
- vii. **Joint Promisees: (Sec. 38)** "An offer to one of several joint promises has the same legal consequences as an offer to all of them."

## **B. Refusal To Perform (Sec.39)**

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

## **C. Who Can Demand Performance?**

It is only the promisee who can demand performance of the promise under a contract, for the general rule is that "a person cannot acquire rights under a contract to which he is not a party."

## **D. By Whom Contracts Must Be Performed**

- By the promisor himself: (Sec. 40) "If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it, should be performed by the promisor himself, such promise must be performed by the promisor..." Generally where personal skill, taste etc. Are involved, it is presumed that the promisor would himself perform the contract.
- By promises representative: (Sec. 37) "...Promises bind the representatives of the promisors in the case of death of such promisors before performance, unless a contrary intention appears from the contract".

Example: A promises to deliver goods to B on a certain day on payment of Rs.10,000. A dies before that day . A's representatives are bound to deliver the goods to B, and B is bound to pay Rs.10,000 to A's representatives.

## **E. Offer To Perform (Tender)(Sec 37)**

“A party who has not already performed his obligation must offer to perform the same. (Sec. 38) “Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract”. Example: A promises to paint a wall for B. A must perform this promise personally.

## **F. Devolution Of Joint Rights And Joint Liabilities (Joint Promises)**

When two or more persons make a joint promise to other or others, they are known as joint promisors e.g. A and B sign a promissory note, they are joint promisors. When a promise is made to two or more persons, they are Joint Promisees. Following rules govern such promises:

(1) All promisors must jointly fulfill the promise: (2) Any one of the joint promisors may be compelled to perform: (3) Right of contribution between joint promisors: (4) Effect of release of one joint promisor: Example: A, B and C Jointly promise to pay D Rs. 5000. D may compel either A or B or C to pay him Rs. 5000.

## **G. Time And Place For Performance**

- ▶ **Within a reasonable time:** (Sec 46) “Where a promisor is to perform his promise without application by the promisee, and no time for performance is specified, the engagement must be performed within a reasonable time.” “The question what is a reasonable time is, in each particular case, a question of fact.”
- ▶ **During usual hours of business:** (Sec.47) “When a promise is to be performed on a certain day, and the promisor has undertaken to perform it without application by the promisee, the promisor may perform it at any time during the usual hours of business on such day and at the place at which the promise ought to be performed.”
- ▶ **Promisee’s duty to apply for performance:** (Sec. 46) “When a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, it is the duty of the promisee to apply for performance at proper place and within the usual hours of business.”

- **Promisor should apply for fixing a reasonable place:** (Sec.49) “When a promise is to be performed with application by the promisor and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for the performance of the promise, and to perform it at such place.”
- **In the manner prescribed by promisee:** (Sec. 50) “The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions.”

## H. Performance Of Reciprocal Promises

[Sec. 2 (f)] “Promises which form the consideration or part of the consideration for each other are called reciprocal promises.” Rules regarding the performance of reciprocal promises are:

- **When promises are to be performed simultaneously:** “When a contract consists of reciprocal promises to be simultaneously performed no promisor need to perform his promise unless the promisee is ready and willing to perform his reciprocal promise.”
- **In the order, which the nature of transaction requires:** (Sec. 52) “Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they shall be performed in that order; and where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires.”
- **When the performance of a promise is dependent upon other:** (Sec. 54) “When the contract consists of reciprocal promises, such that one of them can not be performed or that its performance cannot be claimed till the other has been performed and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party for any loss which such other party may sustain by the non-performance of the contract.” These are known as mutual and dependent promises.
- **When one party prevents the other from performing his promise:** (Sec.53) “ When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise the contract becomes voidable at the option of the party so prevented.
- **Where the promise is partly legal and partly illegal:** (Sec.57)

“Where persons reciprocally promise, firstly, to do certain things which are legal, and secondly, under specified circumstances, to do certain other things which are illegal the first set of promises is a contract, but the second is a void agreement.”

## I. Time Of Performance

- ▶ **When time is the essence of the contract:** (Sec.55) “When a party to a contract promises to do certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes voidable to the option of the promisee, if the intention of the parties was that time should be the essence of the contract.”
- ▶ **When time is not the essence of the contract:** If it was not the intention of the parties that time should be the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time, but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure.
- ▶ **Condition for compensation when contract is voidable and goods are accepted:** “If in case of a contract voidable on account of the promisor’s failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of promise at the time agreed unless, at the time of such acceptance, he gives notice to the promisor of his intention to do so.” (Sec.55)

## Discharge Of A Contract

A contract is discharged, terminated when the rights and obligations created by it come to an end. A contract is terminated in the following ways:

- I. **By Performance (Sec. 37):** When the parties to a contract perform their respective promises, the contract comes to an end. Nothing remains to be performed.

II. **By Tender (Attempted Performance):** When a promisor makes an offer of performance tender and the offer is not accepted, the promisor is not responsible for non-performance, i.e. He is discharged from his obligations under the contract. But he does not lose his rights under the contract i.e. The promisee is not discharged from his obligations.

III. **By Supervening Impossibility:** Impossibility is of two types:

- i. **Impossibility At The Time Of Contract:** (Sec.56) “An agreement to do an act impossible in itself is void.”: Example A agrees with B to discover gold by magic. The agreement is void.
- ii. **Subsequent Or Supervening Impossibility** Where a contract originates as one capable of performance but later due to change of circumstances its performance becomes impossible, it becomes void by subsequent or supervening impossibility (section 56). In English law this is called “Doctrine of Frustration”. Example: A and B contract to marry each other. Before the time fixed for marriage, B becomes mad. The contract becomes void.

Supervening impossibility may arise in any of the following ways:

1. Destruction of the subject matter:
2. When the foundation of the contract ceases to exist: If in a contract, it is deemed that the parties had assumed certain state of things to continue and that state of things ceases to exist, the contract would come to an end.
3. Change of Law: A contract which becomes illegal after it is made, becomes void and the parties to the contract will be discharged from their respective obligations.
4. Death or personal incapacity: Where the contract is of personal nature the death or incapacity of the promisor would discharge the contract.
5. Declaration of war: A contract entered into with an alien enemy before the war breaks out is either suspended or discharged after the declaration of war if it does not aid the enemy in the pursuit of war, it is suspended and would be performed after the war is over, otherwise it is terminated and the parties to the contract are discharged from their respective obligations.



## **Exceptions To The Principle Of Supervening Impossibility**

### **Impossibility As A Rule Is No Excuse For Non-Performance:**

Following are some of the circumstances in which non-performance of a contract was held not to be excused.

- iii. **Difficulty of performance:** If a contract becomes difficult to perform but not impossible the promisor would not be discharged on that account.
- iv. **Commercial Impossibility** would not discharge of a contract. A contract would not be deemed to be impossible because it does not remain profitable to the promisor or would make the promisor to incur losses.
- v. **Action of a third party:** If a man chooses to answer for the voluntary act of a third person, there is no reason in law or justice why he should not be held for his inability to procure that act.
- vi. **Strikes, lock-outs, civil disturbances and riots** do not discharge a contract unless there is a clause in the contract to that effect.
- vii. **Partial impossibility:** Where a contract is entered into for more than one purpose, the contract would not become impossible, if one of the objects has become impossible to achieve.

### **Consequences of Supervening Impossibility**

Supervening impossibility makes a contract void. The parties are discharged from their respective obligations under the contract (Sec. 65). The party who has received any advantages under it should restore it to the other party.

#### **IV. Mutual Agreement**

A contract is created by the parties to it, therefore, it can also come to an end by their mutual agreement. Termination by mutual agreement may occur in any one of the following ways.

1. **Novation:** When a new contract is substituted for an existing contract, either between the same parties or between different parties, it is called novation.

2. **Alteration:** When one or more of the terms of a contract are changed, it is called alteration. In case of alteration, parties to the contract do not change. Example: A agrees to supply to B 20 readymade pants, 10 of the size 32 and 10 of the size 34. Later on B requests A to supply all 20 pants of the size 32 only. A agrees to it. The old contract comes to an end.
3. **Rescission:** When both the parties to a contract agree to put an end to the contract, without performing it, the contract is said to be rescinded by mutual agreement. Example: A promises to supply to B 20 shirts on 15th January and B promises to pay Rs 5000 on the same day after delivery, On 10th January, both the parties agree that the contract would not be performed. Parties are said to have rescinded the contract.
4. **Remission:** When a party to a contract accepts, from the other party, a performance lesser than what he had contracted for, he is deemed to have remitted the remaining performance, and the contract is discharged. Example: A owes B Rs.500 rupees but pays on by Rs. 200, and B accepts at in satisfaction of the whole debt. The whole debt is discharged.
5. **Waiver:** When a party to a contract abandons his right under the contract, the other party is released from his obligations. Example: A pays Rs 1000 to B to paint a wall for him. Later on A forbids B to paint the picture. B is no longer bound to perform the promise.
6. **Merger:** When a superior right and an inferior right coincide and meet in one and the same person, the inferior right vanishes into the superior right. This is known as merger. Example: A has taken a house on lease from B for 10 years. After one year A buys the house from B. His rights of a leasee vanish into his rights of ownership and the contract of lease comes to an end.

#### V. **By Lapse Of Time**

The Limitation Act provides the time limit in which certain rights can be enforced. If that time limit expires, the promisee cannot enforce the promisor and promisor is discharged. Example: A owes Rs 10,000 to B. The last date for the repayment of the loan has expired and B does not file a suit against A for two years. B loses the right to recover the money back.

## VII. By Operation Of Law

This covers the following cases: **1. Death:** If a contract involves personal skill or ability, death of the promisor would terminate the contract. **2. Insolvency:** When a person is adjudged insolvent and hands over all his property to the official receiver/assignee, he is supposed to have the right to earn his livelihood in the ordinary way and therefore the courts, under certain circumstances and subject to certain conditions, discharge him from all debts which were payable in insolvency but remain unpaid. He does not remain liable to pay those debts. **3. Merger:** **4. Material alteration:** A change which affects or alters, in a specific manner, the rights and liabilities of the parties is called material alteration. A material alteration made in a written document or contract by one party without the consent of the other, will make the contract void, e.g. An endorsee of a promissory note/ altering the amount of note.

## VIII. By Breach Of Contract

Breach is the non-performance of the promise by the promisor. It entitles the promisee to rescind the contract. It, therefore, operates as a mode of discharging a contract.

## Contract Of Agency

### Definition Of Agent And Principal

(Sec. 182) "An agent is a person employed to do any act for another or to represent another in dealing with third persons. The person for whom such act is done or who is so represented, is called the principal."

Test of Agency: The true test of agency is the authority that one person possesses to create contractual relationship between the person he is representing and the person to whom he represents. Where a person is in the habit of advising another in business dealings he does not become the agent of the other.

### Agent and Servant

A servant is a person who acts under the direct control and supervision of his master while an agent does not. "A principal has the right to direct what the agent has to do; but a master has not only that

right but also the right to say how it is to be done” An agent is, therefore, sometimes described as ‘Superior Servant’. An agent binds the principal with the third parties but a servant does not create relations between his master and third persons.

### **Who may employ agent?**

(Sec. 183), “Any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent.” “Whatever a person can do personally he can do through an agent.” Thus a guardian of a minor can appoint an agent for the minor.

### **Who may be an agent?**

A minor or even a person of unsound mind can act as agents but they would not be responsible to the principal or to the third parties in cases where a person competent to contract would have been responsible.

**Consideration for the contract of agency:** (Sec. 185) “No consideration is necessary to create an agency.” Principal’s agreement to be represented by the agent is deemed to be sufficient detriment to support the promise by the agent to act as such and be liable to the principal for negligence.

## **Creation Of Agency**

The relationship of principal and agent may be created in any of the following ways:

1. **By Express Agreement:** “The authority of an agent may be expressed or implied.” (Sec. 186) “An authority is said to be expressed when it is given by words spoken or written.” (Sec. 187): Example: A asks B to sell his cow for a commission of 10% on sales. B agrees to do so. Agency has been created.. The agreement need not be in writing. But in certain cases, law requires the agreement to be in writing, e.g. For sale or purchase of land, the law requires the agent to be appointed by executing a formal power of attorney.
2. **By Implied Agreement** Sec. 187: “... An authority is said to be implied when it is to be inferred from the circumstances of the case, and things spoken or written, or the ordinary course of

dealing...” Example: A owns a shop. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A’s funds with A’s knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

- i. **Agency by estoppel** (Sec. 237): “When an agent has without authority done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has, by his words or conduct, induced such third persons to believe that such acts and obligations were within the scope of the agent’s authority.” Example: A starts manufacturing plastic products. A, B and C are sitting together. B in the presence of A tells C that A has appointed him (B) as selling agent of his product. A does not contradict this statement, though he had not appointed him as his agent. Later on C enters into a contract with B on the presumption that B is A’s agent. A would be bound by this transaction. A would be precluded from denying that B is his agent.
- ii. **Agency by holding out:** The principle of holding out is a part of the law of estoppel. But agency by holding out requires some positive or affirmative conduct by the principal. Example: A sends his servant to buy goods from B on credit. B gives the goods to A’s servant and A pays for them. Later on A’s servant, without A’s asking for it, buys goods from B on A’s credit and runs away. A would be liable to pay for the goods, though a servant is not an agent, but by paying for the credit purchases made by his servant, A held out that his servant was his agent also and as such he would be liable for the purchases made by his servant.
- iii. **Agency of Necessity:** If a person protects the property or interest of another where such property or interests are in imminent danger and the instructions of the owner cannot be obtained, the former would be deemed to be an agent of the latter so as to make the latter liable for whatever he has done provided the former has acted bonafide in the interests of the latter. The principle of necessity also extends to cases where an agent exceeds his authority if the following conditions are fulfilled  
(i) The agent was not in a position to communicate with the

principal. (ii) The agent takes reasonable and necessary course in the circumstances. (iii) The agent acts bonafide. Example: A sends some bananas to B with the instructions that B should send them to C. When B takes delivery of the bananas, he finds that the bananas are not in a condition to sustain the journey to C's place and would perish before reaching B, therefore, sells them at the best possible price. A would be bound by this sale under agency by necessity.

In cases of accident and emergency a master of a ship can sell or pledge the goods in order to save their value and such sale or pledge would be binding on the owners of the cargo.

### **Husband and Wife:**

A wife can bind the husband for the contracts she enters into for the purchase of household necessities suiting to the couples joint style of living provided. They are living together and the wife is the in-charge of domestic establishment and the husband has not made reasonable allowance to the wife for her needs. Example: H and W are husband and wife respectively. W chooses to live separately and buys goods on credit from A. On her failure to pay for the purchases A cannot recover the money from H because they are not living together.

However, a husband can escape the liability if he can prove that (i) he had warned the tradesman from supplying the goods on credit to his wife; (ii) he had already supplied sufficient articles in question to his wife (iii) he had supplied sufficient means to his wife for the purchase of articles in question. But if the wife is deserted by her husband and thus forced to live separately, she may of necessity become agent of her husband and can pledge her husband's credit for necessaries to the extent a reasonable maintenance makes it necessary.

3. **Agency By Ratification:** A person may become another's agent after having done some work for the latter, if the latter ratifies the act. When a person adopts or accepts an act done on his behalf but without his authority he is said to have ratified it. Example: A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A. Implications of Ratification: (i)

Ratification relates back to the date of the act. It is tantamount to prior authority. This means that the agency comes into existence not from the time when the act is ratified but from the time when the act was done. I.e. (Ratification is equivalent to an antecedent authority). (ii) No Authority for future: The ratification of an act done without authority does not confer authority to do similar acts in future.

### **Conditions Of A Valid Ratification**

Ratification is enforceable only when the following conditions are fulfilled.

- ▶ **Must contract as agent:** The agent must contract as agent for a principal in contemplation; or the agent should not make the contract for himself.
- ▶ **Only named principal can ratify:** Only that principal who was named or was identifiable at the time of the contract, can ratify the contract. He can do so, even if the agent never intended that he should do so. Example: A makes a contract with B on behalf of his uncle, D. Later on C, A's elder brother want to have the benefit of the contract and wants to ratify the same. C cannot do so. D, when comes to know of the contract, wants to ratify the same; he can do so and enjoy the benefit of the contract even if A does not want it.
- ▶ **The principal should be in existence:** Mere contemplation at the time of the contract is not sufficient. If the principal was not in existence at the time of the contract, he cannot ratify such contract.
- ▶ **The Principal must be competent to contract** at the date of the contract as well as at the date of ratification. Thus, a minor cannot ratify a contract made on his behalf after becoming a major.
- ▶ **The principal must have full knowledge of the material facts** (Sec. 198): "No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective."
- ▶ **The principal must ratify the whole transaction (Sec. 199).**
- ▶ **The principal must ratify the contract within a reasonable time** after the contract is made.
- ▶ **The act to be ratified should not be void or illegal**, though ratification can be made of voidable contracts or even of tortuous acts.

- **Ratification of unauthorized act cannot injure third person.**
- **Ratification by Govt:** Acts done by public servant in the name of the Government may be ratified by subsequent approval in the same manner as private transaction.

### **Extent Of Agents Authority**

It is necessary to know all dimensions of his (agent) authority. They are as follows:

- **Actual Authority:** Actual authority is one which is conferred on the agent by the principal. It may be express or implied. (1) Express Authority: An authority is said to be express when it is given by words spoken or written (Sec. 187). (2) Implied Authority: (i) An authority is said to be implied when it is inferred from the circumstances of the case.(Sec. 187) (ii) An agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such act. (Sec. 188)
- **Ostensible or Apparent Authority:** Apparent or ostensible authority is that authority which an agent appears to be possessing, though, in fact, he may not have.
- **Authority in Emergency:** “An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.” (Sec. 189).

### **Delegation Of Authority By Agent**

“An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally...” sub-agent may not enjoy the confidence of the principal [“A sub-agent is a person employed by, and acting under the control of, the original agent in the business of the agency” (Sec.191).

**Exceptions:** In the following circumstances delegation made by an agent to sub-agent would be proper: (1) **Nature of agency:** (2) **Custom of Trade:** Where it is a custom of trade that an agent appoints a sub-agent. (3) **Ministerial Acts:** Where the acts to be done are purely ministerial



and do not involve the exercise of discretion, or personal or professional skill. (4) **Express Delegation:** Where the principal has expressly permitted delegation. (5) **Implied Permission:** Where the principal impliedly permits delegation i.e. From act or conduct it may be inferred that he has allowed delegation of authority. (6) **In emergency:** In case of emergencies an agent can always delegate the authority to a sub-agent.

### **Duties Of An Agent**

1. **To follow principal's directions or customs:**
2. **Skill and diligence to work:**
3. **To render proper account:** (Sec. 213): "An agent is bound to render proper accounts to his principal on demand." He should always be ready to produce them to the principal.
4. **To communicate with the principal (Sec. 214)**
5. **Not to deal on his own account: (Sec. 215)**
6. **To pay sums received for principal**
7. **Not to delegate authority (Sec. 190)**
8. **On Principal's death or insanity (Sec. 209)**

### **Rights Of An Agent**

1. **Right to Remuneration:** Every agent is entitled to receive the remuneration agreed upon with the principal.
2. **Right of retainer (Sec. 217)**
3. **Right of Lien (Sec. 221)**
4. **Right of indemnity**

### **Rights And Duties Of Principal Towards Agent Rights Of Principal**

(1) He can enforce the various duties of an agent. (2) He can recover compensation for any breach of duty by the agent. (3) He can forfeit agent's remuneration where the agent is guilty of misconduct in the business of agency. (4) Principal is entitled to any extra profit that the agent has made out of his agency. This includes illegal gratification, if any. (5) Principal is entitled to receive all sums that the transactions, entered into, by the agent, on behalf of the principal were void or illegal.

## **Duties Of Principal**

1. To Pay Remuneration.
2. Duty to Indemnify.
3. Compensation for injuries.
4. Should not prevent the agent from earning remuneration.

## **Principal's Liabilities To Third Parties For The Acts Of The Agent**

1. Liability for acts done by agent within authority.
2. Ratification of acts beyond the scope of his authority.
3. When an agent commits fraud or misrepresentation.

**Liability for tort:** If an agent commits a tort in the course of and within the scope of his agency, the principal may in certain cases be liable for the same.

1. **Notice given to agent as notice to principal (Sec. 229)**
2. **Liability under the principle of estoppel**
3. **Liability when his name is not disclosed (Unnamed principal)**
4. **Liability when agent does not disclose his agency (undisclosed principal)**

## **Agent And Third Parties**

“In the absence of any contract to that effect, an agent cannot personally enforce contract entered into by him on behalf of his principal nor is he personally bound by them...”

If there is no contract providing for, or relieving the agent from, personal liability the agent would be liable in the following cases:

1. **Foreign Principal**
2. **Unnamed Principal**
3. **Undisclosed Principal**
4. **Incompetent Principal**
5. **Where the agent exceeds his authority**
6. **Where agent's authority is coupled with interest**

7. **Custom of Trade**
8. **Money received by mistake or fraud**

### **Termination Of Agency**

The contract of agency would come to an end in any of the following circumstances:

1. **By Agreement**
2. **By Revocation by the principal:**
3. **Renunciation by the Agent**
4. **Completion of business**
5. **Death or Insanity**
6. **Insolvency of the principal**
7. **Expiration of Time**
8. **Destruction of the subject matter**
9. **Dissolution of a company**
10. **Principal or agent becoming alien enemy**

### **Partnership Act 1932**

The law relating to partnership is contained in the Indian partnership Act, 1932. The Act came into force with effect from October 1, 1932. Prior to enactment of the aforesaid Act, partnership business used to be governed by the Indian Contract Act, 1872.

Section 4 of the Indian Partnership Act, 1932 defines 'partnership' as follows: "a business carried on by all or any of them acting for all."

Essential elements of partnership:

1. Association of two or more persons,
2. Existence of a contract,
3. Carrying on a business,
4. Sharing of profits and
5. Prevalence of mutual agency.

But a partnership firm cannot create another partnership as it does not enjoy the status of the artificial legal person. There must exist a contract between persons who have agreed to form partnership. Such a contract may, however, be either expressed or implied, written or oral.

**Partnership Deed :** Partnership Deed is the document that defines the rights and obligations of partners. Besides names, address and occupation of partners, it lays down the duration of partnership, nature of business, profit sharing ratio, right to interest, salary, commission etc.

### **Registration Of Firms**

The registration of partnership firm is discretionary. The provisions relating to registration of partnership firm are contained in Chapter 7, Sections 56 to 71 of the partnership Act.

### **Effect of Non-registration (Sec. 69)**

An unregistered firm and its partners suffer from the following disabilities:

1. No Suit against other partners and firms
2. No suit against third parties
3. No claim of set off

### **Duration Of Partnership**

Partnership may, from the point of view of its duration, be categorized into the following two classes: (1) Partnership for a fixed term or particular partnership (2) Partnership at will.

### **Kinds Of Partners**

There may be different kinds of partners in a partnership firm. The important classification of partners is given below:

1. Actual or active partners,
2. Dormant or sleeping partner,
3. Nominal partner,
4. Partner in profits only,
5. Sub-partner,
6. Partner by estoppel or by holding out.

1. **Actual or active partners:** Partners actively engaged in the conduct of the business are known as 'active' or 'actual' or ostensible partners.
2. **Dormant or sleeping partner:** The nominal partner is one who lends his name to the partnership firm without any real interest in terms of investing money in the firm or sharing in profits.
3. **Nominal partner:** The nominal partner is known to the outsiders and does not share the profits of the firm.
4. **Partner in profits only:** A person who does not want to take risk of loss may agree to become a partner in profits only.
5. **Sub-partner:** When a partner agrees to share his share of profit in a partnership firm with the outsiders, such an outsider is called a 'Sub-partner'.
6. **Partner by estoppel or by holding out:** If a partner, by his words or conduct holds out to another that he is a partner, he will be stopped from denying that he is not a partner. Such a partner neither contributes any capital nor participates in the management. He is only liable to third parties.

### **Minor As A Partner**

According to Indian Contract Act an agreement of a minor is void, as void, as such he cannot enter into an agreement of partnership. Section 30 of the Partnership Act provides that a minor may be admitted to the benefits of partnership with the consent of all the partners.

### **Rights of Minor Partner**

A minor admitted to the benefits of a Partnership has the following rights:

- Right to share the profits.
- Right to have the access to do the inspection
- Right to file a suit for accounts or demand his share of property or profits.
- Right to exercise option on attaining the age of majority, whether or not to continue in the firm.

## **Liabilities of Minor Partner**

- The liability of a minor is limited to the extent of his share in the firm and therefore, unlike other partners, he is not personally liable.
- If the firm is declared insolvent, his share in the firm vests in the official receiver or assignee but a minor cannot be declared insolvent.

## **Rights, Duties and Liabilities of Partners**

### **Rights**

- Right to take part in the conduct of business
- Right to be consulted
- Right of access to the books
- Right to share profits
- Right to interest on capital
- Right to interest on advances
- Right to indemnity
- Right to act prudently in emergency
- Right to give consent for admission of a new partner
- Right to retire
- Right to carry on competing business after retirement.

### **Duties**

#### **A. Qualifying**

1. To attend his duties diligently
2. To work without remuneration
3. To contribute to losses
4. To indemnify for willful neglect
5. To use firm's a property exclusively for the firm
6. To account for private profits [Sec.16(a)]

#### **B. Others**

1. Duty to carry on business for the common advantage
2. To indemnify for loss caused by fraud

3. To give full information
4. To render true accounts
5. To be just and faithful

## **Liabilities**

1. **Liability of partner for acts of the firm:** Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner
2. **Liability of the firm for wrongful acts of the partner:** Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefore to the same extent as the partner (Section 26).
3. **Liability of the firm for misapplication by partners:** (i) When a partner acting within his apparent authority receives money or property from a third party and misapplies it, or (ii) A firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss (Sec. 27).
4. **Liability for the loss caused by his own fraud**
5. **Liability for the loss caused by his own willful neglect.**

## **Authority Of A Partner**

- A. **Express Authority**
- B. **Implied Authority** “The act of partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm”. Thus the authority of a partner to bind the firm is called ‘Implied authority’.
- C. **Authority In An Emergency:** A partner has authority in an emergency to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm.

## **Reconstitution Of A Firm**

A change in the constitution of the firm occurs when a new partner is admitted or an old partner retires or dies. The partnership is reconstituted on:

1. Admission
2. Retirement
3. Expulsion
4. Insolvency
5. Death of a partner
6. Transfer of interests by a partner.

## **Dissolution Of A Firm**

Dissolution of a firm means an end of the firm. The Indian Partnership Act distinguishes between:

- ▶ Dissolution of firm, and
- ▶ Dissolution of partnership.

Section 39 provides that the dissolution of partnership between all the partners of a firm is called the “dissolution of the firm”.

## **Modes Of Dissolution**

A firm may be dissolved in any of the following modes

- I. **By Agreement (Sec. 40)**
- II. **By Notice (Sec. 43)**
- III. **On The Happening Of Certain Contingencies (Sec. 42)**
  1. Expiry of fixed term
  2. Completion of adventure or undertaking
  3. Death of a partner
  4. Insolvency of a partner

IV. **Compulsory (Sec 41):** A firm is dissolved in the following circumstances:

1. *Insolvency of all partners or all except one*
2. *Business becoming unlawful*



V. **Dissolution By The Court (Sec 44):** Section 44 provides that the

dissolution of a firm may take place on a suit filed by a partner on any of the following grounds, namely:

1. *Insanity of a partner [Section 44(a)]*
2. *Permanent incapacity [Section 44(b)]*
3. *Misconduct [Section 44(c)]*
4. *Persistent breach of agreement [Section 44(d)]*
5. *Transfer of interest [Sec.44 (e)]*
6. *Continuous losses[Section 44(f)]*
7. *Just and equitable causes [Sec.44(g)]*

### **Consequences Of Dissolution**

The consequences of dissolution are as follows:

1. **Continuous liability if fails to give a public notice [Sec. 45]**
2. **Continuous authority of partners for purposes of winding up [Sec. 47]**
3. **Right to have the business wound up [Sec. 46]**
4. **Right to return of premium [Sec. 51]**
5. **Rights where partnership contract is rescinded for fraud or misrepresentations [Sec. 52]**
6. **Rights to impose restrictions [Sec. 53]**
7. **Liability to share personal profits [Sec. 50]**

### **Settlement Of Accounts Upon Dissolution**

1. Treatment of goodwill
2. Meeting losses [Sec.48 (a)]
3. Order of applications of assets [Sec.58(a)]
4. Losses arising from insolvency of a partner
5. Payment of firm's debts and separate debts [Sec. 49]

## **Public Notice**

The Partnership Act requires that a public notice must be given in each of the following cases:

- On Minor Attaining Majority:
- Retirement of a partner:
- Expulsion of a partner:
- Dissolution of the firm.

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## Lesson - 3 Sale Of Goods Act 1930

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The law defining their respective rights and obligations is contained in the Indian Sale of Goods Act, 1930. Before 1930, law relating to sale of goods was contained in the Indian Contract Act, 1872. The departures made by the Sale of Goods Act are in regard to the consideration, implied conditions and warranties etc.

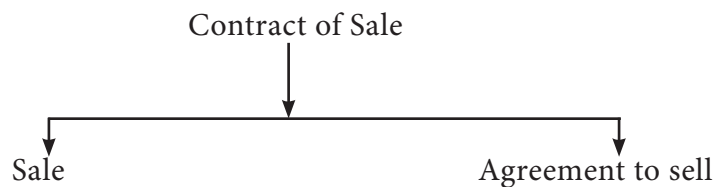
### Essentials Of A Contract Of Sale Of Goods

“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) 1].

Important features of a contract of sale

- ▶ **Two Parties:**
- ▶ **Mutual Consent:** Just the presence of two parties is not sufficient. The parties must agree on the transfer of property.
- ▶ **Transfer of Property:** What a contract of sale stipulates is the transfer of property i.e. The ownership of the goods and not the possession of the goods.
- ▶ **Goods:** Goods means every kind of movable property other than actionable claims and money. But it includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. [Sec. 2(7)]. Since the price of the goods is expressed in terms of the money, money itself cannot be bought, and hence, money is not considered as goods.
- ▶ **Price:** Under a contract of sale, property in the goods is transferred to the buyer for a price. Price is the money consideration for the goods.
- ▶ **Varied requirement as to delivery and payment:** The contract may provide for the immediate delivery of goods or immediate payment of the price or both.
- ▶ **Requires no formalities:**

- **Absolute or Conditional:** An absolute contract of sale is technically called a 'sale'. Thus "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." [Sec. 4 (3)]. Thus a contract of sale is a generic term including 'Sale' as well as 'an agreement to sell'



### Distinction Between 'Sale' And 'Agreement To Sell'

Sl. No	Sale	Agreement to Sell
1.	Ownership is transferred to the buyer.	Ownership does not pass to the buyer. It remains with the seller.
2.	It is an executed contract.	It is an executory contract.
3.	It creates rights in rem.	It creates rights in personam.
4.	The seller can sue for the price though the goods are in his possession	The seller can sue for the damages, if the buyer refuses to take delivery and pay the price.
5.	If the seller re-sells the goods, the buyer can claim damages for conversion and exercise right of recovery of goods from third parties who are aware of the prior sale.	In case of re-sale the buyer can only claim damages.
6.	If the goods are destroyed by accident, the buyer has to bear the loss, though the goods are in the possession of the seller.	In such cases, the seller has to bear the loss, even if the goods are in the possession of the buyer.
7.	If the buyer becomes insolvent, the seller, in the absence of a lien, must deliver the goods to the official receiver and claim only ratable dividend for the price due.	If the buyer becomes bankrupt before payment of price, the seller may refuse to deliver the goods unless paid for, since ownership rests with the seller.

8.	If the seller becomes insolvent,	In such cases, the buyer who has
	the buyer can recover the	paid the price can only claim
	goods from the official receiver since the ownership has passed to him.	ratable dividend.

### Sale Distinguished From Other Transactions

- ▶ **Sale, barter and exchange** : If the goods are exchanged for goods only it is called 'barter' and not sale. If money is exchanged for money (say \$ 10 for Rs.450 ) it is called '**EXCHANGE**' only. But where goods are exchanged for a money consideration, it is called a sale. If the consideration consists partly of money and partly of goods, it would be a contract of sale.
- ▶ **'Hire purchase' and 'Agreement to sell'** : In a contract of sale there is an agreement to buy, but in 'hire purchase', hirer has the option to buy the goods, if he pays all the installments. Hence, if he does not exercise his option, the owner cannot sue for breach of contract but can take his goods back. In an agreement to sell, if the buyer refuses to buy the goods the seller can sue him for breach of contract.
- ▶ **Sale and contract for work and Labour** : If the essence of the contract is the rendering of service and exercise of skill, it is a contract of work and labour, though goods are also delivered under the contract. But if the delivery of goods is the essence of the contract although some labour on the part of the seller may be necessary, it would be a contract of sale.

### Kinds Of Goods

The goods are classified by sec 6, as follows:

- A. Existing goods
- B. Future goods
- C. Contingent goods

- A. **Existing goods:** Existing goods are those which are owned or possessed by the seller at the time of the contract of sale.

Existing goods may be further classified into,

- ▶ **Specific goods:** These are goods which are identified and agreed upon at the time of a contract of sale is made. For example, a specified watch or scooter.
  - ▶ **Ascertained goods:** These are the goods which become ascertained subsequent to the formation of a contract of sale.
  - ▶ **Unascertained goods:** These are the goods which are not identified and agreed upon at the time of the contract of sale. They are defined only by description and may form part of a lot.
- B. **Future Goods:** Future goods means goods to be manufactured or produced or acquired by the seller after the making of the contract of sale.” [Sec.2(6)], Example: A agrees to sell to B the entire crop of Onion, that his land would yield, at Rs.10,000 per ton. This is a contract for the sale of future goods because goods are still to be produced.
- C. **Contingent goods:** Contingent goods are those the acquisition of which by the seller depends upon a contingency which may or may not happen [Sec. 6(2)]. Example: A agrees to sell the cow to B if A inherits C’s property including the cow. C donates the entire property to a trust. The contract becomes void.

### **Perishing Of Goods**

After a contract of sale is made the subject matter of the contract may be destroyed or it may be found that the subject matter had already been destroyed before the date of making the contract, the effect of the two cases would be different.

- A. **Goods perishing before the contract of sale** (Sec.7) provides, “where there is a contract for the sale of specific goods, the contract is void, if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description in the contract.”

**B. Goods perishing after the contract of sale is made**

- i. **Perishing before sale but after an agreement to sell:** “unless otherwise agreed, the goods remain at the seller’s risk, until the property therein is transferred to the buyer...”
- ii. **Goods perishing after sale:** In sale, goods are destroyed after sale. The loss arising from the destruction or damage of the goods would be borne by the buyer.(Sec.26)

**The Price**

A. **Meaning:** “Price means the money consideration for a sale of goods” [Sec.2(10)].

**B. How to fix the price?**

- a. By the contract: The price in a contract of sale may be fixed by the contract between the parties (Sec.69).
- b. In an agreement: The price may be left to be fixed in manner thereby agreed (sec.9). Whatever manner of fixing the price has been agreed upon by the parties to the contract, that would be recognized by law.
- c. Valuation by third party: The price may be left to be fixed by a third party.
- d. By the course of dealings: Where the price is neither expressed in the contract nor any manner of fixing the price is agreed, the price would be determined by the course of dealings between the parties.
- e. Reasonable price: What is a reasonable price is question of fact depending on the circumstances of each case. Generally the market price on the date of supply is taken to be a reasonable price.

C. **Earnest or deposit:** The money so paid is called earnest or deposit. If buyers commit a breach of the contract and seller files a suit for damages, the amount of damages shall be reduced by the amount of earnest money forfeited.

D. **Taxes imposed after the contract of sale [sec.64 (A)]:** Any tax, is imposed or increased after making of the contract of sale of such goods, then the seller can recover the same from the buyer.

- E. **Payment of price a concurrent condition with that of delivery (sec.32):** 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.”

### **Time As Essence Of Contract**

A contract of sale of goods may stipulate the time for the payment of the price and also the time for delivery of goods.

- **Regarding payment:** “unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be the essence of a contract of sale.”
- **Regarding delivery:** as regards stipulation relating to the time of delivery of goods. (Sec.11).

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## Lesson - 4 Law Of Insurance

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The contract of insurance is called an aerator contract, because it depends upon an uncertain event. Lord Mansfield described insurance as “a contract on speculation.”

### **Fundamental Principles Of Insurance:**

- Good faith,
- Insurable interest,
- Indemnity,
- Mitigation of loss,
- Attachment of risk,
- Causa proxima.

### **Good Faith:**

A contract of insurance is a contract, *uberrimae fidei*, a contract based on utmost good faith and if the utmost good faith is not observed by either party the contract may be avoided by the other.

### **Insurable Interest:**

The assured must have an actual interest called the insurable interest, in the subject-matter of the insurance; either he must own part or whole of it, or he must be in such a position that injury to it would affect him adversely.

### **Indemnity:**

Excepting life assurance and personal accident and sickness insurance, a contract of insurance contained in a fire, marine, burglary or any other policy is a contract of indemnity.

### **Mitigation Of Loss:**

In the event of some mishap to insured property, the owner (the insured) must act as though he were uninsured, and make every effort to preserve his property.

**Risk Must Attach:**

A contract of insurance can be enforced only if the risk has attached.

**Causa Proxima:**

Make the insurer liable for loss, such loss must have been proximately caused by the peril insured against. Causa proxima non remota spectator.

**Contract Of Insurance One From Year To Year:**

The general rule is the except in the case of life assurance, a contract of insurance is a contract from year to year only.

**Premium:**

The premium is the price for the risk undertaken by the insurer. It is the consideration for the insurance.

**Days Of Grace:**

The days of grace are the days allowed by the insurance company after the expiry of the stipulated period of insurance during which the assured can pay the premium in order to continue or to renew the policy of insurance.

**Policy:**

The policy is a formal and enforceable stamped document signed and issued by the insurance company embodying the terms of the contract between the parties.

**Interim Receipt, Certificate Or Cover Note:**

A cover note or interim certificate is a document which the insurance company, on receiving the proposal, may issue pending the execution of a policy or the final decision of the directors as to acceptance or rejection of the proposal.

**Re-Insurance:**

Re-insurance is a contract which insures the thing originally insured, and by which an insurer is to be indemnified against any loss which he may sustain by reason of being himself compelled to pay the assured under the original contract of insurance.

**Double Insurance:**

When the same subject-matter is insured with two or more insurers and the total sum insured exceeds the actual value of the subject-matter, it is known as double insurance and it amounts to over-insurance.

**Subrogation:**

The right of subrogation is a necessary corollary of the principle of indemnity and is essential for its preservation.

**Contribution:**

Contribution is the right of the insurers to claim from others some payment towards the loss, and arises only where there is double insurance.

**Marine Insurance**

The law relating to marine insurance is found in the Marine Insurance Act, 1963. A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured, in the manner and to the extent thereby agreed, against marine losses, that is to say, the losses are incidental to marine adventure (Sec.3). There is a marine adventure when (i) any insurable property is exposed to maritime perils; (2) the earnings or acquisition of any freight, passage money, commission, profit or other pecuniary benefit, or the security for any advances, loans, or disbursements is endangered by the exposure of insurable property to maritime perils; (3) any liability to third party may be insured by the owner of, or other person interested in or responsible for, insurable property by reason of maritime perils [Sec. 2(e)].

## **Types Of Policies**

### **Voyage Policy:**

Where the contract is to insure the subject-matter “at and from” or from one place to another or others, the policy is called a voyage policy.

### **Time Policy:**

Where the contract is to insure the subject-matter for a definite period of time, the policy is called a time policy.

### **Valued Policy:**

A valued policy is a policy which specifies the agreed value of the subject-matter insured.

### **Unvalued Policy:**

An unvalued policy is a policy which does not specify the value of the matter insured, but subject to the limit of the sum insured, leaves the insurable value to be subsequently ascertained (Sec. 30).

### **Floating Policy:**

A floating policy is a policy which describes the insurance in general terms, and leaves the name or names of the ship or ships and other particulars to be defined by subsequent declaration.

### **Wager Or Honour Policy:**

It is a policy in which the assured has no insurable interest or the insurer or underwriter is willing to dispense with the proof of interest.

### **Insurable Interest:**

The person who effects an insurance, or issues instructions for effecting it, must have an insurable interest in the subject-matter. **The assured must have insurable interest at the time of the loss, though he may not have been interested when the insurance was actually effected.**

**Insurable Value:**

Insurable value is the amount of the valuation of the insurable interest for the purpose of insurance.

**Disclosure And Representation:**

The assured must disclose to the insurer every material circumstance which is known to him, and he is deemed to know everything which he ought to know in the ordinary course of business.

**Warranties:**

A warranty, according to sec. 35 of the Act, is an undertaking by the assured that some condition shall be fulfilled, or that a certain thing shall be or shall not be done, or whereby he confirms or negatives the existence of a particular state of facts. A warranty may be express or implied. An express warranty is a condition which is set forth in the policy or attached thereto; and an implied warranty is an essential condition implied by law, though not written in the policy.

**Sea-Worthiness:**

The ship must be sea-worthy at the commencement of the voyage, or if the voyage is divisible into distinct stages, at the commencement of each stage.

**Legality:**

So far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

**The Voyage:**

The subject-matter may be insured by a voyage policy “from a port” or “at and from” a port.

**Perils-** Perils are the risks which the underwriter agrees to take upon himself, and are inserted in the policy. Perils of the sea are all perils, losses,

misfortunes of a marine character or a character incident to a ship as such. **The purpose of the policy is to secure an indemnity against accidents which may happen, not against events which must happen.**

## **Losses**

### **Kinds Of Losses:**

A loss may be either Total or Partial. Total loss may be subdivided into two classes: (i) Actual Total Loss, and (ii) Constructive Total Loss. The case of partial loss arises when the subject-matter of the insurance is partially lost. Partial loss is also of two classes: (i) Particular Average, and (ii) General Average.

### **Fire Insurance**

A fire insurance is a contract to indemnify the insured for destruction of or damage to property caused by fire.

### **Average Clause:**

It is becoming very common in policies of fire insurance to insert a condition called the average clause, by which the insured is called upon to bear a portion of the loss himself. This condition is called the pro rata condition of average. **Insurable interest; the insured must have insurable interest in the subject-matter both at the time of effecting the policy and at the time of the loss.**

### **The Risk:**

The risk in fire policy commences from the moment the cover note, or the deposit receipt, or the interim protection is issued and continues for the term covered by the contract of insurance.

### **What Is Fire:**

The word fire as used in the expression "loss by fire" is to be construed in its popular and literal sense, and means a fire which has broken bounds.

**Assignment:**

In English law policy of fire insurance can be assigned only with the consent of the insurer.

**Valued Policy:**

In the “valued policy” the insured can recover a fixed amount, agreed at the issue of the policy without the necessity for any further proof of value at the time of the fire.

**Re-Instatement Or Replacement Policy:**

A clause is inserted in the policy under which the insured can recover not the value of buildings or plant as depreciated, but the cost of replacement of the property destroyed by new property of the same kind, or the insurers may themselves reinstate the property instead of paying in cash.

**Consequential Loss Policy:**

The insured is indemnified for the loss of profits which he sustains through interruption or cessation of his business as a result of fire.

**Life Insurance**

Life assurance may be defined as a contract in which the insurer, in consideration of a certain premium, either in a lump sum or by other periodical payments, agrees to pay to the assured, or to the person for whose benefit the policy is taken, a stated sum of money on the happening of a particular event contingent on the duration of human life.

**Life Insurance Is Not A Contract Of Indemnity:**

“The contract commonly called life assurance when properly considered is a mere contract to pay a certain sum of money on the death of a person, in consideration of the due payment of a certain annuity for his life.... This species of insurance in no way resembles a contract of indemnity.”

**Insurable Interest:**

The assured must have at the time of the contract an insurable interest in the life upon which the insurance is effected.

**Person In His Own Life:**

A person is presumed to have an interest in his own life and every part of it, and can insure for any sum whatsoever, and as often as he pleases.

**Relatives:**

A wife has an insurable interest in the life of her husband, and vice versa.

**Persons Not Related:**

A creditor has an insurable interest in the life of his debtor to the extent of the debt.

**Policies:**

**Whole Life Policy:** which matures only at the death whenever it may occur.

**Endowment Policy:** in which the sum insured is payable after the expiration of certain term of years if the policy-holder is alive, or at his death if he dies previously.

**Joint Life Policies:** are issued under which the sum assured is payable at the death of the first of the two lives.

**Survivorship Policy:** is also granted under which the sum assured is payable at the death of the last or survivor of two lives.



**Surrender Value:**

The amount which the insurers are prepared to pay in total discharge of the contract, in case the assured wishes to surrender his policy and extinguish his claim upon it.

**Loans On Policies:**

Where a policy has a surrender value, it also has a loan value, and assurance companies usually lend 95 per cent of the surrender value.

**Paid-Up Policy Value:**

The amount to which the sum assured would be reduced at any time, if the assured requested a rearrangement of his contract so that no further premium should be payable.

**Principle Of Good Faith And Sec.45 Of Insurance Act:**

The general rule is that in all kinds of insurance, the assured must disclose everything which is likely to affect the judgment of the insurer and what is stated must be truthful.

**Accident Insurance:**

An injury is accidental where it is the natural consequence of an unexpected cause, or the unexpected consequence of a natural cause.

Accident insurance consists of three categories:-

- ▶ Personal accident insurance, of three, including insurance against sickness;
- ▶ Property insurance, including burglary, fidelity, insolvency, etc
- ▶ Liability insurance, including motor insurance, workmen's compensation insurance, etc.

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## Lesson - 5 The Negotiable Instruments Act, 1881

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The law relating to negotiable instruments is primarily contained in the Negotiable Instruments Act, 1881. The word 'negotiable' means transferable from one person to another, and the term 'instrument' means 'any written document by which a right is created in favour of some person.' Thus, the negotiable instrument is a document by which rights vested in person can be transferred to another person in accordance with the provisions of the Negotiable Instruments Act, 1881. The Negotiable Instruments Act does not affect the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. But, the following are Not Promissory Notes. Ex. "I promise to pay B Rs. 500 and all other sums which shall be due to him."

### Essentials or Characteristics of a Promissory Note:

1. In writing.
2. Promise to pay.
3. Unconditional.
4. Signed by the Maker.
5. Certain Parties.
6. Certain sum of money.
7. Promise to pay money only.
8. Number, place, date etc.
9. It may be payable in installments
10. It may be payable on demand or after a definite period
11. It cannot be made payable to bearer on demand or even payable to bearer after a certain period (Sec. 31 of RBI Act).
12. It must be duly stamped under the Indian Stamp Act

### Bill Of Exchange:

A 'bill of exchange' is defined by Section 5 as "an instrument' in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or the order of, a certain person, or to the bearer of the instrument."

### Characteristic features of a Bill of Exchange:

- It must be in writing.
- It must contain an order to pay and not a promise or request. Words, like 'Please pay Rs. 10,000 to A on demand and oblige, do not constitute the instrument a bill of exchange.
- The order must be unconditional.
- There must be three parties, viz., drawer, drawee and payee.
- The parties must be certain.
- It must be signed by the drawer.
- The sum payable must be certain or capable of being made certain.
- The order must be to pay money and money alone.
- It must be duly stamped as per the Indian Stamp Act.
- Number, date and place are not essential. Oral evidence may be obtained as to date and place of execution.

### Cheque:

A cheque is defined as 'a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand' (Section 6). Thus, a cheque is a bill of exchange with two added features, viz.: (i) it is always drawn on a specified banker; (ii) and it is always payable on demand and not otherwise.

### Distinction Between Promissory Note And Bill Of Exchange

Promissory note differs from a bill of exchange in the following respects:

	Promissory Note		Bill of Exchange
1.	There are only two parties – the maker (debtor) and the payee (creditor).	1.	There are three parties – the drawer, the drawee and the payee.
2.	Contains an unconditional promise by the maker to pay the payee.	2.	Contains an unconditional order to the drawee to pay according to the drawer's directions.
3.	No prior acceptance is needed.	3.	A bill payable 'after sight' must be accepted by the drawee or his agent before it is presented for payment.

4.	The liability of the maker or drawer is primary and absolute.	4.	The liability of the drawer is secondary and conditional upon non-payment by the drawee.
5.	No notice of dishonour need be given.	5.	Notice of dishonour must be given by the holder to the drawer and the intermediate endorsers to hold them liable thereon.

### **Difference Between Bill Of Exchange And Cheque:**

	<b>Cheque</b>		<b>Bill of Exchange</b>
1.	Must be drawn only on a banker.	1.	Can be drawn on any person including a banker.
2.	The amount is always payable on demand.	2.	The amount may be payable on demand or after a specified time.
3.	The cheque is not entitled to days of grace.	3.	A usance (time) bill is entitled to three days of grace.
4.	Acceptance is not needed.	4.	A bill payable after sight must be accepted.
5.	A cheque can be crossed	5.	Crossing of a bill of exchange is not possible.
6.	Notice of dishonour is not necessary. (The parties thereon remain liable, even if no notice of dishonour is given.)	6.	Notice of dishonour is necessary to hold the parties liable thereon. (A party who does not receive a notice of dishonour can generally escape its liability thereon.)
7.	Not to be noted or protested in case of dishonour.	7.	Noted or protested to establish dishonour.
8.	The protection given to the paying banker in respect of crossed cheques is peculiar to this instrument.	8.	No such protection is available in the case of bills.

## **Holder And Holder-In-Due-Course:**

According to section 8, a **holder** of a negotiable instrument is “a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.” Thus, a person who has obtained the possession of an instrument by theft or under a forged endorsement is not a holder as is not entitled to recover the amount of the instrument.

A **‘holder in-due-course’**: Is “a person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title (Section 9).”

**Ambiguous Instrument** (Sec.17): An ambiguous instrument is one which may be construed either as a promissory note or as a bill exchange. The holder may at his option treat it as either and the instrument shall be treated accordingly.

**Where Amount is stated differently in Figures and Words** (Sec. 18): If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.

**Inchoate Instruments** (Sec.20): An inchoate instrument means an instrument that is incomplete in certain respects. The person so signing shall be liable upon the instrument, in the capacity in which he signed the same, to any holder-in-due-course for such amount. But, a person other than a holder-in-due-course cannot recover from the person delivering the instrument anything in excess of the amount intended by him to be paid there under.

**Minor** (Sec. 26): A minor may draw, indorse, deliver and negotiate negotiable instruments so as to bind all parties except himself.

**Agency** (Sec. 27): Every person capable of binding himself or of being bound may so bind himself or be bound by a duly authorized agent acting in his name.

**Liability of Agent Signing** (Sec. 28): An agent who signs his name to a P/N, B/E or Cheque without indicating thereon that he does not intend thereby to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable.

**Liability of Legal Representative** (Sec.29): A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable thereon, unless he expressly limits his liability to the extent of the assets received by him as such.

**Negotiable Instruments Made, etc.: Without Consideration** (Sec.43): A negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction.

**Partial Absence or Failure of Money Consideration** (Sec.44): When the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionately reduced.

**Partial Failure of Consideration not Consisting of Money** (Sec. 45): When a part of the consideration for which a person signed a promissory note, bill of exchange or cheque, though not consisting of money, is ascertainable in money without collateral enquiry, and there has been a failure of that part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

**Lost or Stolen Instruments** [Sec. 58]: When a negotiable instrument has been lost, or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or indorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder. However, if such possessor or indorsee is a holder, in due course, he shall be entitled to receive the payment thereof.

**Lost Instruments:** When a bill or note is lost, the finder acquires no title to it as against the rightful owner. He is also not entitled to sue the acceptor or maker in order to enforce payment on it. If the finder obtains payment, the person who pays it in due course may be able to get a valid discharge for it. But the true owner can recover the money due on the instrument from the finder.

**Stolen Instruments:** (1) A person cannot enforce payment of it against any party thereto nor can he retain it against the party from whom he had stolen it. (2) If the thief negotiates the instrument to a purchaser for value who has notice of the theft, the transferee cannot acquire a better title than the thief and thus cannot enforce payment. (3) If a person who has stolen a bill or note payable to bearer transfers it to a holder in due course, he confers a good title on him or any person deriving title from such holder.

### **Instruments Obtained For Unlawful Consideration**

- ▶ The instrument is void.
- ▶ A holder, in due course, however, obtains a good title to an instrument which was originally made or drawn or subsequently negotiated for an unlawful consideration.

**Forged Instruments:**The most common species of forgery is fraudulently writing the name of an existing person. It is also a forgery to sign the name of a fictitious person or non-existing person. Even a man's signature of his own name may amount to forgery, if it is put with the intention that the signature should pass for the signature of another person of the same name.

### **Cheque**

A cheque is the usual method of withdrawing money from an account with a banker. A cheque, in essence, is an order by the customer of the bank directing his banker to pay on demand, the specified amount, or to the order of the person named therein or to the bearer. Section 6 defines a cheque as "bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand."



### Requisites Of A Cheque:

- ▶ Written Instrument. A cheque must be an instrument in writing.
- ▶ Unconditional Order. A cheque must contain an unconditional order.
- ▶ On a Specified Banker Only. A cheque must be drawn on a specified banker.
- ▶ A Certain Sum of Money. The order must be only for the payment of money and that too must be specified.
- ▶ Payee to be certain. A cheque to be valid must be payable to a certain person.
- ▶ Payable on Demand. A cheque to be valid must be payable on demand and not otherwise.
- ▶ Amount of the Cheque. Amount of the cheque must be clearly mentioned.
- ▶ Dating of Cheques. The drawer of a cheque is expected to date it before it leaves his hands.

A cheque bearing an earlier date is **ante-dated** and the one bearing the later date is called **post-dated**. In India, a cheque that bears a date earlier than six months is a **stale cheque** and cannot be claimed for. In England, cheque can remain in circulation for a period of twelve months.

### Crossing Of Cheques:

Crossing of a cheque is a direction to the paying banker by the drawer that payment should not be made across the counter. The payment on a crossed cheque can be collected only through a banker.

Section 123, defines crossing as, “Where a cheque bears across its face an addition of the words ‘and company’ or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words ‘not negotiable’, that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally. A cheque having the cross mark such as ‘X’ is not generally regarded as a crossed cheque. A cheque that is not crossed is called an open cheque.

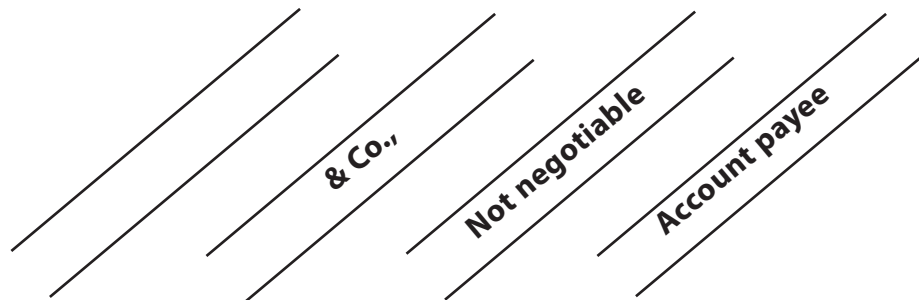
### Significance Of Crossing:

Payment cannot be claimed across the counter on a crossed cheque, crossing of cheques serves as a measure of safety against theft or loss of cheques in transit. By crossing a cheque, a person, who is not entitled to receive its payment, is prevented from getting the cheque encashed at the counter of the paying banker.

### Types Of Crossing:

Crossing may be either (1) General or (2) Special.

**General Crossing:** The term general crossing implies the addition of two parallel transverse lines.



**Special Crossing:** 'Special Crossing' implies the specification of the name of the banker on the face of the cheque. Section 124 in this regard, reads: Where a cheque bears across its face, an addition of the name of a bank, either with or without the words 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed to that banker." The object of special crossing is to direct the drawee banker to pay the cheque, only if it is presented through the particular bank mentioned therein. Thus, it makes the cheque system still safer.

### Specimens of Special Crossing



**Not Negotiable Crossing:** By including the words ‘not negotiable’, the cheque is deprived of its special feature of negotiability. Such a cheque is like any other goods where the title of the transferee is always subject to the title of the transferor. A bank, therefore, should be extra careful in paying such cheques.

**Account Payee Crossing (A/c Payee Crossing):** An A/c payee crossing signifies that the drawer intends the payment to be credited only to the payee’s account and in none else. The addition of ‘A/c payee’ to a crossing has no legal sanctity and the paying banker may ignore such a direction without being liable for any damages.

**Not Negotiable, A/c Payee Crossing:** The instrument is rendered not negotiable, plus A/c payee crossing directs the collecting banker to collect it for the payee only and warns that if the amount is collected for someone else, he may be held liable for damages.

### **Endorsement/Indorsement**

- ▶ It must be written on the instrument itself and be signed by the indorser.
- ▶ The endorsement must be of the entire instrument.
- ▶ Where in a negotiable instrument payable to order, the payee or endorsee is wrongly designated or his name is mis-spelt, he should sign the instrument in the same manner as given in the instrument.
- ▶ Where there are two or more endorsements on an instrument, each endorsement is deemed to have been made in the order in which it appears on the instrument, until contrary is proved.
- ▶ An endorsement may be blank or full. It may also be restrictive.

### **Bill Of Exchange And Promissory Note Kinds Of Bills**

1. **Inland Bill:** “a promissory note, bill of exchange or cheque drawn or made in India and payable in or drawn upon any person resident in India”. (Section 11).
2. **Foreign Bills:** According to Section 12, a foreign bill is negotiable instrument which is noted as an inland instrument.

3. **Trade and Accommodation Bills:** A trade bill is a bill of exchange issued in respect of a genuine trade transaction. Such bills are drawn by the seller on the buyer in respect of payment of the price of the goods sold and purchased.
4. **Time Bills (Usance Bills):** Time bills, also called as usance bills, are bills payable at a fixed period after date or sight of the bills.
5. **Demands Bills:** A bill of exchange or a promissory note is payable on demand when –
  - i. It is made payable '**on demand**' or '**at sight**' or '**on presentation**' (Section 21)
  - ii. No time for payment is mentioned therein (Section 19)
6. **Clean and Documentary Bill:** Where the banker is instructed to deliver to the drawee of the bill, the documents of title against acceptance of the bill, the bill is called as Documents against Acceptance of Bill (**D/A Bill**) and where the documents are to be released only against payment, it is called as Documents against Payment of Bill (**D/P Bill**).

### **Parties To A Bill Of Exchange**

- ▶ The Drawer
  - ▶ The Drawee
  - ▶ The Payee
  - ▶ The Holder
  - ▶ The Indorser
  - ▶ The Indorsee
7. **Drawee in Case of Need:** Such a person whose name is mentioned as an alternative drawee is called a drawee in case of need.
  8. **Acceptor for Honour:** An acceptor for honour is a person who, on the refuse by the original drawee to accept the bill or to furnish better security when demanded by the notary, accepts the bill in order to safeguard the honour of the drawer or any indorser.

### **Parties To A Promissory Note**

- ▶ The Maker
- ▶ The Payee
- ▶ The Holder

- The Indorser
  - The Indorsee
9. **Capacity Of Parties:** The capacity of a party to draw, accept, make or endorse a bill or note is co-extensive with his capacity to enter into contract.

### **Acceptance:**

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. An acceptance of a bill may be **general** or **qualified**.

### **Presentment:**

Presentment of a negotiable instrument is made for two purposes.

- For acceptance, and
- For payment.

### **Dishonour:**

A bill of exchange may be dishonoured either by non-acceptance Or by non-payment.

**Dishonour by Non-Acceptance:** Section 91 enumerates the circumstances when a bill will be considered as dishonoured by non-acceptance.

**Dishonour by Non-Payment:** A negotiable instrument is said to be dishonoured by non-payment when the maker, acceptor or drawee, as the case may default in payment upon being duly required to pay the same (Section 92

### **Self Assessment Questions:**

1. “Every contract is an agreement but every agreement is not a contract”. Do you agree with this statement?
2. “Performance of the conditions of a proposal is an acceptance of the proposal” – Comment.
3. “A Promise against a promise is a good consideration” – Comment.

4. What is the nature and extent of partner's authority to bind the firm by his acts? Are third parties affected by restrictions placed on the implied authority?
5. What are the legal consequences, if the goods are not delivered in time and the payment is not made in time?
6. What are the fundamental principles of Insurance? Explain the losses in life Insurance.
7. What do you mean by crossing a cheque? What are the circumstances in which a banker is entitled to dishonour a cheque?
8. What is Agency by 'Ratification'? What are the essential conditions to make a valid ratification?
9. Enumerate the rights and obligations of finder of lost goods.
10. Explain and illustrate the circumstances under which contracts need not be performed.

### Key Words

- ▶ **Agreement:** A pact, convention, or treaty between nations, sub-national entities, organizations, corporations.
- ▶ **Contingent Contract** is a Contract which has to do or not to do something.
- ▶ **A quasi-contract (or implied-in-law contract)** is a fictional contract created by courts for equitable, not contractual purposes
- ▶ **A partnership** is an arrangement where parties agree to cooperate to advance their mutual interests.
- ▶ **Insurance law** is the name given to practices of law surrounding insurance, including insurance policies and claims.
- ▶ **The Holder in Due Course (HDC)** doctrine is a rule in commercial law that protects a purchaser of debt.
- ▶ **Drawee** - the person (or bank) who is expected to pay a check or draft when it is presented for payment

### Further Reading

1. Robert W. Emerson, Paperback, *Business Law*, Barron's Educational Series, 2009.
2. David P. Twomey and Marianne M. Jennings, *Anderson's Business Law and the Legal Environment, Standard Volume*, Thomas Higher Education, 2011.

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## Unit – IV

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### Objectives:

*The main purpose of this unit is to help you to:*

- ▶ Have a deeper awareness of the system of Company form of organization and its formation processes;
- ▶ Gain a thorough understanding about the Memorandum, Articles of Association and the preparation and contents of a Prospectus;
- ▶ Distinguish between Shares and Debentures and their features;
- ▶ Understand the procedures for appointment of Directors, their powers & duties and the conduct of different types of company meetings;
- ▶ Explain the different modes of winding up of a company

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### Lesson - 1 Nature Of Company And Formation

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A Company, in common parlance, means a group of persons associated together for the attainment of a common end, social or economic.

The Companies Act, 1956 defines the word ‘company’ as a company formed and registered under the Act or an existing company formed and registered under any of the previous company laws (Section 3). Section 12 permits the formation of different types of companies. These may be (i) companies limited by shares, (ii) companies limited by guarantee, and (iii) unlimited companies. The vast majority of companies in India are with limited liability by shares.

#### Definition Of Company:

“A Company is a voluntary association of persons formed for some common purpose with capital divisible into parts known as shares”  
The common stock so contributed is denoted in money and is “the capital” of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his “share”. Shares in a company are transferable.

## Characteristics Of A Company:

The following are the characteristic features of company:

1. **Incorporated Association:** A company must be incorporated or registered under the Companies Act. Minimum number required for the purpose is 7 in case of a public company, and 2, in case of a private company (Sec. 12). As per Section 11, an association of more than 10 persons, in case of banking business, and 20 in case of any other business, if not registered as a company under the Companies Act, or under any other law for the time being in force, becomes an illegal association.
2. **Artificial Person:** A company is created with the sanction of law and is not itself a human being, it is, therefore, called artificial; and since it is clothed with certain rights and obligations, it is called a person. A company is accordingly an artificial person.
3. **Separate Legal Entity:** Unlike partnership, company is distinct from the persons who constitute it. Section 34(2) says that on registration, the association of persons becomes a body corporate by the name contained in the Memorandum. [**Saloman v. Saloman & Co.Ltd. (1877)**]
4. **Limited Liability:** The company being a separate person, its members are not as such liable for its debts. Hence, in the case of a company limited by shares, the liability of members is limited to the nominal value of shares held by them. Thus, if the shares are fully paid up, their liability will be nil. However, companies may be formed with unlimited liability of members or members may guarantee a particular amount. In such cases, liability of the members shall not be limited to the nominal or face value of the shares held by them. In case of unlimited liability companies, members shall continue to be liable till each share has been paid off. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount, i.e., he shall be liable to contribute upto the amount guaranteed by him.
5. **Separate Property:** Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in *Bacha F.Guzdar V. The Commissioner of Income Tax, Bombay (Supra)*. The Supreme Court held that a shareholder is not the part owner



of the company or its property, he is only given certain rights by law, e.g., to vote or attend meetings, to receive dividends.

6. **Transferability of Shares:** Since business is separate from its members in a company form of organization, it facilitates the transfer of members' interests. The shares of a company are transferable in the manner provided in the Articles of the company (Sec. 82). However, in a private company, certain restrictions are placed on such transfer of shares but the right to transfer is not taken away absolutely.
7. **Perpetual Existence:** A company being an artificial person cannot be incapacitated by illness and it does not have an allotted span of life. The death, insolvency or retirement of its members leaves the company unaffected. Members may come and go but the company can go for ever.
8. **Common Seal:** A company being an artificial person is not bestowed with a body of natural being. Therefore, it has to work through its directors, officers and other employees. But, it can be held bound by only those documents which bear its signatures. Common seal is the official signature of a company.
9. **Capacity to sue:** Another fall-out of separate legal entity is that the company, if aggrieved by some wrong done to it may sue or be sued in its own name.

### **Lifting Of The Corporate Veil:**

In case of a dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identifies the persons (members) who are behind the scene and are responsible for the perpetration of fraud. The concept of lifting the corporate veil is a changing concept. The veil of corporate personality, even though not lifted sometimes, is becoming more and more transparent in modern jurisprudence.

The following are some such cases:

- **For the protection of revenue.**
- **Where the company is acting as agent of the shareholders,**
- **Where a company has been formed by certain persons to avoid their own valid contractual obligation,**

- **Where a company has been formed for some fraudulent purpose or is a “sham”,**
- **Where a company formed is against public interest or public policy,**
- **Where the holding company holds 100 per cent shares in a subsidiary company and the latter is created only for purposes of holding company**Where the number of members falls below statutory minimum (Section 45)
- **Where prospectus includes a fraudulent misrepresentation.**
- **Where a negotiable instrument is signed by an officer of a company** [Section 147 (4)(c)].
- **Holding and Subsidiary Companies** (Secs. 212 – 213).
- **Investigation into related companies** (Section 239).
- **For investigation of ownership of a company.** (Sec 247).
- **Where in the course of winding of a company** (Section 542).
- **Where breach of economic offence is involved.**
- **Where company is used as medium to avoid welfare legislation.**
- **Where device of incorporation is used for some illegal or improper purpose.**
- **To Punish for contempt of Court**
- **For determination of technical competence of company.**
- **Where company is a mere sham or cloak.**

**Illegal Association:** (Section 11) No company, association or partnership consisting of more than 10 persons for the purpose of carrying on the business of banking and more than 20 persons for the purpose of carrying on any other business can be formed, unless it is registered under the Companies Act or is formed in pursuance of some other Indian Law. Thus, if such an association is formed and not registered under the Companies Act, it will be regarded as an ‘Illegal association’ although none of the objects for which it may have been formed is illegal. However, Section 11 does not apply in the following cases: Stock Exchange, Association ‘Not for Profit-making’, Joint Hindu Family.

**Effects of an Illegal Association:** Following are the effects of an illegal association:

1. Every member is personally liable for all liabilities incurred in the business.

2. Members are punishable with fine which may extend up to Rs.10,000.
3. Such an association cannot enter into any contract.
4. Such an association cannot sue any of its members or any outsider, not even if the association is subsequently registered as a company.
5. It cannot be sued by a member or an outsider for any debts due to it because it cannot contract any debt.
6. It cannot be wound up even under the provisions relating to winding up of un-registered companies.
7. While an unregistered firm can be dissolved, an illegal association cannot be dissolved because law does not recognize its very existence.
8. The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members.
9. The profits made by an illegal association are, however, liable to assessment to income-tax.

## **Classification Of Companies:**

### **I. On the Basis of Incorporation**

1. **Chartered Companies:** Companies set up as a result of a royal charter granted by a king or queen of a country are known as chartered companies. Example: East India Company, the Bank of England etc.
2. **Statutory Companies:** Companies set up by Special Acts of Parliament or State Legislatures are called Statutory Companies. Example: Reserve Bank of India, Life Insurance Corporation of India, Unit Trust of India etc.
3. **Registered Companies:** Companies registered under the Indian Companies Act, 1956 or under any of the previous Companies Acts are called registered companies. Most of the companies in India belong to this category.
4. **Licensed Companies:** Companies established for the promotion of arts, science, religion, charity or any other similar objects can obtain license under Sec.25 from the Central Government and enjoy certain privileges.

5. **Foreign Companies:** A company incorporated outside India under the law of the country of incorporation but having established its business in India is called a foreign company.

## II. On the Basis of Liability

1. **Companies with Limited Liability:** It is a company where the liability of the shareholder remains limited to the nominal value of the shares held by him.
2. **Companies Limited by Guarantee:** In a guarantee company the liability of a shareholder is limited to the amount he has voluntarily undertaken to contribute towards the assets of the company to meet out any deficiency at the time of its winding up. Such a company may or may not have a share capital.
3. **Unlimited Companies:** Here the liability of its members is unlimited. In other words, their liability extends to their private properties also. Unlimited companies are almost non-existent these days.

## III. On the Basis of Number of Members

1. **Private Company:** As per Section 3(1) (iii), a private company means a company which by its Articles restricts the right to transfer its shares if any, and limits the number of its members to fifty and prohibits invitation of shares from the public.
2. **Public Company:** According to Section 3(1) (iv), a public company means a company which is not a private company.

## IV. On the Basis of Control

1. **Holding Companies:** A company exercising control over another company is called a holding company. [Sec.4(4)].
2. **Subsidiary Companies:** The company so controlled is called a subsidiary company. [Sec.4(1)].

## V. On the Basis of Ownership

1. **Government Company:** Definition (Sec.617): A Government company means any company in which not less than 51% of the paid up share capital is held by the Central Government or by any State Government or Governments, or partly by one or more State Governments and includes a company which is a subsidiary of a Government company.
2. **Foreign Companies (591 to 602):** A foreign company is a company which is incorporated in a country outside India under the law of that foreign country and has a place of business in India. They are of two types: (1) Companies incorporated outside India, establish a place of business in India after April 1, 1956; and (2) Companies incorporated outside India, which established a place of business in India before that date and continue to have an established place of business in India.
3. **Deemed Public Company:** The Companies (Amendment) Act, 2000 has, by introducing a sub-section (11) to Section 43A, made that a private company will not automatically become a public company on account of shareholding or turnover.
4. **One Man Company:** A member may hold virtually the entire share capital of a company. Such a company is known as a “one-man company”. This can happen both in a private company and a public company. The other member/members of the company may be holding just one share each. Such other members may be just dummies for the purpose of fulfilling the requirements of law as regards minimum membership [**Salomon v. Salomon & Co.Ltd.**].
5. **Non-Trading Company/Non-Profit Association:** Such a company must have the objects of promoting of commerce, arts, science, religion, charity or any other useful object and must apply its profit, if any, or other income in promoting its object and must prohibit payment of any dividend to its members. As soon as it obtains a license and is registered accordingly, it will have the same privileges and obligations that a limited company has under the Companies Act, 1956.

6. **Investment Companies:** An investment company is a company the principal business of which consists in acquiring, holding and dealing in shares and securities. It involves only the acquisition and holding of shares and securities and thereby earning income by way of interest, dividend, etc.
7. **FERA Companies:** The FERA companies are those companies which are incorporated in India in which the non-resident interest (viz., foreign equity share capital) was more than 40%. After the Amendment of FERA 1973 in the year 1993, the erstwhile FERA companies would not in future be subjected to obtain the prior approval of the RBI in respect of certain matters.
8. **Finance Companies:** A finance company means a non-banking company which is a financial institution within the meaning of clause (c) of sec.45 of the RBI Act, 1934.
9. **Public Financial Institutions (Sec. 4-A):** The following financial institutions shall be regarded, for the purposes of the Companies Act, as public financial institutions, namely:-
  - i. The Industrial Credit and Investment Corporation of India Limited (ICICI)
  - ii. The Industrial Finance Corporation of India (IFCI)
  - iii. The Industrial Development Bank of India (IDBI)
  - iv. The Life Insurance Corporation of India (LIC)
  - v. The Unit Trust of India (UTI)
  - vi. The Infrastructure Development Finance Company Ltd.

Sub-section (2) of Sec. 4-A empowers the Central Government to specify any other institution, as it may think fit, to be a public financial institution by issuing a notification in the Official Gazette.

### **Formation Of A Company**

We shall discuss the formation in three heads:

- Promotion
- Registration
- Floatation

**Promotion:**

Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company.

**Duties And Liabilities Of Promoters:**

**Duties:** The promoters to make a full disclosure of all material facts relating to the formation of the company. He should not make any secret profit at the expense of the company he promotes, without the knowledge and consent of the company and if he does so, the company can compel him to account for it.

**Liabilities:**

**For Non-disclosure:** In case a promoter fails to make full disclosure at the time the contract was made, the company may either:

- ▶ Rescind the contract and recover the purchase price where he sold his own property to the company, or
- ▶ Recover the profit made, even though rescission is not claimed or is impossible, or
- ▶ Claim damages for breach of his fiduciary duty. The measure of damages will be the difference between the market value of the property and the contract price.

**Registration (Sec 12, 33):**

**Availability of Name:** Section 20 states that a company cannot be registered by a name, which in the opinion of the Central Government is undesirable. Therefore, it is advisable that promoters find out the availability of the proposed name of the company from the Registrar of companies.

**Procedure:**

The promoters will have to get together at least seven person in the case of public company, or two persons in the case of a private company to subscribe to the Memorandum of association.

### **Documents To Be Delivered:**

Section 33 states that the following three documents are required to be presented for the purpose of registration of a company:

- ▶ The Memorandum of the company;
- ▶ The articles, if any;
- ▶ The agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole time director or manager.

### **Statutory Declaration Of Compliance:**

Section 33 also requires a declaration to be filed with the registrar of companies along with the Memorandum and the articles. This is known as “Statutory Declaration of Compliance.”

### **Consent Of Directors:**

In case of a public company, if the first directors are appointed by the articles, then the following must be complied with before the registration of articles with the Registrar of Companies:

- ▶ Written consent of those directors to act, signed by themselves, or by an agent duly authorized in writing, and
- ▶ An undertaking in writing signed by each such director to take from the company and pay for his qualification shares (if any).

Other documents are usually delivered along with the aforesaid documents:

- ▶ The address of the registered office of the company (Sec. 146).
- ▶ Particulars regarding directors, manager and secretary, if any (Sec 303).

These two documents are required to be submitted within 30 days of registration of the company:



### **Certificate Of Incorporation/Consequences Of Incorporation:**

This certificate serves the same purpose in the case of a company which a birth certificate does in the case of a natural person.

### **Effect Of Certificate Of Incorporation:**

The certificate of incorporation is conclusive evidence that all the requirements of the Companies Act in respect of registration and of matters precedent and incidental thereto have been complied with.

### **Floataction/Capital Subscription:**

When a company has been registered and has received its certificate of incorporation, it is ready for “floatation”, i.e., it can go ahead with raising capital sufficient to commence business and to carry it on satisfactorily. Section 70 makes it obligatory for every public company to take either of the following two steps:

- i. Issue a prospectus in case public is to be invited to subscribe to its capital, or
- ii. File a ‘statement-in-lieu of prospectus’ with the registrar, in case capital has been arranged privately. It must be done at least 3 days before allotment.

### **Certificate To Commence Business:**

Where the company has issued a prospectus – Section 149(1), it shall not commence business or exercise any borrowing powers unless:

- a. Minimum subscription
- b. Every director of the company has paid to the company.
- c. No money is, or may become, liable to be repaid to the applicants.
- d. Filed with the registrar a duly verified declaration by one of the directors or the secretary.

Where the company has not issued a prospectus Section 149(2) requires, that it shall not commence business or exercise its borrowing powers unless:-

- a. It has filed with the registrar a statement in lieu of prospectus;
- b. Every director of the company has paid to the company on each of the shares taken or contracted to be taken by him.
- c. Filed with the registrar duly verified declaration by one of the directors or the secretary.

**Penalty:** every person at fault is liable to a fine upto Rs.5,000 for every day of default.

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## **Lesson - 2 Memorandum And Articles Of Association**

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The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated. It tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. If anything is done beyond the powers, that will be ultra vires (beyond powers of) of the company and so void. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities.

### **Form and Contents:**

Shall be in such one of the Forms in Tables B,C,D and E in Schedule I to the Companies Act, 1956 as may be applicable in the case of the company, or in Forms as near thereto as circumstances admit. Section 13 requires the Memorandum of a limited company to contain: (i) the name of the company, with "limited" and "private limited" the name of the State, the objects of the company, the declaration that the liability of the members is limited; and the amount of the authorized share capital, divided into shares of fixed amounts.

### **The Name Clause (Sec. 13(1(a))]:**

The last word in the name of the company, if limited by shares or guarantee is 'limited', unless the company is registered under Sec.25 as an 'association not for profit' (Sec. 13(1)(a) and 25)].

### **The Registered Office Clause (Sec. 13(1)(b))]:**

This clause states the name of the State in which the registered office of the company will be situated. Every company must have registered office which establishes its domicile, and it is also the address at which company's statutory books must normally be kept and to which notices, and all other communication can be sent.

**The Objects Clause (Sec. 13(1)(d)):**

The objects clause defines the objects of the company and indicates the sphere of its activities. A company cannot do anything beyond or outside its objects and any act done beyond them will be ultra vires and void, and cannot be ratified even by the assent of the whole body of shareholders.

Section 13, read along with Tables “B’, ‘C’, ‘D’ and E’, requires the company to divide its objects clause into two parts:

- ▶ Main objects of the company to be pursued by the company on its incorporation and object incidental or ancillary to the attainment of the main objects; and
- ▶ Other objects of the company not included in (a) above.

**Liability Clause [Sec. 13(2)]:**

This clause states the nature of liability of the members. In case of a company with limited liability, it must state that liability of members is limited, whether it is made by shares or by guarantee. In case of companies limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets of the company in the event of its winding-up. In fact, the absence of this clause in the Memorandum means that the liability of its members is unlimited.

**The Capital Clause [Sec. 13(4)(c)]:**

This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value, i.e., the number of shares into which the capital is divided and the amount of each share.

**The Association Clause [Sec. 13(4)(c)]:**

The names, addresses, descriptions, occupations of the subscribers, and the number of shares each subscriber has taken and his signature attested by a witness.

## **Doctrine Of Ultra Vires (Beyond Powers)**

The company's activities are confined strictly to the objects mentioned in its Memorandum, and if they go beyond these objects, then such acts will be ultra vires. The object of declaring such acts as ultra vires is to protect the interests of shareholders and all others who deal with the company.

1. Ultra vires the directors (Not Void)
2. Ultra vires the Articles of Association (Not Void)
3. Ultra vires the Memorandum of Association/Company (Void)

### **Effects Of Ultra Vires :**

- Injunction against the company
- Personal liability of directors to the company
- Personal liability of directors to third party
- Ultra vires contracts are void.

### **Exceptions To Doctrine Of Ultra Vires:**

1. Acquires some property
2. Property can be recovered, existed and is traceable
3. Ultra vires loan to pay its own debts – can recover the money from the company
4. Any person borrows money from the company – the company has right to sue and recover the money from him
5. The company may compel the director to refund the money
6. The company is held liable for the ultra vires torts (civil wrongs) of its employees when it is proved.
  - a. A company exists only for the objects which are expressly stated in its objects clause
  - b. Any act done outside the express or implied objects is ultra vires.
  - c. The ultra vires acts are null and void ab initio.
  - d. The members of a company (even a single member) can get an order of injunction from the court restraining the company from going ahead with the ultra vires act.

- e. If the directors have exceeded their authority, such matter can be ratified by the general body of the shareholders, provided company has the capacity to do by its Memorandum of association.
- f. Any property acquired by a company under an ultra vires transaction may be protected by the company against damage by third persons.
- g. Directors and other officers can be held liable to compensate the company for any loss occasioned to it by an Ultra Vires Act.
- h. Directors and other officers shall be personally accountable to the third parties.
- i. Money or property gained through an ultra-vires transaction available in specie or capable of being identified shall be restituted (restored) to the other party.
- j. In case, an ultra-vires loan, taken by a company is used for payment of its intra-vires debts, the lender of the ultra loan is substituted in place of the creditor who has been paid off and as such can recover the money.

### **Alteration Of Memorandum**

Section 16 provides that the company can not alter the conditions contained in Memorandum except in the cases and in the mode and to the extent express provision has been made in the Act.

### **Change Of Name:**

The name of a company may be changed at any time by passing a special resolution at a general meeting of the company and with the written approval of the Central Government.

### **Change Of Registered Office:**

(a)Change of registered office from one premises to another premises in the same city, town or village. A resolution passed by the Board of Directors shall be sufficient. (b)Change of registered office from one town or city or village to another town or city or village in the same state procedure.

- ▶ Special resolution
  - ▶ Confirmation of regional director
  - ▶ Copy of special resolution and confirmation by regional directors to be filed with ROC.
  - ▶ Notice of new location. Within 30 days the notice of the new location has to be given to the registrar who shall record the same.
- (c) Change of registered office from one State to another State can be done by a special resolution which is required to be confirmed by the Company Law Board (CLB).

**Alteration Of Objects Clause (Section 17):**

Empowers a company to change the place of its registered office from one State to another or to alter its objects by passing a special resolution, if alteration is sought on any of the following grounds:

- ▶ To carry on its business more economically and more efficiently
- ▶ To attain its main purpose by new or improved means
- ▶ To enlarge or change the local area of its operation
- ▶ To carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company
- ▶ To restrict or abandon any of the objects specified in the Memorandum.
- ▶ To sell or dispose of the whole or any part of the undertaking.
- ▶ To amalgamate with any other company or body of persons.

**Alteration Of Liability Clause (Sec. 38):**

The liability of a member of a company can not be increased unless the member agrees in writing. Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner.

**Alteration Of Capital Clause (Section 94):**

It provides that, if the articles authorize a company limited by share capital, by an ordinary resolution passed in general meeting, may alter the conditions of its Memorandum in regard to capital so as –

1. To increase its authorized share capital , 2. To consolidate and divide all or any of its share capital into shares of larger amount than its existing shares, 3. To convert all or any of its fully paid-up shares into stock, and reconvert the stock into fully paid-up shares of any denomination, 4. To sub-divide its shares, or any of them, into shares of smaller amount. 5. To cancel shares which have not been taken or agreed to be taken by any person.

### **Articles Of Association**

The articles of association of a company and its bye laws are regulations which govern the management of its internal affairs and the conduct of its business. They define the duties, rights, powers and authorities of the shareholders and the directors in their respective capacities and of the company and the mode and form in which the business of the company is to be carried out.

### **Registration Of Articles:**

Section 26 states that a public company limited by shares may register articles of association signed by the subscribers to the Memorandum. There are actually three possible alternatives in which such company may adopt articles: (i) it may adopt Table A in full or, (ii) it may wholly exclude Table A and set out its own regulations in full, or (iii) it may set out its own articles and adopt part of Table A.

### **No Article Company (Sec. 28) :**

A company limited by shares may either frame its own set of articles or may adopt all or any of the regulations contained in Table 'A' [Section 28(1)]. But if it does not register any Articles, Table 'A' applies.

### **Subject Matter Of Articles/Contents**

The articles of a company usually deal with the following matters:

1. The business of the company;
2. The amount of capital issued and the classes of shares, and the increase and reduction of share capital;



3. The rights of each class of shareholders and the procedure for variation of their rights;
4. The execution or adoption of a preliminary agreement, if any; the allotment of shares; calls and forfeiture of shares for non-payment of calls;
5. The allotment of shares; calls and forfeiture of shares for non-payment of calls;
6. Transfer and transmission of shares;
7. Company's lien on shares;
8. Exercise of borrowing powers including issue of debentures;
9. General meetings, notices, quorum, proxy, poll, voting resolution, minutes;
10. Number, appointment and powers of directors;
11. Dividends – interim and final – and general reserves;
12. Accounts and audit;
13. Keeping of books – both statutory and others.

**Form And Signature Of Articles** [Sections 29 & 30]:

The articles of association of any company not being a company limited by shares, shall be in one such form in Tables 'C', 'D', and 'E' in Schedule I as may be applicable. Section 30 requires that articles shall be –

1. Printed;
2. divided into paragraphs numbered consecutively;
3. Signed by each subscriber of the Memorandum of association.

**Inspection And Copies Of The Articles:**

A company shall, on being so required by a member, send to him within seven days of the requirement, on payment of one rupee, a copy of the articles.

**Alteration Of Articles**

A company may, by special resolution alter or add to its articles. A printed or type written copy of every special resolution altering the articles must be filed with the registrar within 30 days of the passing of the special resolution.

## **Effect Of Memorandum And Articles / Binding Force Of Memorandum And Articles**

### **Members Bound To Company:**

Each member must observe the provisions of the articles and Memorandum.

### **Company Bound To Members:**

A company is bound to members by whatever is contained in its Memorandum and articles of association.

### **Member Bound To Member:**

The articles bind the member inter se, i.e., one to another so far as rights and duties arising from the articles are concerned.

### **Whether company or members bound to outsiders?:**

No, the Memorandum or articles do not confer any contractual rights to outsiders against the company or its members, even though the name of the outsiders is mentioned in the articles.

### **Whether directors are bound by whatever is contained in the Articles?**

Yes, the directors of the company derive their powers from the articles and are subjected to limitations, if any, placed on their powers by the articles.

### **Constructive Notice Of Articles And Memorandum:**

The Memorandum and articles when registered become public documents and then they can be inspected by anyone on payment of a nominal fee. Every person dealing with the company is presumed to have read these documents and understood them in their true perspective. This is known as 'Doctrine of Constructive Notice'.

## **Doctrine Of Indoor Management:**

The doctrine of indoor management allows all those who deal with the company to assume that the provisions of the articles have been observed by the officers of the company. In other words, they are not bound to enquire into the regularity of internal proceedings. An outsider is not expected to see that the company carries out its internal regulations.

**Exceptions:** The doctrine of indoor management is subject to the following exceptions:

- ▶ Knowledge of irregularity.
- ▶ No knowledge of Articles: The rule cannot be invoked in favour of a person who did not consult the Memorandum and articles and, thus did not rely on them.
- ▶ Void or illegal transaction. The rule does not apply to transactions which are void or illegal ab initio, eg., forgery.
- ▶ Negligence: If an officer of a company does something which would not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make inquiry he cannot rely on the rule.
- ▶ Doctrine does not apply where question is in regard to very existence of agency.

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## Lesson - 3 Prospectus And Statement In Lieu Of Prospectus

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### Definition of Prospectus:

Sec 2 (36) A prospectus means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate. Thus, a prospectus is not merely an advertisement; it may be a circular or even a notice.

A document shall be called a prospectus if it satisfies two things:

1. It invites subscriptions to shares or debentures or invites deposits.
2. The aforesaid invitation is made to the public.

The Board attends to the following matters:

1. Appointment of various expert agencies such as bankers, auditors, secretary, etc.
2. Entering into underwriting contract, brokerage contracts.
3. Making arrangements for the listing of shares on stock exchanges.
4. Drafting a prospectus for the purpose of issue to the public.

### Underwriting

Underwriting, in its simplest form, consists of an undertaking by some person or persons that if the public fails to take up the issue, he or they will do so. In return for this undertaking, the company agrees to pay the underwriter a commission on all shares or debentures, whether taken up by the public or by the underwriters.

### Sub-Underwriting

The underwriters usually choose to spread their risk by using sub-underwriters who agree to take a certain number of shares for which they accept responsibility and for which they receive a commission out of the commission received by the underwriters. The difference between the commission paid by

the company to the principal underwriters and the commission paid by them to the sub-underwriters is known as overriding commission.

### **Brokerage Contracts**

There must be authority in the articles to pay brokerage, and the brokerage must be disclosed in the prospectus, or statement in lieu of prospectus, as the case may be, and it should pay a reasonable brokerage (Sec. 76).

### **Listing Of Shares On A Stock Exchange**

The eligibility criteria for listing of securities of a company are:

- ▶ Minimum issued equity capital of a company should be Rs.5 crores [Rs. 3 crores where trading is screen-based], and
- ▶ The minimum public offer of equity capital shall be not less than 25 per cent.

### **Time Of Floatation:**

The Board of Directors will decide about the time of issue of prospectus. It is advisable to consider the condition of the capital market, the investors' mood, fiscal and monetary policies of the Government and the state of business conditions before issuing a prospectus.

### **Dating Of Prospectus:**

Sec. 55 states that every prospectus must be dated and the date is deemed to be the date of publication of the prospectus. Section 56 of the Companies Act lays down that the matters and reports stated in Schedule II to the Companies Act must be included in a prospectus.

### **Abridged Form Of Prospectus:**

Instead of appending full prospectus, now 'abridged prospectus' need only be appended to the application form. Form 2-A has been prescribed as a format of abridged prospectus.

### **When 'Abridged Prospectus' not necessary?**

In the following circumstances, an 'abridged prospectus' need not accompany the application forms:

- ▶ A bonafide invitation to a person [Sec. 56(3)(a)]
- ▶ When shares or debentures are not offered to the public [Sec.56(3) (b)].
- ▶ Where offer is made only to existing members/debenture holders of the company by way of rights, whether with or without the right of renunciation [Sec.56(5) (a)].
- ▶ In the case of issue of shares or debentures which are in all respects similar to those previously issued and dealt in and quoted on a recognized stock exchange [Sec.56(5) (b)].

### **Registration of the Prospectus (Section 60):**

A copy of the prospectus duly signed by every director or proposed directors must be delivered to the registrar before its publication.

### **Is the issue of prospectus compulsory?: when prospectus is not required to be issued?**

The following are the circumstances:

- ▶ A private company
- ▶ If the promoters or directors feel that they can mobilize resources through personal relationship and contacts.
- ▶ A Memorandum containing the prescribed salient features of a prospectus.
- ▶ A bonafide invitation to a person to enter into an underwriting agreement Sec.56(3)
- ▶ Application form is issued in relation to shares or debentures not offered to the public [Sec. 56(3)]
- ▶ Offered to existing holders of shares or debentures[Sec. 56(5)]
- ▶ The issue relates to shares or debentures previously issued [Sec. 56(5)]
- ▶ Where invitation is made in the form of an advertisement, ordinarily called as "prospectus announcement' [Sec. 66].

### **Shelf Prospectus And Information Memorandum** [Section 60A And 60 B]:

The Companies (Amendment) Act, 2000 has introduced two new sections, viz., Sections 60A and 60B relating to 'Shelf Prospectus' and 'Information Memorandum' respectively. 'Shelf prospectus' means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

### **Information Memorandum** (Section 60B):

'Information Memorandum' means a process undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities is assessed by means of a notice, circular, advertisement or document [Section 2(19B)].

### **Statement In Lieu Of Prospectus (Section 70):**

If a public company makes a private arrangement for raising its capital then it must file a statement in lieu of prospectus with the registrar at least three days before any allotment of shares or debentures can be made.

If allotment of shares or debentures is made without filing the Statement in lieu of prospectus, the allottee may avoid it within two months after the statutory meeting, or where no such meeting is to be held, within two months of the allotment. Contravention also renders the company and every director liable to a fine up to Rs. 10,000.

### **Misleading Prospectus** (Sections 62-63):

The prospective shareholders are entitled to all true disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not to omit material facts,

- ▶ Which contains untrue statements in it.
- ▶ Which does not contain particulars which ought to have been there i.e. Suppression of facts which if they had been there i.e suppression of facts which if they would not have induced the purchaser to invest money.



## **What is an untrue statement?**

According to Section 65(1), if the statement is misleading in the form and context in which it is included; and where the omission from a prospectus of any matter is calculated to mislead, to be a prospectus in which an untrue statement is included.

If there is misrepresentation in the prospectus, a shareholder has a right

- ▶ Against the company
- ▶ Against the directors and others who has authorized the issue of misleading prospectus.

## **Remedies Against The Company:**

Any person who, takes shares from the company may,

- ▶ Rescind the contract to take the shares
- ▶ Claim damages.

He must, however, take action to rescind the contract:

- ▶ within a reasonable time,
- ▶ before proceedings to wind up the company have commenced, and
- ▶ before he does anything which is inconsistent with the right to repudiate, e.g., to accept dividends.

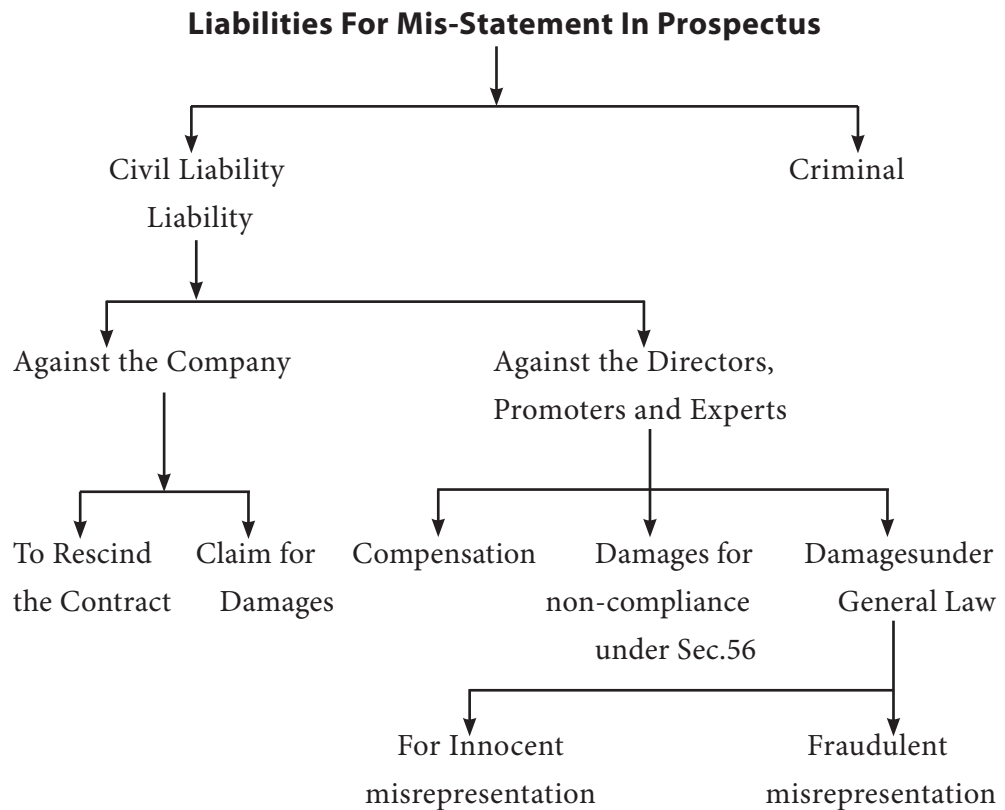
## **Remedies Against Directors Or Promoters:**

A shareholder who had been induced to take shares may claim :

- ▶ Damages for fraudulent misrepresentation
- ▶ Compensation under Section 62;
- ▶ Damages for non-compliance with the requirements of Section 56 regarding contents of the prospectus.

The liability of a promoter or a director or any other person who has authorized the issue of misleading prospectus is two-fold ,viz.,

- Civil liability and
- Criminal liability



**I. Civil Liability** (Section 62):

The following persons shall be liable to pay compensation to every subscriber for loss or damage (1) director of the company at the time of the issue of the prospectus; (2) person who has authorized himself to be named and is named in the prospectus as a director, (3) every promoter of the company; and (4) who has authorized the issue of the prospectus.

**Damages For Fraudulent Misrepresentation:**

An allottee of shares may bring an action for deceit, i.e., fraudulent misrepresentation.

### **Compensation For Untrue Statement [Sec. 62]:**

File a suit for compensation under Section 62. A claim can be made, whether the statements are fraudulent or innocent.

### **Remedies Against Experts:**

The allottee of the shares is entitled to claim from the expert: (i) damages, (ii) compensation under Section 62.

### **Liability Under Section 56:**

An omission from a prospectus of a matter required to be stated under Section 56(i.e., as per Sch. II) may give rise to an action for damages at the instance of a subscriber for shares, who has suffered loss.

## **II. Criminal Liability For Misstatement In Prospectus**

(Section 63):

Every person authorizing its issue is punishable:

- i. With imprisonment for a term up to two years, or
- ii. Fine up to Rs. 50,000, or
- iii. With both imprisonment and fine.

### **Liability Under Section 68:**

Every person authorizing its issue. Shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to Rs. 1,00,000 or with both.

### **Golden Rule For Framing Of Prospectus :**

The 'Golden Rule' for framing of a prospectus was laid down by Justice Kindersely in *New Brunswick & Canada Rly. & Land Co. V. Muggeridge* (1860).

Briefly, the rule is: Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Thus, the persons issuing the prospectus must not include in the prospectus all the relevant particulars specified in Parts I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge which might in any way affect the decision of the prospective investor to invest in the company.

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## Lesson - 4 Share & Share Capital

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Meaning of a Share. Section 2(46) defines a share “as a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied. A share signifies the following:

- ▶ The interest of a shareholder in the company; the right to receive dividend, attend meetings, vote at the meeting and share in the surplus assets of the company, if any, in the event of the company, being wound up ;
- ▶ The liability of the shareholder in the company to pay calls on shares until fully paid up;
- ▶ The right of the shareholder to transfer the shares subject to the articles of association.
- ▶ Binding covenants on the part of the company as well as the shareholder, as given in the Articles of the company.

Thus, a share of a company in the hands of a shareholder signifies a bundle of rights and obligations. A share is not a negotiable instrument.

### **Share Vs. Share Certificate :**

Sec. 82 of the Companies Act. 1956, describes a share as a moveable property transferable in the manner provided by the articles of the company and Sec. 84, on the other hand, describes a ‘share certificate’ to mean a certificate, under the common seal of the company, specifying any shares held by any member.

### **Share Vs. Stock**

#### **Share:**

The share capital of a company is divided into a number of indivisible units of specified amount. Each of such unit is called a ‘share’.

## Stock:

The term 'stock' may be defined as the aggregate of fully paid-up shares of a member merged into one fund of equal value. It is a set of shares put together in a bundle. The 'stock' is expressed in terms of money and not as so many shares. Stock can be divided into fractions of any amount and such fractions may be transferred like shares.

**Distinction:** Following are the main points of difference:

	Share		Stock
1.	A share has a nominal value.	1.	A stock has no nominal value.
2.	A share has a distinctive number which distinguishes it from other shares.	2.	A stock bears no such number.
3.	Share can be issued originally to the public	3.	A company cannot make an original issue of stock. Stock can be issued by existing company by converting its fully paid-up shares.
4.	A share may either be fully paid-up or partly paid-up.	4.	A stock can never be partly paid-up, it is always fully paid-up.
5.	A share cannot be transferred in fractions. It is transferred as a whole.	5.	A stock may be transferred in any fractions.
6.	All the shares are of equal denomination.	6.	Stock may be of different denominations

## Classes Of Shares:

The most common classes of shares are:

- ▶ Preference,
- ▶ Equity or Ordinary, and
- ▶ Deferred or Founders'

## **I . Preference Share:**

A preference share is one which carries the following two rights over holders of equity shares: (i) a preferential right in respect of dividends at a fixed amount or at a fixed rate, and (ii) a preferential right in regard to repayment of capital on winding up.

The preference or priority of the preference shareholders is in relation to the rights of equity shareholders [Section 85].

Participating and Non-participating : If a preference share carries either one or both of the following rights then it is known as participating share:

- ▶ To participate further in the profits either along with or after payment of a certain rate of dividend on equity shares,
- ▶ To participate in the surplus assets at the time of winding up [Section 85].

Thus, if a preference share does not carry either of these rights, then it will be known as non-participating share .

Preference shares are divided into

- A. Cumulative preference share
- B. Non-cumulative preference share
- C. Cumulative convertible preference shares
- D. Redeemable preference share
- E. Irredeemable preference share

### **A. Cumulative preference share**

If a preference share carries the right for payment of arrears in dividend from future profits, then such a share is known as cumulative preference share.

### **B. Non-cumulative Preference share**

If a preference share does not carry the right to dividend in arrears, then such a preference share is known as non-cumulative or simple. The

preference shares are always presumed to be cumulative unless expressly described as non-cumulative.

**C. Cumulative Convertible Preference Shares (ccps):**

Such shares are issued as preference shares but are convertible into equity shares within a period of 3 years to 5 years, as may be decided by the company

**D. Redeemable and Irredeemable :**

Redeemable preference shares are those shares which are to be redeemed by the company either at a fixed date, or after a certain period of time or at the option of the company as per Section 80.

**Conditions:**

Shares issued earlier cannot be converted into redeemable preference shares: There must be authority in the articles. The shares can be redeemed only when they are fully paid up; it will only be redeemed: (a) out of profits of the company which would otherwise be available for dividend, or (b) out of the proceeds of a new issue of shares.

If there is a premium payable on redemption, it must have been provided out of profits or out of the securities premium account before the shares are redeemed. Where the shares are redeemed out of profits, a sum equal to the nominal amount of the shares redeemed is to be transferred out of profits to the “Capital Redemption Reserve Account.”

**Voting Rights Of Preference Shareholders:**

The preference shareholders will vote only on matters directly relating to preference shares;

- ▶ Any resolution for winding up of the company,
- ▶ Any resolution for the reduction or repayment of share capital,
- ▶ Any resolution at any meeting, if dividend on cumulative preference shares remains unpaid for at least two years



## **II. Equity Share:**

‘Equity share’ means a share which is not a preference share [Section 85]. The rate of dividend is not fixed. The Board of Directors recommend the rate of dividend which is then declared by the members at the Annual General Meeting. New issues of share capital of a company limited by shares shall be of two kinds only, namely:- (a) equity share capital: (i) with voting rights, or (ii) With differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed and (b) Preference share capital.

Prior to the Amendment to the Companies Act in 2000, public companies were not allowed to issue equity shares with differential rights. Thus, companies are now allowed to issue non-voting equity shares. The holders of equity shares carrying voting rights shall have voting rights in proportion to the paid-up equity capital of the company [Section 87(1)].

### **iii. Deferred Or Founders’ Shares:**

A pure private company can issue shares of a type other than those discussed above [Section 90]. Thus, it may issue what are known as deferred shares. As deferred shares are normally held by promoters and directors of the company, they are usually called founders’ shares. They are usually of a smaller denomination, say one rupee each.

## **Issue Of Shares At Par, At Premium And At Discount**

A company may issue shares at par, or at a premium, or at a discount.

### **Issue At Par:**

Shares are deemed to have been issued at par when subscribers are required to pay only the amount equivalent to the nominal or face value of the shares issued.

### **Par Value Of Shares:**

‘Par value’ is the notional face value of the shares which a company issues to its investors.

**Issue At A Premium:**

If the buyer is required to pay more than the face value of the share, then the share is said to be issued or sold at a premium. The premium cannot be treated as profit and, therefore, cannot be distributed as dividend. The amount of premium received in cash and the equivalent of it received in kind must be kept in a separate bank account known as the 'Securities Premium Account'. As per SEBI guidelines, 2000 every company entitled to make a public issue can offer its shares at par or premium.

**Issue At A Discount:**

If the buyer of shares is required to pay less than the face value of the share, then the share is said to be issued or sold at a discount. Certain conditions subject to which shares can be issued at a discount:

It is authorized by a resolution, that is,

- ▶ The issue must be of a class of shares already issued
- ▶ The maximum rate of discount must not exceed 10 per cent
- ▶ Not less than one year has, at the date of issue, elapsed since the date on which the company was entitled to commence business.
- ▶ Issued within two months of the sanction by the Company Law Board.
- ▶ Every prospectus must mention particulars of the discount allowed on the issue of shares.

**Issue Of Sweat Equity Shares [Sec. 79A]:**

'Sweat-equity shares' means equity shares issued by the company to employees or directors at a discount or for consideration other than cash. 'Sweat equity shares' may be issued for providing know-how or making available intellectual property rights (say, patents) or value additions, by whatever name called. Conditions: (a) Must be of a class of shares already issued. (b) Authorised by a special resolution (c) The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued. (d) Not less than one year has, at the date of the issue, elapsed since the date on which the company was entitled to commence business;

(e) they should issued in accordance with the regulations made by the Securities and Exchange Board of India.

### **Bonus Shares:**

A company may, if the articles so provide, capitalize profits by issuing fully paid-up shares to the members, thereby transferring the sums capitalized from the profit and loss account or reserve account to the share capital [Section 205(3)]. Such shares are known as bonus shares and are issued to the existing members of the company free of charge. The issue of bonus shares is regulated not only by the Companies Act, 1956 but also by the guidelines issued by SEBI in this regard.

### **Right Shares:**

The existing members of the company have a right to be offered shares, when the company wants to increase its subscribed capital. Such shares are known as “right shares” but they are not issued free of charge.

### **Share Captial**

**Meaning of share capital:** It means the capital of a company, or the figure in terms of so many rupees divided into shares of a fixed amount, or the money raised by the issue of shares by a company.

### **Nominal, Authorised Or Registered Capital:**

This is the sum stated in the Memorandum as the share capital of a company with which it is proposed to be registered. This is the maximum amount of capital which it is authorised to raise by issuing shares, and upon which it pays stamp duty.

### **Issued Capital:**

It is the part of the authorized capital which the company has issued for subscription. The amount of issued capital is either equal to or less than the authorized capital.

**Subscribed Capital:**

It is that portion of the issued capital which has been subscribed for the purchasers of the company's shares. The amount of subscribed capital is either equal to or less than the issued capital.

**Called-Up Capital:**

The company may not call up full amount of the face value of the shares. Thus the called-up capital represents the total amount called-up on the shares subscribed. The total amount of called-up capital can be either equal to or less than the subscribed capital.

**Uncalled Capital:**

Represents the total amount not called up on shares subscribed, and the shareholders continue to be liable to pay the amounts as and when called. The company may reserve all or part of the uncalled capital, which can then be called in the event of the company being wound up. It is known as **Reserve Capital** or Reserve Liability [ Section 99].

**Paid-Up Capital:**

Paid-up capital is the amount of money paid-up on the shares subscribed.

**Alteration Of Share Capital:**

Section 94 provides that, if the articles authorise a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its Memorandum in regard to capital to;

- ▶ Increase of authorised share capital : A company limited by shares if the articles authorise, can increase its authorised share capital by passing an ordinary resolution.
- ▶ Consolidate and sub-divide shares : Consolidation is the process of combining shares of smaller denomination, Sub-division of shares is just the opposite of consolidation.

- ▶ Convert shares into stock and vice versa : Stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.
- ▶ Diminish share capital : Section 94 provides that a company may cancel shares and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital.
- ▶ Reduce capital : (i) by reducing or extinguishing the liability of members for uncalled capital. (ii) by paying off returning capital which is in excess of the wants of the company, (iii) pay off paid-up capital on the understanding that it may be called up again. (iv) a combination of the preceding methods. (v) Write off or cancel capital which has been lost or is not represented by available assets.

### **Reduction Of Share Capital Without The Sanction Of The Court:**

There are some cases in which there is reduction of share capital and no confirmation by the court is necessary. These are:

- ▶ Forfeiture of shares.
- ▶ Surrender of shares
- ▶ Diminution of capital
- ▶ Redemption of redeemable preference shares.
- ▶ Purchase of shares of a member by the company under section 402.
- ▶ Purchase of its own shares as per section 77A

### **Raising Of Capital / Issue Of Shares**

Issue of shares may be made in 3 ways:

1. By private placement of shares;
2. By allotting entire shares to an issue-house, which in turn, offers the shares for sale to the public; and
3. By inviting the public to subscribe for shares in the company through a prospectus.

**Private Placement Of Shares:**

Shares are issued privately to a small number of persons known to the promoters or related to them by family connections.

**By An Offer For Sale:**

The Issue-house publishes a document called an offer for sale, with an application form attached, offering to the public shares or debentures for sale at a price higher than what is paid by it or at par. This document is deemed to be a prospectus [Section 64(1)].

**By Inviting Public Through Prospectus:**

The company invites offers from members of the public to subscribe for the shares or debentures through prospectus.

**Issue Of Shares To Existing Shareholders:**

The capital is also raised by 'issue of rights shares' to the existing shareholders (Sec.81). In the case, the shares are allotted to the existing equity shareholders in proportion to their original shareholding.

**Public Issue Of Shares:**

Public issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.

Allotment of Shares: It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons.

**Share Certificate (Section 113):**

The share certificate states the name, address, occupation of the holder together with the number of shares and their distinctive number and amount paid-up. It must bear the common seal of the company, must be stamped and bear the signature of one or more directors.

### **Share Warrants (Section 114):**

A share warrant is a negotiable instrument. It entitles the bearer to the shares specified in it and he can transfer the ownership of shares by merely delivering the share warrant to the transferee.

### **Membership:**

Membership can be in the following ways:

- The subscribers of the Memorandum
- Every other person who agrees in writing to become a member
- Every person holding equity share capital of a company

### **Member And Shareholder:**

In the case of an unlimited company or a company limited by guarantee, a member may not be a shareholder.

### **Modes Of Acquiring Membership:**

By subscribing to the Memorandum of association..

- By agreement and registration.
- By agreeing to purchase qualification shares.

### **Calls On Shares:**

The company may ask for some payment at the time of application for shares (but money not less than 5 per cent of the nominal value) and another sum at allotment. The balance may be payable as and when called for.

### **Forfeiture Of Shares:**

Forfeiture of shares means taking them away from the member. This is absolutely a serious step for not only does it deprive the shareholder of his property but also, unless the shares are re-issued, it involves a reduction of capital.

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## Lesson - 5 Debentures

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According to Sec. 2(12), 'debenture' includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.

### Characteristic features of a debenture:

- ▶ Debentures is issued by a company and is usually in the form of a certificate which is an acknowledgement of indebtedness.
- ▶ It is issued under the company's seal.
- ▶ It is one of a series issued to a number of lenders. (
- ▶ It usually specifies a particular period or date as the date of repayment.
- ▶ It generally creates a charge on the undertaking of the company or some parts of its property.
- ▶ A debenture-holder does not have any right to vote in the company meetings.

### Classes Of Debentures

Debentures may be classified according to the following characteristics, viz.,

- ▶ Negotiability,
- ▶ Security,
- ▶ Permanence,
- ▶ Convertibility, and
- ▶ Priority.

1. Classification based on negotiability:

- (1) Bearer debentures and (2) Registered debentures.

2. Classification based on security:

- (1) Secured debentures and (2) Unsecured or naked debentures.

3. Classification based on permanence:

- (1) Redeemable debentures and (2) Irredeemable or perpetual debentures

4. Classification based on convertibility:

- (1) Convertible debentures and (2) Non-convertible debentures.

5. Classification based on priority:

- (1) First debentures and (2) Second debentures.

**Debentures with voting rights not to be issued** (Sec. 117): A company cannot issue any debentures carrying voting rights.

**Issue of debentures at a discount:** Debentures can be issued at a discount, unless the Articles provide otherwise.

**Debentures and debenture stock:** The difference between debentures and debenture stock is the same as the difference between shares and stock.

**Debenture trust deed:** [New Sec. 117-A as inserted by the Companies (Amendment) Act, 2000], A trust deed for securing any issue of debentures shall be in specified form and shall be executed within the prescribed period.

**Appointment of debenture trustees and duties of debenture trustees** [Sec. 117-B]: A person shall not be appointed as a debenture trustee, if he –  
(a) Beneficially holds shares in the company  
(b) is beneficially entitled to moneys which are to be paid by the company to the debenture trustee  
(c) has entered into any guarantee in respect of principal debts secured by the debentures or interest thereon.

**Liability of company to create security and debenture redemption reserve** [New Sec. 117-C as inserted by the Companies (Amendment) Act, 2000]: Creation of debenture redemption reserve: Where a company issues debentures after the commencement of this Act, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, from out of its profits every year until such debentures are redeemed.

**Liability of trustees for debenture-holders** (Sec.119): A trustee is liable for any breach of trust where he fails to show the degree of care and diligence required of him as trustee, having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions.

### **Remedies Of Debenture Holders**

- He may sue for his principal and interest.
- He may, petition under Sec. 439 for the winding up of the company by the Court. But in addition he has also the following courses open to him:
  - Debenture-holders' action.
  - Appointment of receiver.
  - Foreclosure.
  - Sale.
  - Proof for the balance.

## **Creation Of Charges:**

A company like any other person can, when it borrows money, give its creditors security. Often it mortgages or charges its property to its debenture-holders.

## **Fixed And Floating Charges:**

### **Fixed charge:**

A fixed or specific charge is one which is created on some specific and definite assets of the company, e.g., a charge on land and building.

### **Floating charge:**

A floating charge is an equitable charge which is created on some class of property which is constantly changing, e.g., a charge on stock-in-trade, trade debtors, etc.

### **New financial instruments:**

Issuer of capital shall make instruments such as Deep Discount Bonds, Debentures with Warrants, Secured Premium Notes etc., so that an investor can make reasonable determination of the risks, returns, safety and liquidity of the instruments.

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## Lesson - 6 Company Management & Remuneration

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### **Directors:**

A company in the eyes of the law is an artificial person. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board.

### **Definition Of Director:**

The Companies Act defines a 'director' as "any person occupying the position of a director by whatever name called" [Sec.2(13)]. This is however, an inadequate definition.

### **Only Individuals Can Be Directors (Sec. 253):**

No body corporate, association or firm can be appointed as director of a company.

### **Number Of Directors: Minimum Number (Sec.252):**

Every public company (other than a deemed public company) shall have at least 3 directors and every other company (e.g., a private company, a deemed public company) at least 2 directors.

### **Share Qualification of Directors**

The Articles of a company usually require its directors to hold a certain number of shares. Such shares are called qualification shares. The nominal value of the qualification shares should not exceed Rs.5,000. He should obtain his qualification shares within 2 months after his appointment as director.

### **Appointment Of Directors**

#### **1. First Directors (Sec. 254 and Clause 64 of Table A)**

- ▶ The Articles of a company usually name the first directors by their respective names or prescribe the method of appointing them.
- ▶ If the first directors are not named in the Articles, the number of directors and the name of the directors shall be determined in writing by the subscribers of the Memorandum or a majority of them (Clause 64 of Table A).

- ▶ If the first directors are not appointed in the above manner, the subscribers of the Memorandum who are individuals become directors of the company.

## **2. Appointment of directors by the company** (Secs. 255 to 257, 263 and 264)

Directors must be appointed by shareholders in general meeting. At least 2/3rds of the total number of directors shall be liable to retire by rotation. Such directors are called rotation directors.

Appointment of a new director (Sec. 257): (1) Fourteen days' notice and deposit of Rs.500. (2) Consent in writing to act as director (Sec. 264). (3) Separate ordinary resolution for each appointment (Sec. 263).

Retirement of directors where annual general meeting is not held: A director who is to retire by rotation at the annual general meeting shall not continue in office after the last day on which the annual general meeting in each year should have been held.

## **3. Appointment of director by directors** (Secs. 260, 262 and 313)

The directors of a company may appoint directors: (1) As additional directors (Sec. 260), (2) In a casual vacancy (Sec. 262) and (3) As alternate director (Sec. 313).

## **4. Appointment of directors by third parties:**

The number of directors so appointed shall not exceed 1/3rd of the total number of directors, and they are not liable to retire by rotation.

## **5. Appointment by proportional representation** (Sec. 265):

The system of proportional representation ensures representation of the minority shareholders on the Board of Directors.

## **6. Appointment of directors by the Central Government** (Sec. 408):

Any director appointed by the Central Government shall not be required to hold any qualification shares.

## **Roles of a Director:**

### **Directors As Agents:**

A company, as an artificial person, acts through directors who are elected representatives of the shareholders.

### **Directors As Employees:**

Although the directors of a company are its agents, they are not employees or servants of the company for being entitled to privileges and benefits which are granted under the Companies Act to the employees.

### **Directors As Officers:**

For certain matters under the Companies Act, the directors are treated as officers of the company [sec.2 (30)].

### **Directors As Trustees:**

Directors are treated as trustees

- ▶ Of the Company's money and property;
- ▶ And of the powers entrusted to them.

### **Qualifications And Disqualifications Of Directors**

A director must

- ▶ be an individual,
- ▶ be competent to contract, and
- ▶ hold a share qualification, if so required by the Articles.

### **Disqualification Of Directors (Sec. 274)**

The following persons are disqualified for appointment as directors of a company:

1. A person of unsound mind.
2. An undischarged insolvent.
3. A person who has applied to be adjudicated as an insolvent and his application is pending.
4. A person who has been convicted by a court of any offence involving moral turpitude and a period of 5 years has not elapsed from the date of expiry of the sentence.
5. A person whose calls in respect of shares of the company held for more than 6 months have been in arrear.
6. A person who is disqualified for appointment as director by an order of the court under Sec. 203.
7. Such person is already a director of a public company which
  - i. Has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or

- ii. Has filed to repay its deposit or interest thereon on due or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

## **Managerial Remuneration**

### **Managerial Personnel:**

The expression 'managerial personnel' refers to the (a) managing director. (b) Whole-time / part-time directors, or (c) Manager.

### **Overall Maximum Managerial Remuneration (Sec. 198):**

Remuneration not to exceed 11 per cent: The total managerial remuneration of the directors and the manager in respect of any financial year shall not exceed 11 per cent of the net profit of the company for that financial year computed in the manner laid down in Sec. 349 and 350.

### **Meetings Of Directors (Sec. 285 To 288)**

- ▶ Number of meetings – once in every 3 months (Sec. 285).
- ▶ Notice of meetings (Sec. 286): Every officer of the company whose duty is to give notice and who fails to do so shall be punishable with fine which may extend to Rs.1,000.
- ▶ Quorum for meetings (Sec.287): The quorum shall be 1/3rd of its strength or 2 directors, whichever is higher.

### **Powers Of Directors**

#### **General Powers Of The Board (Sec. 291):**

The Board of directors of company is entitled to exercise all such powers and to do all such acts and things as the company is authorized to exercise and do.

#### **Powers To Be Exercised At Board Meetings (Sec. 292):**

The following powers, on behalf of the company,

- ▶ To make calls on shareholders in respect of money unpaid on their shares
- ▶ the power to authorise the buy-back of shares
- ▶ to issue debentures
- ▶ to borrow moneys otherwise than on debentures
- ▶ to invest the funds of the company; and make loans.



**Other powers:** These powers are:

- To fill vacancies in the Board (Sec. 262)
- To sanction or give consent for certain contracts in which particular directors, their relatives and firms are interested (Sec. 297)
- To receive notice of disclosure of directors' interest in any contract or arrangement with the company (Sec. 299)
- To receive notice of disclosure of shareholdings of directors (Sec. 308)
- To appoint as managing director or manager a person who has already been the managing director or manager of another company (Secs. 316 and 386)
- To make investments in companies in the same group (Sec. 372).

**Exceptions:**

- Directors acting malafide.
- Directors themselves wrong-doers.
- Incompetency of Board.
- Deadlock in management.
- Residuary powers. I.e., powers not expressly conferred on the directors or shareholders, in a general meeting.

**Powers to be exercised with the approval of company in general meeting** (Sec. 293):

- To sell, lease or otherwise dispose of.
- To remit or give time for repayment of any debt.
- To invest (excluding trust securities) the amount of compensation received.
- To borrow moneys where the moneys to be borrowed (together with the moneys already borrowed by the company) are more than the paid-up capital.
- To contribute to charitable and other funds not directly relating to the business.

**Audit Committee** [Sec. 292-A as introduced by the Companies (Amendment) Act, 2000]:

The Audit Committee shall act in accordance with terms of reference to be specified in writing by the Board.

## **Duties Of Directors**

1. Fiduciary duties and 2. Duties of care, skill and diligence.

1. Fiduciary Duties: As fiduciaries, the directors must

- i. Exercise their powers honestly and bona fide for the benefit of the company as a whole and
  - ii. Not place themselves in a position in which there is a conflict between their duties to the company and their personal interests.
2. Duties of care, skill and diligence: Directors should carry out their duties with reasonable care and exercise such degree of skill and diligence as is reasonably expected of persons of their knowledge and status.

### **Other Duties Of Directors:**

The other duties of a director are

- To attend board meetings,
- Not to delegate his functions except to the extent authorized by the Act or the constitution of the company, and
- To disclose his interest.

### **Liabilities Of Directors**

**1.Liability to third parties:** (1) Material misrepresentations. (2) Independently of the Act: Directors, as agents of a company, are not personally liable on contracts entered into an agents on behalf of the company. (3) Liability for acts ultra vires the company: Where a director enters into a contract, which is ultra vires the company, the director is personally liable for breach of implied warranty of authority. (4)Liability for frauds and torts.

### **2.Liability to the company**

The liability of directors towards the company may arise from

- Ultra vires acts,
- Negligence,
- Breach of trust, and
- Miffeasance.

### **Vacation Of Office, Removal And Resignation Of Directors**

**Vacation of office by directors (Sec. 283):**

- (1) Statutory Vacation.
- (2)Additional grounds in case of private companies.
- (3) Acceptance of officer of profit.

## Removal Of Directors

Directors may be removed by:

- (1) the shareholders,
- (2) the Central Government,
- (3) the Company Law Board.

### (1) Removal by Share holders:

In certain circumstances, the shareholders may remove the directors.

### (2) Removal by Central Government: (Secs. 388-B to 388-E):

The Central Government may, in certain circumstances, remove managerial personnel from office on the recommendation of the Company Law Board.

### (3) Removal by Company Law Board (Sec. 402):

Where, on an application to the Company Law Board for prevention of oppression (under Sec. 397) or mismanagement (under Sec. 398).

## Resignation Of Directors:

There is no provision in the Companies Act, 1956 relating to the resignation of office of a director. Overall maximum managerial remuneration:

The total managerial remuneration to the managing / whole-time directors and / or manager of a public company or a private company which is a subsidiary of a public company in respect of any financial year must not exceed 11 per cent of the net profits of the company for that financial year. The percentage aforesaid shall be exclusive of any fees payable to directors for attending meetings of the Board of Directors or any committee thereof.

## Removal Of Directors

Directors may be removed by

### 1. Shareholders (Sec.284)

The shareholders may, by passing an ordinary resolution at their general meeting, remove a director before the expiry of his period of office.

### 2. Central Government (Secs.388-B to 388-E)

The Central Government may exercise this power where in its opinion there are circumstances suggesting –

- ▶ That the director concerned in the conduct and management of the affairs of the company is or has been guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust; or

- ▶ That the business of the company is not or has not been conducted and managed by the director in accordance with sound business principles or prudent commercial practices; or
- ▶ That the company is or has been conducted and managed by the director in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or
- ▶ That the business of the company is or has been conducted and managed by the director with intent to defraud its creditors, members or any other person or against public interest.

### **3. Company Law Board (Sec.402)**

Where, on an application to the Company Law Board for prevention of oppression or mis-management, the Company Law Board finds that the relief ought to be granted, it may by an order provide for the termination, setting aside or modification of any agreement between the company and the director. When the appointment of a director is so terminated or set aside he cannot sue the company for damages or compensation for loss of office.

### **Other Managerial Personnel**

#### **Managing Director:**

The term ‘managing director’ includes a director occupying the position of a managing director, by whatever name called.

**MANAGER:** ‘Manager’, according to Sec. 2 (24), means an individual who has the management of the whole or substantially the whole of the affairs of a company.

#### **Sole Selling Agents:**

The term ‘sole selling agent’ is not defined in the Act, it means an individual, firm or company who or which is given exclusive rights to sell in a particular area the goods of the company concerned.

#### **Secretary:**

A company secretary means “a person who is a member of the Institute of Company Secretaries of India”. According to Sec. 2 (45) of the Companies Act as amended in 1988 ‘secretary’ means a company secretary within the meaning of Sec. 2 (1) (c) of the Company Secretaries Act, 1980, and includes any individual possessing the prescribed qualifications appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties.

## Distinction Between Managing Director & Manager

Managing Director	Manager
1. A managing director is entrusted with the substantial powers of the management.	1. A manager has the management of the whole, or substantially the whole of the affairs of a company.
2. A company may have two managing directors.	2. A company can have only one manager as he is vested with the management of the whole or substantially of the whole or substantially the whole of the affairs of the company.
3. A managing director must be a director.	3. A manager may or may not be a director.
4. A managing director is appointed by the directors from among themselves and appointed either resolution of the Board or General Meeting.	4. A manager is usually appointed by the Board of Directors.

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## Lesson - 7 Meetings And Resolutions

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### General Meetings Of Shareholders:

#### Kinds Of Company Meetings:

Broadly speaking, company meetings may be classified as follows:

**1.Meetings of Shareholders or Members:** This again may be of four types:

- i. Statutory Meeting
- ii. Annual General Meeting
- iii. Extraordinary General Meeting
- iv. Class Meetings

#### **2.Meetings of Directors**

- i. Meetings of Board of Directors
- ii. Meetings of Committees of Directors
- iii. Meetings of Creditors, Debenture holders and Contributories.

#### **1. Statutory Meeting (Sec. 165):**

Every company limited by shares and every company limited by guarantee and having a share capital shall, within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company. This meeting is called the 'statutory meeting'. This is the first meeting of the shareholders of a public company and is held only once in the lifetime of a company.

#### **Statutory report:**

The Board of Directors shall, at least 21 days before the day on which the meeting is to be held, forward a report, called the 'statutory report', to every member of the company.

**Procedure at the meeting:**

- List of members.
- Discussion of matters relating to formational aspect.
- Adjournment.

**Objects of the meeting and report**

- To put the members of the company in possession of all the important facts relating to the company.
- To provide the members an opportunity of meeting and discussing the management, methods and prospects of the company.
- To approve the modification of the terms of any contract named in the prospectus.

**2. Annual General Meeting (Secs. 166 and 167):**

Company to hold annual general meeting every year (Sec. 166)  
Every company shall in each year hold, in addition to any other meetings, a general meeting as its annual general meeting and shall specify the meeting as such in the notice calling it. There shall not be an interval of more than 15 months between one annual general meeting and the another. But the first annual general meeting should be held within a period of 18 months from the date of its incorporation.

The Registrar may, for any special reason, extend the time for holding any annual general meeting by a period not exceeding 3 months. But no extension of time is granted for holding the first annual general meeting. Every annual general meeting shall be called during business hours on a day that is not a public holiday. It shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated. As regards holding of the annual general meeting, no distinction is made between a public company and a private company.

21 days' notice (Sec.171): A general meeting of a company may be called by giving not less than 21 days' notice in writing. Annual general meeting is a statutory requirement: The annual general meeting of a company is a statutory requirement. It has to be called even where the



company did not function during the year. Canceling or postponing of convened meeting: Where an annual general meeting is convened for a particular date and notice is issued to the members, the Board of Directors can cancel or postpone the holding of the meeting on that date provided power is exercised for bona fide and proper reasons.

Canceling of failure to hold annual general meeting: If a company fails to hold an annual general meeting;

- ▶ Any member can apply, under Sec. 167, to the Company Law Board for calling the meeting.
- ▶ The company and every officer who is in default shall be punishable with fine.

**Powers Of Company Law Board To Call Annual General Meeting (Sec. 167):**

If default is made by a company in holding an annual general meeting in accordance with Sec. 166, any member of the company may apply to the Company Law Board for calling such a meeting.

**Penalty For Default (Sec. 168):**

If default is made by a company in holding a meeting in accordance with Sec. 166 or in complying with any direction of the Company Law Board in calling a meeting under Sec. 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 2,500 for every day after the first during which such default continues.

**3. Extraordinary General Meeting (Sec. 169):**

A statutory meeting and an annual general meeting of a company are called ordinary meetings. Any meeting other than these meetings is called an extraordinary general meeting. It is called for transacting some urgent or special business which cannot be postponed till the next annual general meeting. It may be convened. (1) by the Board of Directors on its own or on the requisition of the members; or (2) by the requisitionists themselves on the failure of the Board of directors to call the meeting.

### **(1) Extraordinary meeting convened by the Board of Directors.**

The Board of Directors may call an extraordinary general meeting:

- **on its own.**
- **on requisition of the members.**

### **(2) Extraordinary meeting convened by the requisition.**

**Power of Company Law Board to order meeting (Sec. 186):** If for any reason, it is impracticable for a company to call, hold or conduct an extraordinary general meeting, the Company Law Board may call an extraordinary meeting.

## **II. Class Meetings:**

Under the Companies Act, class meetings of various kinds of shareholders and creditors are required to be held under different circumstances. Under Sec. 106, class meetings of the holders of different classes of shares are to be held, if the rights attaching to these shares are to be varied.

### **Requisites Of A Valid Meeting:**

A meeting can validly transact any business, if the following requirements are satisfied:

1. The meeting must be duly convened by a proper authority.
2. A proper notice must be served in the prescribed manner.
3. A quorum must be present.
4. A chairman must preside.
5. Minutes of the proceedings must be kept by Proper Authority .

### **1. Proper Authority To Convene Meeting**

A meeting must be convened or called by a proper authority. Otherwise it will not be a valid meeting. The proper authority to convene general meetings of a company is the Board of Directors. The decision to convene a general meeting and issue notice for the same must be taken by a resolution passed at a validly held board meeting.

## **2. Notice Of Meetings**

A meeting in order to be valid, must be convened by a proper notice issued by the proper authority. It means that the notice convening the meeting be properly drafted according to the Act and the rules, and must be served on all members who are entitled to attend and vote at the meeting.

### **Length Of Notice:**

For general meeting of any kind at least 21 days notice must be given to members. A shorter notice for Annual General Meeting will be valid, if all members entitled to vote giving their consent.

The number of days in each case shall be **clear days**, i.e. The days must be calculated excluding the day on which the notice is issued, a day or so for postal transit, and the day on which the meeting is to be held.

### **Contents Of Notice:**

Every notice of meeting of a company must specify the place, the day and hour of the meeting, and shall contain a statement of the business to be transacted thereat.

- ▶ **Place of Meeting:** Every annual general meeting of a company must be held either at the registered office of the company or at some other place within the same city, town or village in which the registered office of the company is situated.
- ▶ **Day of Meeting:** Every annual general meeting of a company must be held on a day that is not a public holiday.
- ▶ **Time of the Meeting:** Every annual general meeting shall be called for a time during the business hours of the company.

## **3. Quorum**

Quorum is the minimum number of members who must be present at a meeting as required by the rules. Any business transacted at a meeting without a quorum is invalid. The main purpose of having a quorum is to avoid decisions being taken at a meeting by a small minority which may be found to be unacceptable to the vast majority of members.

The number constituting a quorum at any company meeting is usually laid down in the Articles of Association. In the absence of any provision in the Articles, the provisions as to quorum laid down in the Companies Act, 1956 (under Sec.174) will apply. The Articles may provide for a larger quorum, but it cannot provide for a smaller quorum than that laid down in the Act. Sec.174 of Companies Act provides that the quorum for general meetings of shareholders shall be *five members* personally present in case of a public company; and two *members* personally present for any other company.

### **Agenda**

The word 'agenda' literally means 'things to be done'. It refers to the programme of business to be transacted at a meeting. Agenda is essential for the systematic transaction of the business of a meeting in the proper order of importance. It is customary for all organisations to send an agenda along with the notice of a meeting to all members. The business of the meeting must be conducted in the same order in which the items are placed in the agenda and the order can be varied only with the consent of the meeting.

### **Proxy**

The term 'proxy' is used to refer to the person who is nominated by a shareholder to represent him at a general meeting of the company. It also refers to the instrument through which such a nominee is named and authorised to attend the meeting.

## **4. Chairman Of A Meeting**

'Chairman' is the person who has been designated or elected to preside over and conduct the proceedings of a meeting. He is the chief authority in the conduct and control of the meeting.

A chairman is usually a member of the body over which he is to preside. He may be either appointed or designated before hand as chairman by the rules or elected at the meeting itself according to rules. In the case of a company, the Articles usually designate the Chairman of the Board of Directors to preside over the general meetings of the company. Where the

rules do not designate a chairman or the designated chairman is absent at the commencement of the meeting, the meeting itself elects a *pro tem* (temporary) chairman to preside over the meeting.

### **Powers And Duties Of The Chairman**

#### **Powers:**

1. To maintain order and decorum.
2. To decide points of order.
3. To decide priority of speakers.
4. To maintain relevancy and order in debate.
5. To adjourn a meeting.
6. To exercise a casting vote.
7. To ascertain the sense of a meeting and declare the result of voting.

#### **Duties:**

1. To see that the meeting is properly convened and duly constituted.
2. To see that the proceedings of the meeting are conducted according to rules.
3. To see that no discussion is allowed unless there is a specific motion.
4. To maintain order and decorum in the meeting.
5. To see that all members, including the minority, get equal opportunity to express their views.
6. To see that the sense of the meeting is properly ascertained on each and every motion.
7. He should see that the poll is taken properly according to the provisions of the Act.
8. He must exercise his casting vote bona fide in the interest of the company.
9. He must exercise correctly his power of adjournment

## **5.Minutes Of The Board Meeting**

Every company is required to have the minutes of all board meetings. The pages of the minutes book must be consecutively numbered and each page must be signed and the last page of the book must be signed by the Chairman of the meeting.

### **Resolution & Motion:**

#### **Motion**

A 'motion' is a definite proposal put before a meeting for its consideration and adoption.

#### **Resolution**

A 'resolution' on the other hand is the formal expression of the decision of a meeting. When a motion has been duly voted upon and passed by a majority, with or without amendment, it is called a 'resolution'.

A resolution once adopted and recorded in the minutes becomes the official decision of the meeting and cannot be rescinded or revoked except by the consent of two-thirds majority in a meeting specially called for the purpose.

### **Kinds Of Resolutions:**

There are three kinds of resolutions under the Companies Act, 1956. They are:

1. Ordinary resolutions;
2. Special resolutions; and
3. Resolutions requiring special notice.

#### **1. Ordinary resolution [(Sec. 189 (1))]:**

An ordinary resolution is a resolution passed at a general meeting of a company by a simple majority of votes (i.e., votes cast in favour of the resolution exceed votes cast against it) including the casting vote of the chairman, if any).

When is an ordinary resolution required? Ordinary resolution is necessary for the following among other purposes:

- a. Rectification of name or adoption of new name by a company where it resembles the name of an existing company with the previous approval of the Central Government [Sec. 22 (1) (a)].
- b. Issue of shares at a discount [Sec. 79 (2)]
- c. Alteration of share capital [Sec. 94 (2)].
- d. Re-issue of redeemed debentures (Sec.121).
- e. Adoption of statutory report (Sec. 165).
- f. Passing of annual accounts and balance sheet, along with reports of Board of Directors and Auditors (Sec. 210).
- g. Appointment of auditors and fixation of their remuneration [Sec. 224 (1)].
- h. Appointment of first directors who are liable to retire by rotation [Sec. 255 (1)].
- i. Increase or reduction in the number of directors within the limit fixed by the Articles (Sec. 258).
- j. Appointment of managing / whole-time director (Sec. 269).
- k. Removal of a director and appointment of a new director in his place [Sec. 284(1)].
- l. Approval of appointment of sole-selling agents (Sec. 294).
- m. Winding up a company voluntarily in certain events [Sec. 484 (1) (a)].
- n. Appointment and fixation of remuneration of liquidators in a members voluntary winding up [Sec. 490 (1)].
- o. Nomination of a liquidator in a creditors' voluntary winding up [Sec. 502 (1)].

## **2. Special resolution [Sec. 189 (2)]:**

A special resolution is one which satisfies the following conditions:

- a. The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting.
- b. The notice has been duly given of the general meeting.
- c. The votes cast in favour of the resolution by members entitled to vote are not less than 3 times the number of votes cast against the resolution by members so entitled and voting.

- d. An explanatory statement setting out all material facts concerning the subject-matter of the special resolution including, in particular, the nature of the concern or interest of every director and the manager, if any, shall be annexed to the notice of the meeting.

### **When is a special resolution required?**

Special resolution is necessary for the following among other purposes:

- a. Alteration of Memorandum for changing the place of registered office from one state to another with the leave of the Company Law Board [Sec. 17(1) and (2)]. Special resolution is also required for changing the 'objects clause' of the Memorandum.
- b. Changes of name of a company with the consent of the Central Government (Sec. 21).
- c. Omission or addition of the word 'Private' from or to the name of a company (Sec. 21).
- d. Change of name of a charitable or other non-profit company by omitting the word or words 'Limited' or 'Private Limited' [Sec. 25 (3)].
- e. Alteration of the Articles of a company [Sec. 31(1)].
- f. Conversion of any portion of the uncalled capital into reserve capital (Sec. 99).
- g. Reduction of share capital [Sec. 100 (1)].
- h. Variation of shareholder's rights (Sec. 106).
- i. Removal of a company's registered office outside the local limits of any city, town or village [Sec. 146 (2)].
- j. Keeping registers and returns at a place other than the registered office [Sec. 163(1)].
- k. Payment of interest out of capital [Sec. 208 (2) and (3)].
- l. Applying to the Central Government for appointing an Inspector for investigating a company's affairs in some cases [Sec. 237 (a)].
- m. Appointment of sole selling or buying agent in the case of companies having paid-up share capital of Rs. 50 lakhs or more [Sec. 294-AA(3)].



- n. Fixing the remuneration of directors where the Articles require such resolution [Sec. 309 (1)].
- o. Allowing a director to hold an office of profit under a company [Sec. 314(1) (1-B)].
- p. Alteration of Memorandum to render the liability of directors unlimited [Sec.323(1)].
- q. Applying to the court to wind up a company [Sec. 433 (a)].
- r. Winding up a company voluntarily [Sec. 484 (1) (b)].
- s. Authorizing the liquidator of a company to accept shares as consideration for the transfer of its assets [Secs. 494 (1)] and
- t. Disposal of books and papers of a company in voluntary winding up when its 'affairs' have been completely wound up [Sec. 550 (1) (b)].

### **3. Resolutions requiring a special notice (Sec. 190)**

A resolution requiring a special notice is not an independent class of resolutions. It is only a different kind of an ordinary resolution of which notice of the intention to move a resolution has to be given to the company. The notice shall be given not less than 14 days before the meeting at which the resolution is to be served and the day of the meeting.

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## **Lesson - 8 Accounts, Audit And Prevention Of Oppression And Mis Management**

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### **Accounts:**

#### **Books Of Account To Be Kept By Company (Sec. 209):**

The Act requires every company to maintain at its registered office proper books of account with respect to

- ▶ All receipts and disbursements of money and the matters in respect of which the receipts and disbursements take place;
- ▶ All sales and purchases of goods of the company;
- ▶ The assets and liabilities of the company, and
- ▶ In the case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or to other items of cost as may be prescribed by the Central Government in the case of such class of companies. The object of this clause is to make efficiency audit possible.

#### **Inspection Of Books Of Account (Sec. 209-A):**

The books of account and other books and papers shall be open to inspection during business hours (i) by the Registrar; (ii) by such other officer of the Government as may be authorized by the Central Government in this behalf. (iii) by such officers of the Securities and Exchange Board of India as may be authorized by it.

### **Statutory Books:**

In addition to the books of account required to be maintained by a company under Sec. 209, the company is also required to maintain some other books with a view to safeguarding the interest of shareholder. Such books are called statutory books and are as follows:

- ▶ Register of investments not held in company's name (open to inspection of members and debenture-holders) [Sec. 49 (7)].

- Register of charges (open to inspection of all) [Sec.143 (1)].
- Register of members (open to inspection of all) (Sec. 150 (1)).
- Index of members where their number is more than 50 (open to inspection of all) [Sec. 151 (1)].
- Register of debenture-holders (open to inspection of all) [Sec. 152 (1)].
- Index of debenture-holders where their number is more than 50 (open to inspection of all) [Sec. 152 (2)].
- Foreign register (and a duplicate) of members and debenture-holders, if any (open to inspection of all) (Sec. 158).
- Minute books containing minutes of proceedings of general meetings (open to inspection of members) [Sec. 193] (1)].
- Books of account and annual accounts [Secs. 209 (1) 210].
- Register of contracts, and companies and firms in which directors are interested (open to inspection of members) [Sec. 301 (1)].
- Register of directors, managing director, manager and secretary (open to inspection of all) [Sec. 303 (1)].
- Register of directors' shareholding (open to inspection of members and debenture-holders during 14 days before and 3 days after the annual general meeting and to the Registrar and the Central Government) [Sec. 307 (1)].
- Register of loans made, guarantees given or securities provided to companies under the same management (open to inspection of all) [Sec. 370 (1.C)]

### **Statistical Books:**

In addition to statutory books, there are many other books which are required to be maintained for the proper and efficient running of a company. These books are not only found to be desirable but often indispensable in practice. Some of the important statistical or non-statutory books are as follow:

1. Share application and allotment book.
2. Share call book.
3. Register of share warrants.
4. Register of share certificates.
5. Register of share transfers.
6. Register of lost share certificates.
7. Register of balance tickets issued.
8. Register of transfers certified.

9. Agenda book.
10. Register of lists of dividends.
11. Dividend mandates register.
12. Register of debenture interest.
13. Register of documents sealed.
14. Register of powers of attorney.
15. Register of probates.
16. Register of directors' attendance

### **Auditors:**

To safeguard the interest of the shareholders, the Companies Act provides for the employment of an auditor. The auditor is the servant of the shareholders and his duty is to examine the affairs of the company on their behalf at the end of a year and report to them what he has found.

### **Qualifications And Disqualifications Of Auditors (Sec. 226)**

#### **Qualifications** [Sec. 226 (1)]:

A person shall not be qualified for appointment as an auditor of a company, unless he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

#### **Disqualifications** (Sec. 226 (3)):

The following persons, even if they are otherwise qualified, shall be disqualified from being appointed as auditors of a company:

- ▶ A body corporate.
- ▶ An officer or employee of the company.
- ▶ A person who is a partner, or who is in the employment of an officer or employee of the company.
- ▶ A person who is indebted to the company for an amount exceeding Rs. 1,000 or who has given any guarantee of any third person to the company for an amount exceeding Rs. 1,000.
- ▶ A person holding any security of that company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000.

### **Appointment Of Auditors (Secs. 224 And 225):**

Appointment in annual general meeting: Every company shall, at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion.

### **Restriction On The Appointment Of Auditors:**

A company shall not appoint or re-appoint any person who is in full-time employment elsewhere or firm as its auditor if such person or firm is, at the date of such appointment or re-appointment, holding appointment as auditor of more than the specified number of companies.

### **Compulsory Re-Appointment:**

At any general meeting a retiring auditor, by whatsoever authority appointed (Board of Directors, general meeting, annual general meeting or Central Government), shall be re-appointed except in the following cases:

- ▶ If he is not qualified for re-appointment;
- ▶ If he has given notice to the company in writing or his unwillingness to be re-appointed;
- ▶ If a resolution has been passed to the effect appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
- ▶ Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of death, incapacity or disqualification of that person or of all those persons, the resolution cannot be proceeded with [Sec. 224 (2)]

Appointment by the Central Government: Where at an annual general meeting no auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy.

Appointment of auditors by a special resolution: Sec. 224-A puts another restriction that in the case of a company in which not less than 25 per cent of the subscribed share capital is held, whether singly or in any combination, the appointment or re-appointment at each annual general meeting of an auditor or auditors shall be made by a special resolution

First auditors: The first auditors of a company shall be appointed by its Board of Directors within one month of its incorporation.

Subsequent appointment (Sec. 225): At the expiry of the term of an auditor, the members may, in the annual general meeting, appoint another person in his place.

Penalty (Sec. 232): If default is made by a company in complying with any of the provisions of Sec. 225, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 5,000.

Casual vacancy: The Board of Directors may fill any casual vacancy in the office of an auditor.

### **Removal Of Auditors:**

The first auditors of company appointed by the directors prior to the first annual general meeting of the company may be removed by the members in a general meeting even if their tenure of office has not expired.

### **Remuneration Of Auditors:**

The remuneration of the auditors of a company shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

### **Position Of Auditors:**

1.As an agent of the members. 2.As an officer of the company and 3.As an employee of the company

## **Rights And Powers Of Auditors**

1. Right of access to books, accounts and vouchers (Sec. 227).
2. Right to obtain information and explanations (Sec. 227)
3. Right to visit branch offices and right of access to books, etc. (Sec. 228)
4. Where the accounts of any branch office are audited by a person other than the company's auditor, the company auditor shall –
  - a. Be entitled to visit the branch office, if he deems it necessary to do so, for the performance of his duties as auditor; and
  - b. Have a right of access at all times to the books and accounts and vouchers of the company maintained at the branch office.
5. Right to receive notice of general meeting and to attend them (Sec. 231)
6. Right to receive remuneration.

## **Duties Of Auditors:**

- 1.Acquaintance with the Articles and the Companies Act.
- 2.Report to members (Sec. 227).
- 3.Duty of care and caution.

## **Further Duties:**

- 1.Statutory report (Sec. 165)
- 2.Prospectus (Sec. 56).
- 3.Assistance in investigation (Sec. 240).

## **Prevention Of Oppression And Mismanagement**

Special powers have been vested in the Company Law Board for the protection of members against oppression by the majority of shareholders and for intervention in case of mismanagement of a company's affairs. This has been done because the cardinal rule laid down in *Foss v. Harbottle*, that the minority is bound by the decision of the majority, is abused in many cases. Secs. 397 and 409 provide for remedial measures.



If the oppressed minority consider that to wind up the company would not relieve but on the contrary, they would be unfairly prejudiced by winding up, they may petition the court under Sec. 397, and the court may impose a solution on the disputants. A certain number of members (stated below) may apply to the Company Law Board for relief on the grounds that the affairs of the company are being conducted:-

- In a manner oppressive to any member or members, or
- In a manner prejudicial to the interests of the company, or
- In a manner prejudicial to the public interest, or
- That material change has taken place in the management or control of the company and that by reason of, it may pass any orders with a view to bringing an end to the matters complained of, or apprehended.

If the Company Law Board is satisfied that the affairs of the company are being conducted as complained of, it may pass any order with a view to bringing an end to the matter complained of, or apprehended. The number of members necessary to make application is (i) in the case of a company having share capital, 100 members or 10 per cent of the total number of member, whichever is less, or members holding 10 per cent of the issued capital; (ii) in the case of a company not having share capital, 20 per cent of its total number of members. The Central Government is also entitled to apply to the Company Law Board for an order as above.

The Company Law Board may in its discretion make any order that it thinks fit, and in particular, it may provide for: (i) the regulation of the company's affairs in future, and may even frame fresh regulation; (ii) the acquisition of the shares or interests of any members by other members or by the company; (iii) the consequent reduction of the share capital in case of (ii) above; (iv) termination, setting aside or modification of any agreement, howsoever arrived at, between the company and the managing agent, secretaries and treasurers, managing director, any other director, or manager; (v) termination, setting aside or modification of any agreement between the company and any other person with the latter's consent; (vi) setting aside any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within 3 months of the application which would amount to a fraudulent preference in the case of an individual's insolvency; (vii) any other matter for which

in the opinion of the Company Law Board it is just and equitable that provision should be made (Sec. 402). No compensation is payable for loss of office resulting from the termination of agreement by the Company Law Board. Any person whose agreement of office has been terminated cannot act for the company for 5 years thereafter without the leave of the Company Law Board. In addition to the above order, heavy penalties are provided.

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## Lesson - 9 Winding Up

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### Winding Up By Court

A winding up by the court, or compulsory winding up, as it is often called, is initiated by an application by way of petition presented to the Appropriate court for winding up order.

### Grounds For Compulsory Winding Up:

- a. Resolved to be wound up by the court.
- b. If default is made in delivering the statutory report to the registrar or in holding the statutory meeting.
- c. If the company does not commence its business within a year from its incorporation, or suspends its business for a whole year.
- d. If the number of members falls below seven (or in case of a private company, below two).
- e. If the company is unable to pay its debts.
- f. If the court is of opinion that it is just and equitable that the company should be wound up.
- g. Just & Equitable: (a) Main object failed (b) Deadlock in management (c) Cannot carry on business except losses. (d) Mere bubble – and does not carry any business or does not have any property. (e) Majority of shareholder have adapted an aggressive policy towards the minority.

### Who May Petition:

The following persons may file petition: (1) the company; (2) creditor; (3) contributory; (4) all or any of the above parties; (5) the registrar; (6) any person authorized by the Central Government (7) by virtue of Sec. 440, when a company is already being wound up voluntarily, the court may order winding up by it.

### **Voluntary Winding Up:**

A company may be wound up voluntarily: (i) when the period (if any) fixed for its duration has expired or an event on the happening of which the company is to be wound up has happened and the company in general meeting has passed an ordinary resolution to wind up; or (ii) if the company passes a special resolution to wind up voluntarily (Sec. 484). There are two kinds of voluntary winding up, namely: **Member's** or **Creditors'**.

### **Winding Up Under Supervision:**

Where a company is being wound up voluntarily by the court may order the continuation of voluntary winding up subject to its supervision with any terms or conditions. The liquidator will continue to exercise all powers subject to any restrictions laid down by the court.

## **Consequences Of Winding Up**

### **As To Shareholders:**

A shareholder is liable to pay full amount of shares held by him.

### **As To Creditors:**

A secured creditor may either (i) rely on the security and ignore the liquidation, or (ii) value his security and prove for the balance of his debt, or (iii) give up his security and prove for the whole amount. Unsecured creditors of an insolvent company are paid in this order: (i) preferential payment under Sec.530, (ii) other debts pari passu.

### **As To Servants And Officers:**

A winding up order operates as a notice of discharge to the employees and officers of the company except when the business of the company is being continued (Sec. 444). A voluntary winding up also operates as a notice of discharge.

### **As To Proceedings:**

After a winding up petition is presented the court may stay all proceedings against the company.

### **As To Costs:**

If the company, while in liquidation, brings or defends any action and is ordered to pay costs, they are paid first out of the assets of the company.

## **Offences Antecedent To Or In Course Of Winding Up**

### **Offences Of Officers:**

Every past and present officer of a company which is being wound up must assist the liquidator and if he fails to do so he is liable to be punished. He is liable to be imprisoned up to 5 years, or fined or given both punishments.

### **Misfeasance Proceedings:**

In the course of winding up a company it appears that any person who has been guilty of any misfeasance or breach of trust in relation to the company, the court may, examine into the conduct of the person, director, managing agent, secretaries and treasurers, manager, liquidator or officer aforesaid, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the court thinks just, or to contribute such sum to the assets of the company by way of compensation, notwithstanding that offence is one for which the offender may be criminally liable.

## **Liquidators**

### **Compulsory Winding Up:**

The official Liquidator attached to each High Court will become the liquidator on a winding up order being passed.

**Powers Of Liquidator:**

(i) institute or defend any suit, prosecution, or the legal proceeding in the name of the company, (ii) carry on the business of the company for its beneficial winding up, (iii) sell company's property, (iv) raise money on the security of the company's assets, and (v) do all other things necessary for the winding up.

**Duties Of Liquidator:**

Summon meetings of creditors or contributories get in the property and pay the debts and distribute the balance among contributories. Keep the proper books of account, minutes books, and allow inspection thereof. Keep all the funds of the company in "the public account of India" in the Reserve Bank of India.

**Voluntary Liquidator:**

The voluntary liquidator is appointed by resolution in general meeting of the company and or of the creditors and his remuneration fixed. A voluntary liquidator is a paid agent of the company and is liable in damages, if he neglects his duties as such.

**Disclaimer By A Liquidator:**

Section 535(1) empower the liquidator, with the leave of the court to disclaim any onerous property of the company.

**Self Assessment Questions:**

1. What are the characteristics of a company?
2. List out different kinds of company?
3. What is Statement-in-lieu of Prospectus?
4. What is Memorandum of Association? What are its contents?
5. Describe the procedure involved in alteration of Memorandum of Association.
6. What is Articles of Association? What are its contents?
7. What is Prospectus? What are its contents? What are the consequences of mis-statements in prospectus?

8. What is Doctrine of Ultravires? What are the effects of Ultravires transactions?
9. Define share capital. List out the different kinds of shares.
10. What are the different methods of appointment of Directors?
11. What are the powers and duties of Directors?
12. What are the requisites of valid meeting?
13. What is a statutory meeting? What are the contents of statutory report?
14. What is the Annual General Meeting? What are the usual businesses that are transacted in the AGM?
15. What is Extraordinary General Meeting? Who can convene it?
16. What are the different kinds of resolutions?
17. "A company has an identity separate from its members" – Explain the statement critically.
18. What do you mean by Articles of Association? What are the effects of Articles? Can Articles be altered?
19. State the important consequences of Mis-statement in the prospectus.
20. Distinguish between a share and a stock.
21. What is a statutory meeting? What is the nature, scope and extension of business to be transacted at such meeting?
22. Discuss the duties of the Directors and their liabilities to the company and third parties.
23. What are the powers of the court in relation to the prevention of oppression and mis-management?
24. State the grounds on which court can order winding up of a company.
25. What are the characteristic features and classes of debentures?
26. Explain the statutory and statistical books that are to be maintained by a company.

### **Key Words**

- ▶ A **Company** is a business organization. It is an association or collection of individual real persons and/or other companies, who each provide some form of capital.
- ▶ The **Memorandum of Association** of a company, often simply called the memorandum. It is a document that governs the relationship between the company and the outside.

- A **Share** is a single unit of ownership in a corporation, mutual fund, or other organization.
- A **debenture** is a document that either creates a debt or acknowledges it, and it is a debt without collateral.

### **Further Reading**

1. Roger leroy Miller and Gaylord A. Jentz, ***Business Law Today, Standard Edition***, South-Western College/West, 2010.
2. Dawn Bennett-Alexander and Laura Hartman, ***Employment Law for Business***, Irwin/mcgraw-Hill, 2009.

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## Unit - V

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### Objectives:

*On reading this unit you should be able to:*

- ▶ Understand the role of Government in ensuring the safety and welfare of workers;
- ▶ Know the scope and objectives of Factories Act, Industrial Disputes Act, Minimum Wages Act and Workmen Compensation Act; and
- ▶ Analyse the various important provisions that protect the employees and workers through Factories Act, Industrial Disputes Act, Minimum Wages Act and Workmen Compensation Act.

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### Lesson - 1 Factories Act, 1948

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#### Introduction

In common parlance, invariably factory and industry are understood as interchangeable. This is incorrect. The term industry refers to a steady and systematic activity in which a trade is organised, whereas a factory is the place where such activities are being carried on.

The entire day-to-day administration of the factories is governed by the principal Act of 1948 amended Act, which is an improvement of 1934 Act. This Act extends to the whole of India, including Jammu and Kashmir. Unless otherwise provided, it also applies to factories belonging to the Central and State Governments. (Section 116)

The Bhopal tragedy of 1984 has created an awareness among the public for preventing pollution and this has made the government to take steps in amending the present 1948 Act by incorporating Chapter IV A from Sections 41 A to 41 H, pertaining to provisions as regards hazardous processes.

## **Objectives Of The Act**

The objectives of the Factories Act of 1948 is,

- ▶ To improve health, welfare and safety of the workmen.
- ▶ To regulate by imposing restriction as to hours of work including rest and provisions for availing of leave.
- ▶ To make stringent provisions as regards employment of women and young persons and duration of their work.

## **Meaning Of The Term 'Factory'**

Factory means any premises including the precincts therefore –

- ▶ Wherein ten or more workers are working or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
- ▶ Whereon twenty or more workers are working or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

Factory does not include a mine as it is covered by Indian Mines Act, 1952 or a mobile unit belonging to the armed forces of the Union, a railway running shed or a hotel, restaurant or eating place.

To put it in a nutshell, factory means (i) any premises including precincts (ii) where ten or more persons are engaged in manufacturing process with the aid of power or (iii) twenty or more persons are engaged in manufacturing process without the aid of power.

## **Manufacturing Process – Section 2 (K)**

Manufacturing Process means any process for –

- Making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adopting any article or substance with a view to its use, sale, transport, delivery or disposal, or
- Pumping oil, water, sewage or any other substance, or
- Generating, transforming or transmitting power, or

- Composing types for printing, printing by letter press, lithography taking photography and other similar process or book binding;
- Constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; or
- Preserving or storing any article in cold storage [Section 2 (k)].

### **Power [Section 2(G)]**

It means mechanical or electrical energy transmitted as a step or aids to carry out manufacture and not energy generated by human or animal agency. Mere use of power not connected with activities of manufacturing will not make the premises a factory. [New Taj Mahal Hotel vs. Inspector of Factories, (1956) I.L.I.J.273].

Manufacturing process must be done with the aid of power, according to Section 2 (m). Use of power may be incidental or consequential to manufacturing process. According to Section 4, on application by the occupier of a factory, different departments or branches of the factory may be treated as separate factories. Likewise, two or more factories specified by the occupier can also be treated as a single factory by the State government by passing suitable orders.

### **Worker [Section 2(L)]**

Worker means a person employed directly or through any agency (including a contractor) with or without the knowledge of the principal employer, whether for remuneration or not, in any manufacturing process or in cleaning any part of the machinery or premises used for a manufacturing process or in any other kind of work incidental to, or connected within the manufacturing process, or the subject of the manufacturing process but does not include any member of the armed forces of the Union [Section 2 (1)].

In order to term a person as a worker, there must be employer – employee relationship. That is, the employer must not only be in a position to direct what work the employee should do but also how the work has to be done by him.

## **Rights Of Workers (Section 111A Inserted By 1987 Amendment Act)**

A worker shall have the right to (i) obtain from the occupier information relating to workers' health and safety at work; (ii) get trained in the factory or at a training centre or institution when sponsored by the occupier and approved by the Chief Inspector; and (iii) represent to the Inspector, directly or otherwise, the matter of inadequacy of health or safety in the factory.

### **Occupier [Section 2(M)]**

Any person who has ultimate control and management over the affairs of the factory will be deemed to be an occupier.

- ▶ In a partnership firm, the individual partners and in the case of association of individuals, members thereof shall be regarded as occupier.
- ▶ In companies, the directors are regarded to be occupier because they are vicariously liable for the functions of the company.
- ▶ In government owned and controlled factories, the person or persons appointed to manage the affairs of the factory shall be deemed to be the occupier.
- ▶ In the case of partnership firm or association of individuals, and partner or member may be prosecuted. A manager cannot be regarded as an occupier, unless he is entrusted with the control and management of the factory.
- ▶ Owner, lessee or a licensee having control over the factory with regard to its management is deemed to be the occupier [Emperor vs. Ram Pratap, (1896) 20 Bom.423].

### **Licensing And Registration Of Factories [Section 6]**

Under Section 6, the State government may make rules regarding the submission of plans and approval, licensing and registration of factories. The site chosen to locate the factory must have the previous permission in writing of the State government of Chief Inspector of factories. Such permission will be granted to applicant unless he had duly complied with the directions of the government.

Every application must be duly accompanied with a certified plan, showing all the details together with the challan representing the fees payable for such registration, licensing or renewal of licence. If permission is not granted either by the State government or the Chief inspector, within 3 months from the date of submission of such application, permission is presumed to have been granted.

On the refusal of the State government to grant permission, the aggrieved applicant can prefer an appeal within the 30 days from the date of refusal. Every order refusing to grant permission or licence must be a speaking order (a speaking order is an order passed after hearing both the sides and it is passed with reasons stated). Licence or permission cannot be denied merely on the direction by the government without hearing the applicant [Shihabudeen Kunju vs. State of Kerala, (1985) 2L.L.J.106].

Under Section 7, the occupier must give 15 days notice to the State government or Chief Inspector of factories before he begins to occupy or use any premises as a factory. Such notice should contain the following:

- ▶ The name and situation of the factory;
- ▶ The name and address of the occupier;
- ▶ The name and address of the owner of the premises or building (including the precincts thereof);
- ▶ The address to which communications relating to the factory may be sent;
- ▶ The nature of the manufacturing process to be carried on in the factory during the next 12 months;
- ▶ The total rated horse power installed or to be installed in the factory (not including the rated horse power of any separate stand-by plant);
- ▶ The name of the manager of the factory for the purpose of this Act;
- ▶ The number of workers likely to be employed in the factory; and
- ▶ Such other particulars as may be prescribed.

It is essential to intimate by notice the inspector with a copy addressed to the Chief Inspector of the factories, if any new person is appointed as manager in a factory. Even an acting manager or a person without any designation as manager will be deemed to be an occupier, if control and management of the factory is governed by them. In the absence of a

designated person as manager who ever is an occupier is deemed to be an occupier. [Kama Kishore Jhunjhunwala vs. Prescribed Authority, (1976) 32 F.L.R.355].

### **Penalty For Obstructing Inspector (Section 9)**

When a factory inspector is prevented or obstructed from exercising his powers, such person shall be punished with imprisonment for 6 months or fine upto Rs, 10,000 or with both.

### **Certifying Surgeons (Section 10)**

Certifying surgeons are qualified medical practitioners, who are appointed by the State government for specified areas or factories. With the approval of the State government, a certifying surgeon may be authorized and qualified medical practitioners to exercise any of the powers used by him. However, an occupier of a factory or any person who becomes directly or indirectly interested in such factory cannot be appointed as a certifying surgeon. These restrictions could be exempted by the State Government in appropriate cases by passing orders in writing.

### **Health, Safety And Welfare Measures**

By way of implementing the recommendation of the Royal Commission on Labour in India, the present Factories Act, has underlined the importance of health, safety and welfare of the workers. It has made special provisions for health under Sections 11 to 20, for safety under Sections 21 to 40 including Chapter IV A (1987 Amendment Act) and welfare of the workers under Sections 42 to 50.

### **Health (Sections 11 To 20)**

**Cleanliness (Section 11) :** House keeping is the modern term used for keeping the factory premises clean and tidy. Factories must not only be kept clean but must be maintained with cleanliness in such a way that accumulation of dirt and refuse must be avoided. Constant cleaning of effluvia (disagreeable vapours) arising from any drain is needed. Removal of dirt and refuse alone is not enough, but they have to be disposed of in a suitable manner without causing detriment to the residents of the locality.

***Disposal of wastes and effluents (Section 2)*** : Wastes and effluents are to be disposed of in order to maintain the hygiene inside the factory. However, such wastes cannot be let out without treatment. This is because wastes would pollute the surroundings. Norms laid down by the State Pollution Control Board have to be observed strictly in this regard.

***Ventilation and Temperature (Section 13)***: Ventilation and air circulation ensure normal health to the workmen. In order to maintain ventilation and fresh air circulation, temperature in the working place should be secured. For this purpose, the interior walls and roofs of the factory must be properly designed and provided with heat resisting or heatproof materials by way of insulation. Reasonable care should be taken for colour washing interior walls with psychologically pleasing colours such as light green, etc.

***Dust and Fumes (Section 14)*** : Effective measures have to be adopted in order to prevent the workers inhaling dusts, fumes and other impurities that are present (which cannot be seen through naked eye) in the air. Control devices or tools have to be used for the purpose of preventing dust and fumes. Use of exhaust fans is highly recommended in such places.

No stationary internal combustion engine is allowed to be operated unless proper arrangements are made to prevent accumulation of injurious fume are caused thereon. [Gregeon vs. Hick Hargreavaes (1955) All E.R.860].

***Artificial Humidification (Section 15)***: In factories where artificial humidification is adopted from the point of view of manufacturing a product (e.g., in a textile mill), the norms prescribed by the Government must be strictly followed for increasing or decreasing or maintaining such artificial humidification, Humidifiers for keeping air moisture at even level shall be provided.

Water used in these factories must constantly be changed and it must be pure. Otherwise it will give room for water borne diseases among workers.

***Overcrowding (Section16)*** : Every worker requires at least 350 cubic feet (now after the commencement of the Act, 500 cubic feet) for the purpose of enabling him to work with ease and comfort ensuring mobility.

However, while calculating the aggregate space, no account shall be taken of any space, which is more than 14 feet above the level of the floor. The Chief Inspector of Factories, by notice may specify the number of persons to be employed in a room.

**Lighting (Section17) :** Too much light throws glare on normal vision. Diffused light does not help to promote proper vision. Hence, the required light with minimum power must be provided. Glazed windows and sky lights through which rooms are ventilated have to be constantly cleaned from the inner and outer surfaces. Glares and shadows must be avoided from distorting the vision of eye. Otherwise, workmen would strain their eyes leading to risks.

**Drinking water (Section18) :** Potable, pure or wholesome drinking water shall be made available to workmen at convenient points, A notice board must be displayed indicating availability of such facility. The notice shall also contain the caption, 'drinking water' in local language. If the strength of the workers increases beyond 250, cool water equipment must be provided to ensure supply of chilled water. The points at which drinking water is supplied shall legibly marked "Drinking water" in a language understood by a majority of employees. Such water points must be located beyond 6 meters or any washing place, urinals, latrine, spittoon and open drainage, carrying silage or effluent. Shorter distance shall be permitted for locating water points only with the approval of Chief Inspector of Factories.

**Latrines and Urinals (Section 19) :** For a human being, two places are very important and both of them have to be kept clean and tidy. They are – (i) Latrines and urinals; (ii) places where people rest and relax.

Factories where more than 250 workers are ordinarily employed, the latrine and urinal accommodation shall be of the prescribed sanitary type. The floors and internal walls upto a height of 3 feet and above from the floor level should be laid in glazed tiles. If tiles are not provided for, the latrines cannot be kept clean, as the bad water would pass through the pores of latrine walls. Sweepers shall be employed whose primary duty is to keep the latrines and urinals clean and washing places tidy.



**Spittoons (Section 20) :** Spittoons are nothing but pots that are specially provided for, into which, the workers have to spit. Workers cannot spit, as they like, as that would spoil the cleanliness and hygiene of the factory. Sufficient number of spittoons should be provided, taking into account the number of persons employed. A fine of Rs.5 would be imposed on any one who violated the rule.

### **Safety (Sections 21 To 40)**

Safety is prior to security. According to this concept, the present Factories Act ensures several safety measures as sound in Sections 21 to 40, which are enumerated below:

#### **Fencing of Machinery (Section 21)**

In every factory the following namely,

- ▶ Every moving part of a prime mover, and every fly-wheel connected to a prime mover, whether the prime mover or fly-wheel is in the engine house or not;
- ▶ The headrace and tailrace of every water wheel and water-turbine;
- ▶ Any part of a stock-bar, which projects beyond the headstock of a lathe;
- ▶ Every part of an electric generator, a motor or rotary converter;
- ▶ Every part of transmission machinery; and
- ▶ Every dangerous part of any other machinery must be fenced in a secured manner by substantial construction, which should be constantly maintained. They have to be kept in proper position when the parts of machinery are in motion (Section 21).

The manager of the factory should take particular care to provide safeguard devices to keep the machine in tact, so that it cannot come into contact with workers and thereby cause injury.

#### **Work on or near Machinery in motion (Section 22) :**

Such of those parts of machine that are in motion may have to be constantly examined in order to ensure that there is no friction, The examination, including lubrication on these moving parts of the machinery

must be done only by the adult male workers with tight fitting clothes, It is better such tight fitting clothes are supplied by the occupier.

***Employment of Young persons on Dangerous machines (Section 23):***

Where complex machinery is functioning in a factory, it becomes very essential to stop any machinery either by striking a gear or for cutting off power. In old type of machines, driving belts were mounted on fast and loose pulleys. They were used forming part of transmission machinery. Hence, power must be cut off in order to prevent the driving belts riding upon moving shafts. Suitable, efficient mechanical device must be provided for instantaneously stopping the machines.

***Self-acting Machines (Section 25) :***

In a factory, traversing part of a self acting machine together with a material carried on by it could be allowed to run over a space under which any person is liable to pass.

However, such machinery shall be allowed to traverse both outward and inward directions only beyond a distance of 45 cms from any fixed structure. The fixed structure shall not be part of the machine. Workers must be capable of passing under the moving part of self-acting machine in connection with their employment.

***Casing of new machinery (Section 26) :***

Power driven machinery, revolving shaft, spindle wheel and pinion should be properly encased, i.e., covered and guarded effectively. Spur wheel, helical wheel, fly wheel, friction gear not requiring adjustments which are in constant motion should be safely encased. Even hiring these machines without the safeguards is punishable with fine upto Rs.500 and imprisonment for 3 months or both.

***Prohibition of Employment of Women and Children near Cotton openers (Section27) :***

Women and children are generally prohibited in being employed in pressing cotton in which a cotton opener is at work. If the feed end of a cotton opener is portioned by a separate wall or screen extending upto the ceiling or roof from the delivery end, then women and children could be employed on the side of the feeding end and definitely not at the delivery end.

***Hoists and lifts (Section 28) :***

In a factory where hoists and lifts are in use, their construction must have been done out of quality materials with adequate strength to withstand the strain of weight. Such lifts should be fitted with gates and enclosures. Lifts have to be thoroughly examined at least once in six months by competent persons, besides this, routine and other examinations have to be conducted. Entries have to be made recording the date of examination.

***Lifting machine, chains, and ropes and lifting tackles (Section 29) :***

Lifting machines and cranes that are used in a factory must be properly fastened and strongly coupled with chains and ropes. These chains and ropes tied up with the hoists sufficiently protect the lifts and cranes in contingencies like power failure or mechanical failure. The lifts should be fitted with ropes or chains connected with a cage so that the balance could be maintained with weights. The chief Inspector of factories has to ensure whether these lifts and cranes including the ropes are maintained properly.

***Revolving machinery (Section 30) :***

In the case of use of revolving or grinding machines, it is necessary that the optimum speed should be indicated for the safe working of the machine. Although indications may be there signifying the maximum speed, the optimum speed must be written on the machine for the safe use of it. This would enable prevention of risk to the user and reduction of strain to the machine. Such a notice must be displayed on the peripheral space of the grinding stone, abrasive wheel, etc.

**Hazardous Processes**

Section 41-A-41-H: Hazardous process has become an important subject after the Bhopal gas tragedy. Precautionary measures and for handling situations involving hazardous processes have been highlighted under Chapter IV-A, Why is hazardous process has become a major issue, so as to enforce the provisions under Chapter IV-A. It is for this reason; a new concept under hazardous processes has been introduced with effect from 1.10.1987.

With view to avoid hazards, in storing, handling, transporting and using dangerous materials, these new provisions have been provided by way of addition to the existing ones under safety measures.

## **Welfare Of Workers**

The present Factories Act has provided several measures under Chapter V for welfare of the workers under Sections 42 to 48, dealing with washing facilities, facilities for storing and dressing, facilities for sitting, First-aid appliances, canteen, shelter, rest rooms, lunch rooms and crèches

**Washing facilities (Section 42) :** Suitable and adequate washing facilities, as prescribed by the State government have to be provided separately and exclusively for male and female workers. These places should be accessible.

**Facilities for storing and drying clothes (Section 43) :** Suitable places must be provided by the occupier to enable the workers to keep their clothes safe so that there is no risk of theft in that place.

### ***Sitting Facilities (Section 44) :***

Arrangements shall be made for workers to sit and take rest where their work involves a standing posture.

### ***First Aid appliances (Section 45) :***

The term first aid itself signifies immediate medical help required by the affected parties. First aid boxes containing essential medicines, including cotton must be provided for every department with not less than 150 workers.

Where in a factory, 500 or more workers are employed, the occupier should provide an ambulance room, which is indispensable in the matter of giving medical attention to workers who have sustained serious injuries.

### ***Canteen (Section 46) :***

Factories employing 250 or more workers shall provide one or more canteens as per the rules of the State government. A managing committee consisting of representatives of employees and employers should manage such canteens.

### ***Shelters, rest rooms and lunch rooms (Section 47) :***

Suitable shelters, rest rooms, lunch rooms with provision for drinking water shall be provided for every factory employing 150 or more workers.

***Creches (Section 48) :***

Creche is a room or place for accommodating children below the age of six. Such creche must be properly lighted and adequately ventilated. Trained women assistants shall be employed to attend to the children and maintain them clean and healthy.

***Welfare Officers (Section 49) :***

In factories, where 500 or more workers are employed, there shall be such number of qualified welfare officers employed by the management as per norms prescribed by the State government regarding their qualification, duties and conditions of service.

**Working Hours, Holidays & Annual Leave**

**Adult [Section 2(a)], Adolescent [Section 2(b)] and Child [Section 2(c)]**

An adult is a person who has completed the age of 18. An adolescent is a person who has completed the age of 15 but has not completed the age of 18. A child is a person who has not completed the age of 15.

It is very important to note that according to Section 67, a child who has not completed the age of 14 cannot be employed to work in a factory.

**Working Hours**

Weekly hours (Section 51): No adult worker shall be required or allowed to work in a factory for more than 48 hours in a week. At present it is reduced to 40 hours.

Work not done in the factory under direction of office will not be counted. [Superintendent & Remembrancer of Legal Affairs, Bengal Vs. J.J. Andrews, (1931) I.L.R. 50 Cal. 519].

Daily Hours (Section 54): No adult worker shall be required or allowed to work in a factory for more than 9 hours in any day and 40 hours in a week. However, to facilitate the change of shift, this limit may be exceeded, subject to the previous approval of the Chief Inspector of Factories.

Where work of the same kind is carried out by two or more sets of workers working during different periods of the day, each of such sets is called a “group” or “relay” and each of such periods is called “shift” [Section 2(r)].

### ***Classification of Workers :***

The manager of the factory shall classify the workers into such groups, as he may deem fit and proper. This would depend upon the nature of work, the number of workers in each group, wherein all the adult workers are not required for such work during the same period [Section 61 (4)]. For each group, which is not required to work on a system of shifts, the manager of the factory shall fix the periods during which the group may be required to work. [Section 61 (5)].

### ***Group working on a system of shifts :***

The manager shall fix the period during which each relay of the group may be required to work on shifts. This is done in spite of the reason that there is already a pre-determined schedule that has been fixed as a system specifying the shift in which the respective relays have to work [Section 61 (6)].

### ***Register of Adult Workers (Section 62) :***

Registers disclosing the particulars of adult workers working in the factory shall be maintained by the manager incorporating the changes from time to time. Registers shall show (a) the name of each adult worker in the factory, (b) the nature of his work, (c) the group, if any, in which he is included, (d) the place or spot where his group works on shifts, the relay to which he is allotted; and (e) such other particulars as may be prescribed. Work in accordance with Notice (Section 63) : All adult workers who are required or allowed to work in the factory, shall be in accordance with the notice periods of work as displayed on the general notice board and in conformity with the entries made in the register of adult workers.

It shall be the duty of the occupier or manager in the factory, not to allow any adult worker beyond the stipulated period of hours of work. Furthermore, he shall not allow the total number of workers to exceed the number that has already been notified and allocated for work. The plea of payment of overtime wages would not justify employing a worker to do work beyond the usual hours of work.

### **Holidays (Sections 52 & 53)**

No adult worker shall be required or allowed to work in a factory, on the first day of the week, which is a Sunday. This would mean that a worker,

shall have a holiday for every six days of continuous work. However, the manager may call upon a worker to work on a Sunday. In such cases, one day holiday must be given either out of the 3 days preceding the Sunday or out of the 3 days succeeding the Sunday. Before making this arrangement, a manager shall deliver a notice to the office of the inspector expressing his intention to that effect.

Furthermore, notice must also be displayed in the factory, intimating such change. No substitution can however be made, in such a way that it makes a worker to work for more than 10 days consecutively. Sunday shall, for the purpose of calculating weekly hours of work, be included in the preceding week, where any worker works on a Sunday.

### ***Compensatory Holidays :***

It is mandatory that a worker shall be allowed compensatory holidays of equal number to the holidays so lost. This arises on account of the worker being deprived of the weekly holidays under Section 52 made by the State Government exempting the factory from such provisions. The compensatory holidays must be allowed to the workman within 2 months or within a month in which the substitution of such holidays becomes due. The manner in which compensatory holidays has to be allowed, is prescribed by the State Government.

### **Annual Leave With Wages (Section 79 To 82)**

Section 78 to 84 of the Factories Act deal with annual leave with wages. If any award or agreement including settlement or contract of service provides for a longer annual leave with wages under provisions of Section 79 to 82, the worker shall be entitled to such leave. But there cannot be any award or settlement reducing the annual leave as provided under the Act.

### **Rules Relating To Annual Leave With Wages (Section 79)**

There are two cumulative conditions that are said to be mandatory for the purpose of availing of annual leave with wages: (a) A worker should have put in continuous years of service which means that he should have actually worked for 240 days or more during the calendar year. (b) During that year, for every 20 days of actual work put in by him, a workman

becomes eligible for one day rest leave in the succeeding year. In the case of a child, one day for every 15 days of work performed during the previous calendar year.

(1) In spite of the fact that a worker might not have completed 240 days in a calendar year, the legal representative or nominee of such worker shall be entitled to claim such earned wages proportionately before the expiry of the second working day from the date of such discharge or dismissal or quitting.

(2) However, if a worker has been superannuated or has expired, then such earned wages must be settled before the expiry of two months from the date of such superannuation or death [Section 79 (2)].

(3) In calculating leave period, fraction of leave of half a day or more shall be treated as one full day's leave. The unavailed leave by a worker shall be carried forward to the succeeding year, provided no such accumulation of unavailed leave shall exceed 30 days in a year. In case of excess, unavailed earned leave would lapse. But the number of times the leave that may be taken during any year shall not exceed 3 times.

#### **Other Provisions Of Chapter Viii (Section 81 To 84):**

A worker who has been allowed earned leave for not less than 4 days in the case of an adult and 5 days in the case of a child, they shall be paid the wages due for the period before their leave begins respectively. If the employer does not make such payment, it shall be recoverable as delayed wages under the provisions of Payment of Wages Act, 1936.

#### **Power To Make Rules (Section 83):**

The State Government may make rules directing managers of factories to keep registers containing prescribed particulars and requiring the registers to be available for examination by Inspectors.

#### **Power To Exempt Factories (Section 84):**

The State Government may exempt a factory from the operation of the leave rules, if it is satisfied that its own leave rules provide benefits, which are not less favourable to the workers than that of the statutory leave rules.



## **Recent Amendments In The Act:**

Government has introduced the Social Security Scheme for the unorganized sector worker on a pilot basis in 50 districts of the country, which was launched on 23/01/2004. This would cover workers in the unorganized sector drawing not more than Rs. 6500 per month.

The scheme provides,

- ▶ A flat rate pension of Rs. 500 per month on retirement at the age of 60 and total disablement. Family pension in case of death of the workers.
- ▶ A personal accident insurance cover for rupees one lakh and
- ▶ Universal health insurance scheme for a worker and his family at the cost of Rs. 548 per annum for a family of 5 members or Rs. 365 per annum for a family of 3 members.

Further, the Ministry took several measures such as labour welfare funds, welfare fund for overseas Indian workers etc.

The Factories (Amendment) Bill, 2003 was introduced in the Lok Sabha on July 29, 2003. The bill proposes to amend Sec. 66 of the Factories Act, 1948, so as to provide flexibility in the matter of employment of women during night with adequate safeguard for their safety, dignity, honour and transportation from the factory premises to the nearest point of their residence.

The Parliamentary Standing Committee on labour and welfare examined the contents and submitted its report on August 27, 2003. The report of the II National Commission on labour was submitted to the Government on June 29, 2002.

## **Summary**

The Factories Act, 1948 was passed with an intention of making the work life of persons employed in factories free from hazards and injuries. The protection is afforded to all workers – men, women, and children. Women and children are given special protection, as they are considered more vulnerable. As the employer prepares the environment, the law seeks to regulate the same in the interests of the workmen. The law provides for scrutiny of the place and approval of plans and specifications before they are registered under the Act for the purpose of ensuring health, safety and welfare of the workers.

Appropriate standards are also prescribed. Working hours of adults are made subject to regulations. Employment of children below the age of 14 is prohibited. The law regulates the employment of minors who are permitted to work. Law provides for the entitlement of annual leave with wages. Special provisions are also envisaged to meet certain eventualities.

Labour reforms in India, in the context of globalization is much desired, but also feared and misinterpreted. This issue has been a sensitive one ever since the liberalization era begins under the Narasima Rao Government in the early 1990. In the hurry to reform and to keep up with the globalization trend set in motion by the GATT (now replaced by the WTO), the immediate focus was on the retrenchment of surplus workers' and the closure of 'SICK' Public and Private Sector units. The TATA's were the pioneers in introducing a number of 'Firsts' in the field of labour welfare. Well ahead of any Indian legislation on this front, several benefits – the eight hour working day, free medical aid, provident fund, gratuity, leave with pay, maternity benefits were incorporated by the TATA's in their work place climate.

### **Self-Assessment Questions**

1. Explain the requirements for constitution of a factory. Define a worker, State the rights and duties of the worker.
2. Explain and enumerate the procedure for Licensing and Registration of Factories. State the responsibilities of the Inspector of Factories with regard to grant and registration of license.
3. Explain the role of the designer and manufacturer in carrying out research work in day-to-day activities of the factories.
4. Discuss and explain briefly health, safety and welfare measures adopted under the Factories Act, 1948.
5. What is hazardous process? What are all the precautionary measures and safety measures have to be adopted under Chapter IV-A of the Factories Act?
6. Write short notes on:
  - (a) Self-acting machines
  - (b) Cre ches
  - (c) Canteen
  - (d) Precaution in case of fire.
7. Explain in detail the working hours prescribed for an adult woman and young person, who are workers in a factory with regard to timings, duration, overtime, etc.

8. How a factory manager avoids double employment of workers?  
What are the rules he has to observe for changing the system of shifts for group workers?
9. Explain the method of declaring rest day in factories. Can it be changed according to the discretion of occupier?
10. What is meant by annual leave with wages and what are the conditions to be fulfilled for availing of annual leave with wages?

### Key Words

- **Administration:** State Governments will administer the Act through their own Factory Inspectors. The onus of compliance with the provisions of the Act wholly rests on the occupier of the factory.
- **Assessment:** Factories Act would apply notwithstanding any provisions inconsistent therewith in any other enactment.
- **Occupier:** A person who has ultimate control and management over the affairs of the factory.
- **Certifying Surgeons:** They are qualified medical practitioners who are appointed by the State Government for specified areas or factories.

### Further Readings

- Agarwal, S.L., *Labour Regulations Law in India (Revised Edition)*, Macmillan, Delhi, 1980.
- Jain D.P., *Industrial Law (Revised Edition)*, Konark, New Delhi, 1991

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## Lesson - 2 Industrial Disputes Act, 1947

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### Introduction

With the growing industrialization, the number of industrial workers in the country is also increasing rapidly. The ownership of the industries have changed hands from individuals to corporate houses. The expectations of workers have changed. The lifestyle has also undergone a change. The employer-employee relationship thus assumes a great importance in the changing scenario. Every one expects industrial harmony; it can be achieved only through satisfactory industrial relations.

### What Is Industrial Relations?

Industrial relations' is a dynamic and developing concept. It refers to the general web of relationship normally obtaining between the employers and the employees and includes the complex relations between trade unions and management.

Industrial relations are an integral aspect of social relations arising out of employer-employee interaction in modern industries, which are regulated by the state in conjunction with organized social forces.

The Encyclopaedia Britannica (1961) states of industrial relations as "a concept extended to denote the relations of the State with employers, workers and their organizations. The subject includes individual relations and joint consultations between employers and workers at their places of work; collective relations between employers and their organizations and trade unions; and the part played by the state in regulating these relations".

The State cannot remain a silent spectator in the hope that the relations will on their own reach the state of harmony. That is why under the Industrial Disputes Act, the appropriate government, where it feels that there may be an industrial dispute, refers the matter to adjudication *suo moto*. Thus, "industrial relations' is not merely a simple relationship; it is a functional, inter-related complexity and requires inter-disciplinary approach.

## Interest Groups In Industrial Relations

Interest groups in industrial relations are the parties involved in it. John Dunlop in the preface to his work “Industrial Relations System” (1958) says: “Industrial societies necessarily create industrial relations, defined as the complex of inter-relations among workers, managers and government,”

The interest groups, therefore, are:

- **Workers and their organizations**
- **Managers (employers) and their organizations**
- **The Government**

Each group has different interests and priorities. The workers and their organizations want higher wages, good working conditions and other benefits like medical insurance, accident benefits etc. As against these, the employers and their organizations want maximum productivity at the lowest possible cost. They, therefore, offer lowest possible wages, although the unit may have capacity to pay higher wages, want long working hours and no other expenses. The interests of the first two groups are thus conflicting.

We have, however, seen that there are attitudinal changes in both the groups and they have realised that both of them need to be reasonable in their approach. The third interest group is the government. It is the responsibility of the government to ensure that there is an atmosphere of industrial peace and harmony. Thus, when the government apprehends that there may be an industrial dispute, it refers the matter for adjudication. **The government endeavours to see that the industrial harmony is maintained even when there is an impending dispute.**

## Industrial Relations In India

In order to understand the issues and problems associated with industrial relations, it is desirable to study its various evolutionary phases. Practically speaking, the growth of industrial relations in India is in no way different from that of other parts of the globe. The various stages of industrial relations progressed from *primitive stage to factory or industrial capitalism stage*.

Ancient scriptures and laws of our country laid emphasis on the promotion and maintenance of peaceful relations between capital and labour. From the very early days, craftsmen and the workers felt the necessity of being united. The utility of unions has been stated in Sukla Yajurveda Samhita, “if men are united, nothing can deter them.” Kautilyas’s Arthashastra gives a comprehensive picture of the organisation and functions of the social and political institutions of India and a good description of unions of employees, craftsmen or artisans. There were well-organised guilds, which worked according to their own byelaws for the management of the unions.

However, there were no organisations of workers during the Mughal rule. The labourers were entirely dependent on their masters and forced work was taken from them. Historical evidence further shows the existence of rules of conduct and prescribed procedure for the settlement of disputes for promoting cordial relations between the parties. The working relations, however, in those days were more or less of a personal character and are very much distinguishable from the present-day industrial relations as have gradually developed with the growth of large scale industries.

A study of modern industrial relations in India can be made in three distinct phases.

- ▶ The first phase can be considered to have commenced from the middle of the nineteenth century and ended by the end of the First World War.
- ▶ The second phase comprises the period thereafter till the attainment of independence in 1947, and
- ▶ The third phase represents the post-independence era.

### **Objects And Scope Of The Act**

The object of the Industrial Disputes Act is to make provision for the investigation and settlement of industrial disputes. The Act is primarily meant for regulating the relations of employers and workmen, past, present and future. The principal aim of the Act is to encourage collective bargaining and to maintain industrial peace by preventing illegal strikes and lockouts and to provide lay off and retrenchment compensation.

The Act was passed with a view to removing certain shortcomings found in the working of the Trade Disputes Act, 1929. It came into force on the first day of April 1947 [sec. 1(3)].

It extends to the whole of India [Sec.1 (2)]. It extends to all industries whether they are carried on by private owners or by the government. The Act has been amended from time to time. The latest amendment was made in 1984.

Thus, though the main object of the Act is to provide for investigation and settlement of industrial disputes, the amendment Act seeks to ensure speedier resolution of industrial disputes by removing procedural delays. Besides creating an efficient statutory machinery for the settlement of industrial disputes and thereby promoting industrial harmony, the Act also seeks to achieve certain other objects, referred to as 'certain other purposes' in the preamble.

The objects are:

- ▶ Promoting measures for securing and preserving amity and good relations between employer and workmen.
- ▶ Enquiring into any matter connected with or relevant to an industrial dispute.
- ▶ Promoting the settlement of industrial disputes.
- ▶ Adjudication of industrial disputes.
- ▶ Reference of individual disputes to grievance settlement authorities.
- ▶ Voluntary reference of disputes to arbitration.
- ▶ Prevention of illegal strikes and lock-outs.
- ▶ Compensation for lay-off and retrenchment of workmen.
- ▶ Provision for the payment of wages from the date of the award till the suit pending before courts of law is decided.
- ▶ Prevention of unfair labour practices.

These objects of the Act center round the securing of industrial harmony and social justice.



## **Defintions**

The following are some of the important definitions:

### **Appropriate Government**

It means in relation to any industrial dispute concerning any industry carried on by or under the authority of the Central Government or by a railway company, or any controlled industry as may be specified, or any relation to an industrial dispute concerning banking or an insurance company, a mine, or an oil-field or a major port, the appropriate government would be the Central Government

In relation to any industrial dispute other than those specified above, the appropriate government would be the State Government. The general rule is that an industrial dispute arising between an employer and his employees would be referred for adjudication by the State Government except in the cases mentioned above. The definition is exhaustive.

### **Average Pay [Sec.2 (Aaa)]**

This clause lays down the manner of calculating the average pay for the purpose of payment of compensation at the time of retrenchment of a workman.

The determination of average pay is to be made in a different way in the case of

- ▶ Monthly paid workmen,
- ▶ Weekly paid workmen, and
- ▶ Daily paid workmen.

The average pay is calculated in the following manner for the different categories of workers:

- ▶ In the case of monthly paid workmen, the average of the wages paid for three complete calendar months;
- ▶ In the case of weekly paid workmen, the average of the wages paid for four complete weeks;
- ▶ In the case of daily paid workmen, the average of the wages paid for twelve full working days.

The period of three months, four weeks or twelve days as specified above, must precede the day on which the average pay becomes payable. In case a workman has not worked for the period specified above, the average pay shall be calculated as the average of wages paid to the workmen for the period he actually worked.

### **Workman [Sec.2(S)]**

‘Workman’ means any person (including an apprentice employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward. His terms of employment may be express or implied. For the purpose of any proceeding under this Act in relation to an industrial dispute, ‘workman’ includes any person who has been dismissed, discharged or retrenched in connection with, or as a consequence of that dispute, or whose dismissal, discharge or retrenchment has led to that dispute.

### **Industry [Sec.2 (j)]**

In the light of the judgment in Bangalore Water Supply Case, the term ‘Industry’ has been defined in Sec.2 (j) as amended in 1982 as follows: ‘Industry’ means any systematic activity carried on by co-operation between an employer and his workmen (whether such workmen are employed by such employer directly or by or through any agency including a contractor) for the production, supply or distribution of goods or services with a view to satisfy human wants or wishes (not being wants or wishes which are merely spiritual or religious in nature). It makes no difference whether or not

- ▶ Any capital has been invested for the purpose of carrying on such activity; or
- ▶ Such activity is carried on with a motive to make any gain or profit.

‘Industry’ includes-

- ▶ Any activity of the Dock. Labour Board established under Section 5-A of the Dock Workers (Regulation of Employment) Act, 1948.
- ▶ Any activity relating to the development of sales or business or both carried on by an establishment.

## **Industrial Dispute [Sec.2 (k)]**

It means any dispute or difference between

- ▶ Employers and employers;
- ▶ Employers and workmen; or
- ▶ Workmen and workmen, which is connected with
  - a. The employment or non-employment
  - b. The terms of employment or,
  - c. The conditions of labour of any reason

In the ordinary language an industrial dispute is implied to mean a dispute between the workmen and the management.

The definition of 'industrial dispute' contains the following two limitations:

- ▶ The adjective 'industrial' related the dispute to an industry as defined in the Act, and
- ▶ The definition expressly states that not all sorts of disputes and differences but only those which bear upon the relationship of employers and workmen and the terms of employment and the conditions of labour, are contemplated.

## **Individual And Collective Disputes**

The industrial disputes may be

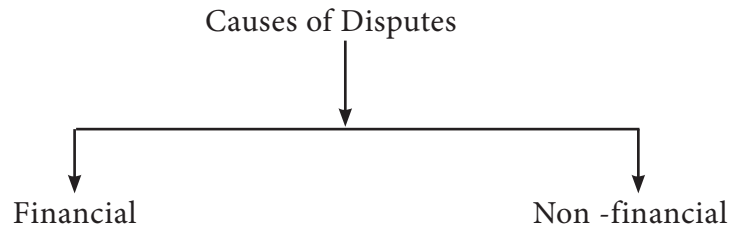
- ▶ **Individual disputes or**
- ▶ **Collective disputes.**

Now Section 2A of the Act provides that where any employer discharges, dismisses, retrenches or otherwise terminates the services of an individual workman, any dispute or difference between that workman and his employer connected with, or arising out of such discharge, dismissal, retrenchment or termination shall be deemed to be an industrial dispute even if no other workman nor any union of workman is a party to the dispute.

A collective dispute may relate to any of the following matters:

- ▶ Wages, bonus, profit sharing, gratuity, compensatory and other allowances.
- ▶ Hours of work, leave with wages, holidays.
- ▶ Rules of discipline, retrenchment of workmen, closure of establishment, rationalisation.

All collective disputes are industrial disputes and not vice versa



**Financial causes:**

- Wages
- Bonus
- Dearness allowance
- Travelling allowance
- Leave with Pay
- Gratuity
- Holidays with Pay
- Promotion & transfer

**Non – Financial causes:**

- Transport
- Housing
- Education
- Working hours
- Working condition
- Discipline
- Recreation Facility

**Effects Of Industrial Dispute**

**1.Strike [Sec.2 (Q)]**

It means-

- A cessation of work by a body of persons employed in any industry acting in combination; or
- A concerted refusal of any number of persons who are or have been so employed to continue to work or to accept employment; or
- A refusal under a common undertaking of any number of such persons to continue to work or to accept employment.

## Types Of Strike

- ▶ Stay-in, Sit-down, Pen-down or Tool-down Strike :In all such cases, the workmen after taking their seats, refuse to do work. All such acts on the part of the workmen acting in combination, amount to a strike.
- ▶ Go-slow : Go-slow does not amount to strike, but it is a serious case of misconduct.
- ▶ Sympathetic Strike : Cessation of work in the support of the demands of workmen belonging to other employer is called a sympathetic strike. The management can take disciplinary action for the absence of workmen. However, in *Ramalingam Vs. Indian Metallurgical Corporation, Madras, 1964-I L.L.J.81*, it was held that such cessation of work will not amount to a strike since there is no intention to use the strike against the management.
- ▶ Hunger Strike : Some workers may resort to fast on or near the place of work or residence of the employer. If it is peaceful and does not result in cessation of work, it will not constitute a strike. But if due to such an act, even those present for work, could not be given work, it will amount to strike (*Pepariach Sugar Mills Ltd. Vs. Their Workmen*).
- ▶ Work-to-rule : Since there is no cessation of work, it does not constitute a strike.

## 2. Lay-Off [Sec.2 (Kkk0)]

It means the failure, refusal or inability of an employer on account of the shortage of coal, power or raw material or the accumulation of stocks or the breakdown of machinery or natural calamity or for any other connected reason to give employment to a workman whose name is borne on the muster rolls of his industrial establishment and who has not been retrenched.

Lay-off does not involve alteration in the conditions of service. A lay-off is not the same, this as the order of dismissal. It is more akin to an order of suspension.

### **3.Lock-Out**

It means temporary closing of a place of employment or the suspension of work or the refusal by an employer to continue to employ any number of persons employed by him. Under the present definition, two alternative acts of the employer constitute a lockout:

- ▶ Temporary closing of a place of employment or suspension of work; or
- ▶ Refusal to continue to employ any number of persons employed by him.

Essentials of Lock-out :

The essentials of a lock-out are as follows:

- ▶ There is a temporary closing of the place of employment, or suspension or withholding of the work by the employer in some form.
- ▶ There is an element of demands for which the place of employment is locked-out or closed.

There is an intention to re-employ the workers, if they accept the demands.

#### **Meaning of Lock-out**

Section 2(1) defines lock-out thus: “Lock-out” means temporary closing of a place of employment, or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him.

The requirements of lock-out, according to this definition are:

- ▶ Temporary closure of the place of employment;
- ▶ Suspension of work;
- ▶ Refusal to employ;
- ▶ By an employer; and
- ▶ To continue to employ any number of persons employed by him.

The total Mandays lost on account of strikes and lockouts have declined by 4.80 million in 2003

YEAR	STRIKES		STRIKES & LOCKOUTS		TOTAL	
	Number	Mandays Lost (in million)	Number	Mandays Lost (in million)	Number	Mandays Lost (in million)
1998	665	9.35	432	12.71	1097	22.06
1999	540	10.62	387	16.16	927	26.79
2000	426	11.96	345	16.80	771	28.76
2001	372	5.56	302	18.20	674	23.77
2002	295	9.66	284	16.92	579	26.58
2003	244	2.00	245	20.00	489	22.00

\* Source – Labour Bureau, Shimla

### Difference between Lock-out and Lay-off

- ▶ Under lock-out the employer refuses to give employment because of closing of a place of employment or suspension of work. Under lay-off the employer refuses to give employment because of shortage of coal, power or raw materials or the accumulation of stocks or the breakdown of machinery or natural calamity or for any other reason to give employment.
- ▶ Lock-out is resorted to by the employer to coerce or pressurize the workmen to accept his demands; lay-off is for trade reasons beyond the control of the employer.
- ▶ Lock-out is due to an industrial dispute and continues during the period of dispute; lay-off is not concerned with a dispute with the workmen.

However, both are of temporary nature and in both cases the contract of employment is not terminated but remains in suspended animation.

### 4.Retrenchment [Sec.2 (Oo)]

The term as used in the Industrial Disputes Act means the termination by the employer of the service of a workman for any reason whatsoever otherwise than as a punishment inflicted by way of disciplinary action. Thus, the discharge of a workman on the ground that he did not pass the test, which would have enabled him to be confirmed, was 'Retrenchment' [Santosh Gupta Vs State Bank of Patiala, AIR (1980) SC 687.

'Retrenchment' does not, however, include-

- ▶ Voluntary retirement of a workman; or
- ▶ Retirement of the workman on reaching the age of superannuation, if the contract of employment between the employer and workman contains a stipulation in the behalf; or
- ▶ Termination of the service of a workman on the ground of continued ill health.

#### **Difference Between Lock-Out And Retrenchment :**

- ▶ Lock-out is temporary; retrenchment is permanent. Retrenchment results in complete severance of industrial relationship between an employer and an employee; while lock-out keeps this relationship alive even during the cessation of work. The former results in severance of relationship between the employer and the employee; while the latter amounts to only suspension of this relationship.
- ▶ Lock-out is with a motive to coerce the workmen to accept the demands of the employer; retrenchment is resorted to dispense with surplus labour.
- ▶ Lock-out is due to and during an industrial dispute; there is no such dispute in case of retrenchment.

#### **5.Closure [Sec.2 (Cc)]**

It means the permanent closing down of a place of employment or part thereof.

Public Utility Service: 'The phrase Public Utility Service' means -

- ▶ Any railway service or any transport service for the carriage of passengers or goods by road, water or air;
- ▶ Any section of an industrial establishment on the working of which the safety of the establishment or the workmen employed therein depends;
- ▶ Any postal, telegraph or telephone service;
- ▶ Any industry which supplies power, light or water to the public;
- ▶ Any system of public conservancy or sanitation;



- ▶ Any industry specified in the First Schedule which the appropriate government may, if satisfied that public emergency or public interest so requires, by notification in the Official Gazette, declare to be a public utility service for a specified period not exceeding six months in the first instance. The appropriate government, if necessary, may extend it from time to time.

## **Lock-Out And Closure**

The distinction between the closure and the lock-out is well settled. In case of a closure, the employer does not merely close down the place of business, but he closes business itself while lock-out indicates the closure of the place of business and not the closure of the business itself. Lock-out means suspension of the work and a discontinuance of the carrying on the business.

If an employer shuts down his place of business as an instrument of coercion, or as mode of exerting pressure on the employees, there would be lock-out. If, on the other hand, he shuts down his work because he cannot, for instance, get the raw materials or because he is unable to sell the goods or because he is losing money, that would not be a lock-out.

## **6.Gherao**

Gherao means encirclement of the manager to criminally intimidate him to accept the demands of the workers. It amounts to criminal conspiracy under Section 120-A of the I.P.C and is not saved by Sec.17 of the Trade Unions Act on the grounds of its being a **concerted activity**.

## **Award [Sec.2 (d)]**

An award is an interim or final determination of an industrial dispute or any question relating thereto and by a Labour court, Industrial Tribunal, National Industrial Tribunal or an Arbitrator under Section 10-A.

Interim award means a provisional or temporary relief. Determination implies decision one-way or the other. An order of Labour Court, Industrial tribunal or National Industrial Tribunal granting or refusing to grant any of the relief's, which have been asked for would fall within the term 'award'.

## **Settlement [Sec.2 (P)]**

It means-

- ▶ A settlement arrived at in the course of conciliation proceedings which may be held by a conciliation officer or Board of Conciliation, and includes,
- ▶ A written agreement between the employer and workmen arrived at otherwise than in the course of conciliation proceeding where such agreement has been signed by the parties thereto in the prescribed manner and a copy thereof has been sent to an officer authorised in this behalf by the appropriate government and the conciliation officer.

## **Administration Under The Act**

The Act provides for the constitution of various authorities for the purpose of prevention and settlement of industrial disputes. These are as under –

- ▶ Works committee
- ▶ Conciliation officers
- ▶ Board of conciliation
- ▶ Courts of inquiry
- ▶ Labour courts
- ▶ Industrial tribunals, and
- ▶ National tribunals

A brief description of the constitution, powers and duties of the various authorities is given below:

### **1. Works Committee (Sec.3)**

Constitution: Section 3 of the Act empowers the appropriate government to constitute a works committee by a general or special order in a manner, which may be prescribed. There are two conditions, which must be satisfied before a works committee can be constituted:

- ▶ The establishment must be an industrial establishment.
- ▶ One hundred or more workmen should either be presently employed or should have been employed on any day in the preceding twelve months.

The works committee must be composed of the representatives of the employers and the workmen engaged in the industrial establishment and must be equal in number. It is further provided that the representatives of the workmen shall be chosen in the prescribed manner and in consultation with the registered trade union.

## **2. Conciliation Officers (Sec.4)**

As in the case of a Works Committee, the constitution of which is left to the discretion of the appropriate government, so also in the case of conciliation officers the appropriate government may as per Section 4 of the Act, appoint by notification in the official Gazette, such number of conciliation officers as it thinks fit.

## **3. Board Of Conciliation**

In similar manner, a board of conciliation may also be constituted to promote the settlement of industrial disputes. A board shall consist of a chairman and two or four other members, as the appropriate government thinks fit. The chairman shall be an independent person and the other members shall be persons appointed in equal numbers to represent the parties to the dispute on the recommendation of the parties concerned. If any party fails to make a recommendation within the prescribed time, the appropriate government shall appoint such persons as it thinks fit to represent that party.

Conciliation proceedings before a board are similar in nature to those before a conciliation officer. But members of the boards of conciliation enjoy more powers than those enjoyed by conciliation officers. However, unlike a conciliation officer, the board cannot admit a dispute in conciliation on its own; the board has no jurisdiction until the government makes a reference to it.

## **4. Courts Of Inquiry (Sec.6)**

The appropriate government may, by notification in the official Gazette, constitute a Court of Inquiry (hereinafter called the court) for inquiring into any matter appearing to be connected with or relevant to an industrial dispute.[Sec.6 (1)].

## **5. Labour Courts (Sec.7)**

The appropriate government may, by notification in the official Gazette, constitute one or more Labour Courts for adjudication of industrial dispute relating to any matter specified in the Second Schedule. These courts shall also perform such other functions as may be assigned to them under the Act.

### **The Second Schedule**

Matters within the jurisdiction of Labour Courts:

- ▶ The propriety or legality of an order passed by an employer under the standing orders;
- ▶ The application and interpretation of standing orders;
- ▶ Discharge or dismissal of workmen including reinstatement of, or grant of relief to, workmen wrongfully dismissed;
- ▶ Withdrawal of any customary concession or privilege;
- ▶ Illegality or otherwise of a strike or lock-out; and
- ▶ All matters other than those specified in the Third Schedule.

## **6. Industrial Tribunals (Sec.7-A)**

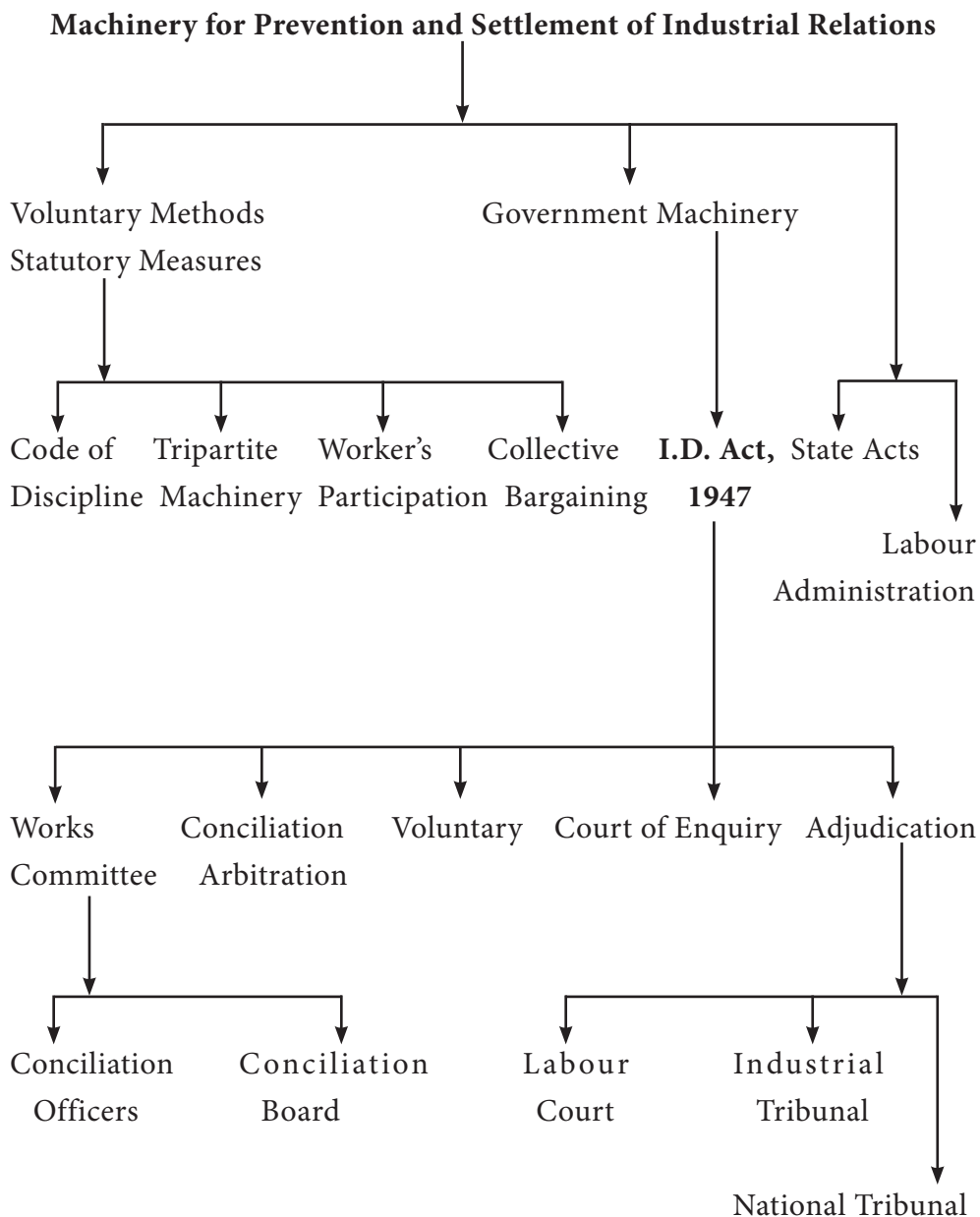
The appropriate government may, by notification in the official Gazette, constitute one or more Industrial Tribunals (hereinafter called the tribunals) for the adjudication of industrial disputes relating to any matter, whether specified in the Second Schedule or the Third Schedule and for performing such other functions as may be assigned to them under this Act [Sec. 7-A (1)].

### **The Third Schedule**

- ▶ Wages including the period and mode of payment.
- ▶ Compensatory and other allowances;
- ▶ Hours of work and rest intervals;
- ▶ Leave with wages and holidays;
- ▶ Bonus, profit sharing, provident fund and gratuity.
- ▶ Shift working otherwise, than in accordance with standing orders;
- ▶ Classification by grades;.

## 7. National Tribunals (Sec. 7-B)

The Central Government may, by notification in the official Gazette, constitute one or more National Industrial Tribunals (hereinafter called National Tribunal) for the adjudication of industrial disputes which, in the opinion of the Central Government, involve questions of national importance or are of such a nature that industrial establishments situated in more than one state are likely to be interested in, or affected.



## Notice Of Change

The object of Section 9-A of the Act is to prohibit an employer from making any change in the conditions of service applicable to his workmen in respect of any matter specified in the Fourth Schedule, unless he has complied with the following conditions:

- ▶ A notice in prescribed manner of the nature of the change proposed to be effected must be given to the workmen likely to be affected by such change; and
- ▶ A period of twenty-one days from the date of notice must have expired.

The appropriate Government has the power to include any other rules or regulations in this category by notification in its official Gazette. The matters, in respect of which notice is required, are enumerated in the Fourth Schedule to the Act and are as follows,

- a. Wages including the period and mode of payment.
- b. Contribution paid or payable by the employer to any provident fund or pension fund.
- c. Compensatory and other allowances.
- d. Hours of work and other rest intervals.
- e. Leave with wages and holidays
- f. Starting, alteration or discontinuance of shift working, otherwise, than in accordance with standing orders.
- g. Classification by grades.
- h. Withdrawal of any customary concession or privilege or change in usage
- i. Introduction of new rules of discipline or alteration of existing rules except in so far as they are provided in standing orders
- j. Rationalisation, standardisation or improvement of plant or technique, which is likely to lead to retrenchment of workmen.
- k. Any increase or reduction (other than casual) in the number of persons employed or to be employed in any occupation or process or department or shift not occasioned by circumstances over which the employer has no control.

## **Illegal Strikes And Lock-Outs (Sec.24):**

A strike or a lock-out shall be illegal, if

- ▶ It is commenced or declared in contravention of Sec.22 or Sec.23; or
- ▶ It is continued in contravention of an order made under Sec.10 (3) or Sec. 10-A (4-A), [Sec.24 (1)].

## **Penalties Regarding Strikes And Lock-Outs**

### **1. Penalty for illegal strike [Sec.26 (1)]:**

Any workman, who commences, continues or otherwise acts in furtherance of a strike, which is illegal, shall be punishable with imprisonment for a term, which may extend to one month, or with fine, which may extend to Rs.1,000 or with both.

### **2. Penalty for illegal lock-out [Sec.26 (2)]:**

Any employer, who commences, continues or otherwise acts in furtherance of lock-out, which is illegal, shall be punishable with imprisonment for a term which may extend to one month, or with fine which may extend to Rs.1, 000 or with both.

### **3. Penalty for instigation, etc. (Sec.27):**

Any person who instigates or incites others to take part in, or otherwise, acts in furtherance of, a strike or lockout, which is illegal, shall be punishable with imprisonment for term which may extend to six months or with a fine which may extend to Rs.1,000 or with both. In the case *Raja Kulkarni Vs. State of Bombay AIR (1954) SC 73*, it was held that Sec.27 did not impose any unreasonable restriction upon the fundamental rights guaranteed by Articles [19(1)(a)] and [(19(1)(c)] of the constitution.

### **4. Penalty for giving financial aid for illegal strike and lock-out (Sec.28):**

Any person who knowingly expends or applies any money in direct furtherance or support of any illegal strike or lock-out shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to Rs.1, 000 or with both.

*There was a sharp decline in the number of strikes and lockouts during 2003 as compared to the previous year. The reduction was more prominent in the Public Sector.*

## Summary

It is gratifying to note that apart from the fundamental rights, our constitution embodies within itself, in Part IV, Directive Principles of State Policy. The functions and duties of the states as contained in the directive principles have given rise to the concept of social justice. The old idea of laissez faire has given place to a new idea of welfare state. The philosophy of social, economic and political justice have been given a place of pride in our constitution, as well as in the aims and objectives of ILO. The development and growth of industrial law presents a close analogy to the development and growth of constitutional law. A series of labour enactments covering labour welfare and social security were enacted for protecting and promoting the overall welfare of different categories of working class. The central and some state governments have enacted laws on industrial relations. The three enactments by the Central Government in the field of industrial relations are (a) the Trade Unions Act which provides for registration of trade unions;(b) the Industrial Employment (standing orders) Act which makes provision for certification of standing orders; and (c) the Industrial Disputes Act which lays down a machinery for the prevention and settlement of industrial disputes.

## Self-Assessment Questions

1. What are the consequences of labour being included in the concurrent list of the Indian Constitution?
2. What are the fundamental right and directive principal under the Indian constitution?
3. What is the procedure for registration of a trade union under the Trade Unions Act?
4. On what objects general and political funds are spent under the Trade Unions Act?
5. What is the procedure for certification of standing orders under the Industrial Employment (Standing Orders) Act?
6. What are the omissions and commissions on the part of a workman, which amount to misconduct?
7. What are the provisions regarding strikes and lockouts under the Industrial Disputes Act?
8. What are the provisions under the Industrial Disputes Act for settlement of industrial disputes?



## Further Readings

- ▶ Agarwal, S.L., *Labour Relations Law in India*, Macmillan Company of India Ltd., New Delhi, 1978
- ▶ Indian Law Institute, *Labour Law and Labour Relations Cases and Materials*, N.M. Tripathi Pvt. Ltd, Bombay, 1987.
- ▶ Mallick, P.L., *Industrial Law*, Eastern Book Company, Lucknow, 1989.

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## Lesson - 3 Minimum Wages Act, 1948

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### Introduction

The Minimum Wages Act of 1948 is not only a measure of social security for the poverty stricken workers, but it is also a device for improving the standard of living of the downtrodden and thereby paving the way for their betterment and ultimate welfare.

The continuing tendency among the employer is only to exploit the labourers who happen to be illiterates and who never possessed the necessary prowess to fight against the ingenuity of the employers.

#### The Minimum Wages Act

- ▶ Assures wages so as to help the workers to eke out their livelihood, at least to an extent of sustaining the adversities, namely, rise in the cost of living.
- ▶ Prevents the employers from exploiting the labourers by paying wages far below their needs; and
- ▶ Lays down principles for fixation of wages on a need based scale.

### Definition

Though Minimum Wages has not been defined anywhere in the Minimum Wages Act, it can be defined generally. In common sense, minimum wages is the bare subsistence money required by the worker not only to meet the basic needs such as food, shelter and clothing but it is also includes moneys required for medical expenses, education for children and traveling expenses to a worker in a family. Family consists of husband, wife, and two children.

## **Objects And Scope Of The Act:**

The Minimum Wages Act contemplates,

- The wages that are paid to the workers should meet their physical needs and at the same time,
- Keep them above starvation level.
- It should ensure sustenance for their family; and
- Also enable them to subsist by preserving their efficiency as workmen in day-to-day life.

## **Components In The Minimum Wage:**

It must be understood that wages that are paid to a workman is not paid exclusively to him, but it is paid to his family as a unit. Therefore, such a wage should enable a worker to sustain his family by meeting certain necessary expenses which are inevitable; such as

- a. Medical expenses
- b. Expenses to meet education for his children; and
- c. In some cases, transport charges.

## **Concept Of Minimum Wage**

Minimum wages that are fixed for workmen have some significance:

- a. Minimum wages are not fixed on Equation principle, namely, money payable towards wages must be commensurate with the labour output.
- b. Equally, minimum wages are not based on the economic principle, namely those who are able financially, must be capable of paying more to the workers.
- c. On the other hand, it is based on ethical principle of pre-judging and assessing the needs of a workman and his family as a unit and making provision for his wages. To put it in a nutshell, minimum wages are considered to be need-based wages, which is according to the directive principle of our Constitution.

## **Cost Of Living Index [Section 2 (D)]:**

The framework of minimum wages hinges on cost of living index, now known as Consumer Index. Cost of living forms an integral part in the fixation of wages for workers. But then, the cost of essential commodities increases now and then because of which a workman finds it hard to lead his life. The essential requirements for providing a staple food consisting of protein, carbohydrates, fat, vitamin, etc., are computed and calculated in terms of price from the available essential commodities.

Calculation of Cost of Living Index: Upto 100 points they merge with the salary. Over and above 100 points, when there is an increase in the cost of these essential commodities, the workers find it difficult to procure these commodities to eke out their livelihood. This renders the position of a workers equivalent to a stage termed as 'between the cup and the lip.'

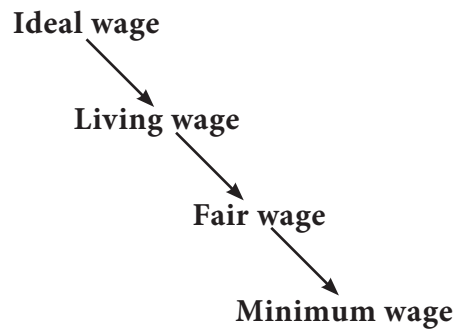
## **Minimum Wages, Fair Wages And Living Wages**

Fixation of wage is no doubt a subtle task, which requires a device for balancing the demand of social justice and the need for improving the sources of national income from the point of raising the standard of living.

Payment of wages is mandatory. Irrespective of the fact whether an industry is big or small. Whether it makes profit or not, minimum wages must be paid to the workmen concerned. A human being must always be allowed to lead a decent life; hence, it is not permitted to pay wages, which is hardly sufficient to make the workman to keep his body and soul together.

Minimal requirements of the worker concerned should be provided under minimum wages. A living wage has been defined as the wage received for normal needs of an average employee regarded as a human being living in a civilized community. A living wage enables a worker to enjoy comfort in life.

The wages mentioned above are not static as they keep on changing, according to the economic scenario of the nation. To neutralize or standardize the two extreme wage limits, namely, minimum wage and living wage, the concept of fair wage is introduced as a via media, as given below:



A **fair wage** is said to be a mean between minimum wage and living wage. Every attempt was made to introduce a fair wage, but then it could not be fixed at the upper limit. Hence, sometimes, fair wage also descends to the level of minimum wage.

**Minimum wage** is said to be the starting stage from the point of view of offering social security to workmen. Labourer's demand should always be viewed with sympathy and hence minimum wages must be paid compulsorily. If an employer is unable to pay even minimum wages or it becomes impossible on his part to carry on his business, then it would be better for him to close his business.

For the purpose of understanding the Minimum Wages Act, it essential to know the following definitions contained in the Act

**“Appropriate Government”** [Section 2(b)] means –

- a. In relation to any scheduled employment carried on by or under the authority of the central Government or a Railway Administration or in relation to a mine, oil-field or major port, or any corporation established by the Central Government, and
- b. In relation to any other scheduled employment under the State Government.
- c. Competent authority means the authority appointed by the appropriate Government by notification in its official Gazette to ascertain from time to time the cost of living index number applicable to the employees employed in the scheduled employment specified in such notification;
- d. **“Cost of living index number”** in relation to employees in any scheduled employment in respect of which minimum rates of wages have been fixed, means the index number ascertained

and declared by the competent authority by notification in the official Gazette to be the cost of living index number applicable to employees in such employment;

- e. **“Employer”** means any person who employs, whether directly or through another person, or whether on behalf of himself or any other person, one or more employees in any scheduled employment in respect of which minimum rates of wages have been fixed under this Act, and includes, Except in sub-section (3) of Section 26;
- f. **“Prescribed”** means prescribed by rules made under this Act;
- g. **“Scheduled employment”** means an employment specified in the Schedule, or any process or branch of work forming part of such employment;
- h. **“Wages”** means all remunerations, capable of being expressed in terms of money, which would, if the terms of the contract of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment and includes house rent allowance.
- i. **“Employee”** means any person who is employed for hire or reward to do any work skilled or unskilled, manual or clerical, in a scheduled employment in respect of which minimum rates of wages have been fixed; and includes an out-worker to whom any articles or materials are given out by another person to be made up, cleaned, washed, altered ornamented, finished, repaired, adapted or otherwise processed for sale for the purposes of the trade or business of that other person where the process is to be carried out either in the home of the outworker or in some other premises not being premises under the control and management of that other person; and also includes an employee declared to be an employee by the appropriate Government; but does not include any member of the Armed Forces of Union.

### **Fixation And Revision Of Minimum Awages**

Fixation and revision of minimum wags could be studied under the following three heads.

- ▶ Fixation of minimum wages, how it is done and to whom it is Applicable (Section3).
- ▶ Contents of minimum wages (Section 4).

- ▶ Procedure for fixing and revising minimum wages (Section 5).  
Sections 3,4 and 5 are said to be the *operative sections* under the Minimum Wages Act.

### **Fixation Of Minimum Wages [Section 3]:**

The responsibility for fixing the minimum rates of wages is that of the appropriate Government. Section 3 provides that the appropriate Government

- ▶ Shall fix the minimum rates of wages payable to employees employed in an employment specified in Part I or Part II of the Schedule to the Act and in an employment added to either part by notification in the official Gazette [Sec.3 (1)(a)].
- ▶ May, in respect of employees employed in an employment specified in Part II of the Schedule, instead of fixing minimum rates of wages for the whole State, fix such rates for a part of the State or for any specified class or classes of such employment in the whole State or part thereof [Provision to Sec. 3(1)(a)].
- ▶ Shall review at such intervals not exceeding five years, the minimum rates of wages so fixed and revise the minimum rates, if necessary [Sec.3 (1)(b)].

### **Procedure For Fixing And Revising Minimum Wages (Sec.5)**

In fixing minimum rates of wages in respect of any scheduled employment for the first time or in revising minimum rates of wages so fixed, the appropriate government shall follow either of the following methods:

- ▶ It shall appoint as many committees and sub-committees as it considers necessary to hold enquiries and advise it in respect of such fixation or revision, as the case may be: or
- ▶ It shall, by notification in the official Gazette, publish its proposals, for the information on persons likely to be affected thereby and specify a date, not less than two months from the date of the notifications on which the proposals will be taken into consideration [Sec.5 (1)].



## **Safeguards In Payment Of Minimum Wages:**

**Wages in kind** (Sec.11). Minimum wages payable under this Act shall be paid in cash [Sec.11 (1)].

But where it has been the custom to pay wages wholly or partly in kind, the appropriate government may by notification in the official Gazette, authorize the payment of minimum wages either wholly or partly in kind [Sec.11 (2)].

The appropriate government may by notification in the official Gazette authorize the provision of the supply of essential commodities at concessional rates [Sec.11 (3)].

**Payment of minimum rates of wages** (Sec.12). Where in respect of any scheduled employment minimum wages have been fixed, the employer shall pay to every employee wages at a rate not less than the minimum rate of wages fixed for that class of employees in the employment.

Such wages shall be paid without any deductions except as may be authorized. Where the contract rate of wages is higher, the statutory obligation does not come into play [Sec.12 (1)].

Section 12 of the Act does not affect the provisions of the Payment of Wages Act, 1936 [Sec.12 (2)].

## **Enforcement Of The Act:**

### **Inspectors (Sec.19).**

The appropriate government may, by notification in the official Gazette, appoint inspectors for the purposes of this Act, and define the local limits within which they shall exercise their functions [Sec. 19(1)].

The powers and functions of the inspectors so appointed are almost similar to those of the inspectors appointed under the Payment of Wages Act, 1936. The inspectors have to see that the provisions of the Minimum Wages Act are complied with.

### **Claims (Sec.20).**

The appropriate government may, by notification in the official Gazette, appoint an authority to hear and decide for any specified area. All claims are

- ▶ Arising out of payment of less than the minimum rates of wages; or
- ▶ In respect of the payment of remuneration for the day of rest under [Sec.13(1)(b)] or for work done on days of rest under [Sec.13(1)(c)];
- ▶ In respect of wages at the overtime rate under (Sec. 14) to employees employed or paid in that area [Sec.20 (1)].

### **Offences And Penalties:**

Penalties for offences (Secs.22 and 22-A). Any employer who—

- ▶ Pays to any employee less than the minimum rates of wages fixed for that employee's class of work, or less than the amount due to his under the provision of this Act; or
- ▶ Contravenes any rule or order made under Sec.13,

Shall be punishable with imprisonment for a term, which may extend to six months, or with fine, which may extend to Rs.500, or with both [Sec.22].

In imposing any fine for offence under Sec.22, the court shall take into consideration on the amount of any compensation already awarded against the accused in any proceedings taken under Sec.20 (Proviso to Sec.22).

Further, any employer who contravenes any provision of this Act or of any rule or order made there under shall, if no other penalty is provided for such contravention by the Act, be punishable with fine which may extend to Rs. 500 [Sec.22-A].

### **Contracting Out [Sec.25]:**

According to the Section 25 of the Act, any agreement or contract between the employer and the employee by which the employee gives up his right to minimum wages or any privilege or concession accruing to him under the Act is null and void, in so far it purports to reduce the minimum rate of wages fixed under the Act. It is immaterial whether the contract or agreement was entered into either before or after the commencement of the Act.

### **Exemptions And Exceptions (Sec. 26)**

The appropriate government may—

- ▶ Direct that provisions of this Act shall not be applicable in relation to the wages payable to disabled persons [Sec 26(1)].
- ▶ Direct by notification in the official Gazette that the provisions of the Act or any of them shall not apply to all or any class of employees employed in any scheduled employment [Sec.26 (2)].
- ▶ Exempt some specified employments from the application of some or all the provisions of this Act [Sec 26(3)].

Nothing in this Act shall apply to the wages payable by an employer to a member of his family who is living with him and a dependent on him. A member of the employer's family includes his or her spouse or child or parent or brother or sister (Explanation to Sec 26(3)).

### **Recent Amendments In The Act**

On the basis of recommendations of Central Advisory Board in its meeting held on December 19, 2003, the National Minimum Wage has been raised from Rs. 55 to Rs. 66 per day with effect from February 1, 2004.

This act is of interest to women workers, as it sets minimum wages for employees, which include those working on a temporary basis, piece rate workers and workers paid daily wages. In addition, no employee can be asked to work more than 9 hours a day without additional wages being paid and the normal working hours must be fixed.

## Summary

This act aims at statutory fixation of minimum wages with a view to prevent the exploitation of workers. It seeks to achieve social justice to workers by securing the enjoyment of minimum wage fixed under the law. There are three levels of wage. They are the living wage, the fair wage and the minimum wage. The components of the minimum wage are set by the standards necessary to cover the basic needs of the workman and to preserve his efficiency. Receipt of the subsistence and wage fixed under the Act are declared to be the fundamental right under Articles 23 and 21 of the constitution. The responsibilities fundamental to the scheme envisaged under the Act are two fold. Firstly, the responsibility of fixing and revising the minimum wage is apportioned between the central and state governments. Secondly, the consequential responsibility of paying the same to the workmen is laid on the employer, both public and private, governed by the Act.

Two methods are envisaged for fixation and revision of the minimum wage. They are substantially similar. Choice of the mode is left to the discretion of the government. Based upon the necessity, the government may either appoint a committee for enquiry and advice or formulate the proposal and publish the same inviting objections. A separate machinery is constituted for hearing and deciding the claims under Act. With a view to ensure quick and inexpensive justice, summary procedure is envisaged.

## Self-Assessment Questions

1. Describe how the scale of minimum wage is fixed from the point of view of its contents, regions and duration of hours of work.
2. State the constitution, role and function of the Advisory Committee Under the Minimum Wages Act.
3. State the measures prescribed under the Minimum Wages Act for Implementation of the provisions of the Act.
4. What are the penalties provided under this Act for non-payment of minimum wages? State the remedies available for the aggrieved party.
5. Write short notes on:
  - (a) Committee Method
  - (b) Notification Method
  - (c) Minimum Rates
  - (d) Contracting out

## Key Words

- ▶ **Minimum Piece Rate System:** Minimum wages fixed by the employer for the production of a single piece.
- ▶ **Minimum Time Rate System:** Minimum wages fixed in accordance with the working hours by the employer.
- ▶ **Administration:** Advisory Committees or Boards appointed by the appropriate government fix and revise the minimum wages and to advise the Central or State Government as the case may be, in the matter.

## Further Readings

- ▶ Agarwala, S.L., *Labour Relations Law in India*, Macmillan: Madras, Government of India, 1969. Report of the National Commission on Labour. New Delhi, 1978.
- ▶ Misra, S.N., *Labour And Industrial Laws*, Pioneer Publications Delhi, 1983

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## Lesson - 4 Workmen's Compensation Act, 1923

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### Introduction

The Workmen's Compensation Act, 1923, was the first social security measure introduced in India prior to independence. The statement of objects and reasons appended to the Bill at the time of its introduction clearly indicates the need to protect workmen from hardship arising from accidents due to the complexity of modern industry.

### Object And Scope Of The Act

The Act considers compensation payable by an employer to his workmen in the case of an accident as a measure of relief and social security. It enables a workman to get compensation irrespective of his negligence. It also lays down the various amounts payable in case of an accident depending upon the type and extent of injury. The employer now knows the amount of compensation he has to pay and is saved of many uncertainties to which he was subject before the Act came into force.

Accordingly, payment of compensation is the main object of the Act. But yet, it seeks to reduce the number of accidents, mitigates the effect of accidents by providing suitable medical treatment, makes the industry more attractive to labour, increases labour efficiency and provides for a cheaper and quicker disposal of disputes relating to compensation, through special tribunals.

### Definitions

Section 2 gives the definitions of the terms used in the Act. Some of the important definitions are as follows:

#### *Employer [Sec.2(1)(e)]*

Employer includes –

- ▶ Any body of persons whether incorporated or not;
- ▶ Any managing agent of an employer; and
- ▶ The legal representative of a deceased employer.

- ▶ Any person to whom the services of a workman are temporarily lent or let on hire to another person by the person with whom the workman has entered into a contract of service or apprenticeship.

The definition of the term 'employer' is not exhaustive. It includes a contractor also. Whether a person, is an employer or not, is a question of fact depending on the facts of a particular case.

**Workman [Sec.2(1)(n)]:**

'Workman' means any person who is –

- I. A railway servant as defined in Sec.3(34) of the Railways Act, 1989, who is not permanently employed in any administrative, district or sub-divisional office of a railway and not employed in any such capacity as is specified in Schedule II, or
- II. Employed in any such capacity as is specified in Schedule II.

But 'workman' does not include –

- iii. A person whose employment is of a casual nature, and who is employed in work not connected with the employer's trade or business;
- iv. Any person working in the capacity of a member of naval, military or air force.

***Wages***

According to Sec.2(1)(m), the term "Wages" include any privilege or benefit which is capable of being estimated in money, other than a traveling allowance or the value of any traveling concession or a contribution paid by the employer of a workman towards any pension or provident fund or a sum paid to a workman to cover any special expenses entailed on him by the nature of his employment.

***Disablement***

The Act does not define the word "Disablement". It only defines the "partial" and "total disablement". Disablement means loss of capacity to work or to move. Disablement of a workman may result in loss or



reduction of his earning capacity. In the latter case, he is not able to earn as much as he used to earn before his disablement.

Disablement may be (i) partial, or (ii) total. Further it may be (i) permanent, or (ii) temporary.

TOTAL 100 % or More	PARTIAL Less than 100 %	
Permanent Total (Cannot do any work)	Permanent partial (Could be engaged in all other jobs at reduced salary)	Permanent
Temporar Total Disablement (Cannot be employed in the original work with full salary)	Temporary Partial (Can be employed in the original job at reduced salary)	Temporary

**Partial Disablement [Section 2(1)(G)]:**

A disablement may be partial or total. A partial disablement only reduces the earning capacity of a workman, while a total disablement incapacitates a workman, from all work, which he was capable of performing at the time of the accident. Partial disablement may be of temporary or permanent nature.

**(A) Temporary partial disablement** means any disablement, which temporarily reduces the earning capacity of workman in any employment in which he was engaged at the time of the accident which caused the disablement.

**(B) Permanent partial disablement** means such a disablement as permanently reduces the earning capacity of workman in every employment, which he was capable of undertaking at the time of the accident which caused the disablement. But, every injury specified in part II of schedule I of this Act shall be deemed to result in permanent partial disablement.

**Permanent**  
(Disablement or being unfit for  
all jobs)

**Temporary**  
(Disablement or being unfit for  
that job originally done)

The distinction between these two types of disablement depends on the fact as to whether an injury results in reduction of earning capacity in all the employments which the workman was capable of doing or only in that particular employment in which workman was engaged at the time of accident.

The type of disablement suffered can be determined only from the facts of the case. But it is provided by the Act that injuries specified in Part II of Schedule I (given below) shall be deemed to result in permanent partial disablement. These injuries are known as ‘\scheduled injuries’.

**Extract From Schedule I**

[See Secs.2(g) and (1) and 4]

Description of Injury	Percentage of Loss of Earning Capacity
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**Part I**

**List of injuries deemed to result in permanent total disablement**

Loss of both hands or amputation at higher sites	... 100
Loss of hand and a foot	... 100
Loss of sight to such an extent as to render the claimant unable to perform any work for which eye-sight is essential	... 100
Very severe facial disfigurement	... 100
Very severe facial disfigurement	... 100
Absolute deafness	... 100

**Part II**

**List of injuries deemed to result in partial disablement**

Amputation cases – upper limbs (either arm)	
Amputation through shoulder joint	... 90
Loss of a hand or of the thumb and four fingers of one hand or amputation from 4-1/2” below tip of olecranon	... 60
Loss of thumb	... 30
Loss of four fingers of one hand	... 50
Loss of three fingers of one hand	... 30
Loss of two fingers of one hand	... 20
Loss of terminal phalanx of thumb	... 20

*Amputation cases – lower limbs*

Amputation of both feet resulting in end-bearing stumps	...	90
Amputation at hip	...	90
Amputation below middle thigh to 3-1/2" below knee	...	60
Amputation below knee with stump exceeding 3-1/2" but not exceeding 5"	...	50
Amputation below knee with stump exceeding 5"	...	40
Amputation of one foot resulting in end-bearing	...	30

*Other injuries*

Loss of one eye, without complication, the other being normal	...	40
Loss of vision of one eye, without complications or disfigurement of eye-ball, the other being normal	...	30

**Loss of fingers of right or left hand**

*Index finger*

Whole	...	14
Two phalanges	...	11
One phalanx	...	9

*Middle finger*

Whole	...	12
Two phalanges	...	9
One phalanx	...	7

*Ring or little finger*

Whole	...	7
Two phalanges	...	6
One phalanx	...	5

**Total Disablement [Section 2 (1)(L)]**

Total disablement means such disablement as incapacitates a workman for all work which he was capable of performing at the time of the accident resulting in such disablement. In order to constitute total disablement, disablement must be of such a character that the person concerned is unable to do any work and not merely the work, which he was performing at the time of the accident.

A total disablement may be temporary or permanent. A permanent total disablement shall be deemed to result from

- ▶ The permanent total loss of the sight of both eyes; or
- ▶ From an injury specified in Part I of Schedule I or from any combination of injuries specified in Part II thereof where the aggregate percentage of the loss of earning capacity as specified in the said Part II against those injuries, amounts to one hundred per cent or more.

A carpenter suffered injury in the course of his employment, which

resulted in amputation of left hand above elbow. Since a carpenter cannot work with one hand, disablement was held to be total and not partial [*Pratap Narain Singh Deo Vs Srinivas Sabata and another* [AIR (1976) SC 222].

### **Employer's Liability For Compensation**

Section. 3 provides for employer's liability to pay compensation to a workman. It lays down that the following conditions must exist before an employer may be held liable to pay compensation to a workman

- Some personal injury must have been caused to a workman;
- Such an injury must have been caused by an accident;
- The accident must have arisen out of and in the course of employment; and
- The injury must have resulted either in the death of the workman or in his total or partial disablement for a period exceeding three days.

But the employer shall not be liable (except in the case of the injury resulting in the workman's death) to pay compensation in the following cases

- If the injury did not result in total or partial disablement of the workman for a period exceeding three days;
- If the workman was at the time of the accident under the influence of drink or drug, or
- If the workman willfully disobeyed an order expressly given or a rule expressly framed for the purpose of securing safety of workman; or
- If the workman willfully removed or disregarded any safety guard or other device which to his knowledge was provided for the purpose of securing his safety.

In the case of disease, no compensation shall be payable to a workman in respect thereof, unless the same is directly attributable to an injury caused by an accident arising out of and in the course of his employment.

But in respect of the occupational diseases, specified in Schedule III of the Act, contracted by a workman, it shall be presumed that the contracting of the disease amounts to an injury caused by an accident arising out of and in the course of his employment.

### **Accident Out Of Employment**

An accident arising out of employment implies a '**casual connection**' between the injury and the accident and the work done in the course of employment. Employment should be the distinctive and the proximate cause of the personal injury whether physical or mental. In the case *Dennis Vs White, (1917) A.C.479*, it was laid down that "when a man runs a risk incidental to his employment and is thereby injured, the injury arises out of employment."

## Accident In The Course Of Employment

It suggests duration of employment or the period of time during which the employment continues. In the case *Saurashtra Salt Mfg. Co. Vs Bai Balu Raja (1958) SC 881*, the Supreme Court held “as a rule the employment of a workman does not commence until he has reached the place of employment and does not continue when he has left the place of employment”.

Following points in this connection are important to note.

- ▶ All movements of a worker from one place to another whether within the premises of the employer or to the premises of some other person in connection with the employment alone shall be taken to be the course of his employment.
- ▶ A person who is busy in performing his duty, under the terms of his employment, at any place, shall be taken to be working in the course of employment.
- ▶ Break for rest, refreshment, etc., within the premises of the employer is regarded as incidental to work and the worker is supposed to be in the course of his employment even for that period.
- ▶ When the workman uses transport provided by the employer for the purpose of going to and from the place of work, he is deemed to be in the course of employment during the time when he uses the transport. [Holmes Vs Great Northern Railway (1900) 2 Q.B.409].

## Occupational Disease

Sub-section (2) declares that the contracting of an occupational disease by a workman shall be deemed to be an injury by accident within the meaning of Section 3, and unless the contrary is proved, the accidents shall be deemed to have arisen out of, and in the course of employment.

## Employer Not Liable

Section 3(1) of the Act has mentioned the following circumstances in which the employer is not liable to pay compensation to a workman for personal injury caused by accident: They are,

1. In respect of any injury which does not result in the total or partial disablement of the workman for a period exceeding three days;
2. In respect of any injury, not resulting in death, caused by an accident which is directly attributable to
  - i. The workman having been at the time of the accident, under the influence of drink or drugs.
  - ii. The willful disobedience of the workman to an order expressly given, or to a rule expressly framed, for the purpose of securing the safety of workman; or

- iii. The willful removal or disregard by the workman of any safety guard or other device, which he knew to have been provided for the purpose of securing the safety of workman.
3. According to sub-section (4) of Section 3, if the occupational disease is not directly attributable to a specific injury by accident arising out of and in the course of his employment.
4. According to sub-section (5), if the injured workman has instituted a suit in a civil court for damages in respect of the injury, against the employer or any other person, and
5. If the accident causing injury or death did not arise out of and in the course of the workman's employment.

### **Amount Of Compensation**

The amount of compensation payable to a workman depends on

- The nature of the injury caused by accident;
- The monthly wages of the workman concerned; and
- The relevant factor for working out lump-sum equivalent of compensation amount as specified in Schedule IV (as substituted by the Amendment Act of 1984).

***There is no distinction between an adult and a minor worker with respect to the amount of compensation.***

Now Section 4 (as substituted by the Amendment Act of 1984) provides for compensation for

- Death;
- Permanent total disablement;
- Permanent partial disablement;
- Temporary disablement, whether total or partial.

### **Procedure For Claiming Compensation**

An injured workman may either file a civil suit for damages against the employer or claim compensation under the Workmen's Compensation Act, 1923. He has to make a choice between these two reliefs.

Section 3(5) of the Act provides that no claim for compensation can be made under the Act, if the workman has filed a civil suit. It further provides that a workman cannot file a suit for damages in any court of law, if

- He has filed a claim under the Workmen's Compensation Act, 1923; or
- There is an agreement between the workmen and his employer providing for the payment of compensation according to the provisions of the Workmen's Compensation Act, 1923.

In a civil suit for damages, the employer can put forward all the defenses available to him under the law of torts. Moreover, a civil suit is a risky and costly affair. A claim under the Workmen's Compensation Act, 1923 is safe and less costly.

## **Appeal (Sec.30)**

Under Section 30 of the Act, an appeal lies to the High Court from following orders of the Commissioner:

- a. An order awarding as compensation, a lump-sum whether by way of redemption of a half-monthly payment or otherwise or disallowing a claim in full or in part for a lump-sum.
- b. An order awarding interest or penalty;
- c. An order refusing to allow redemption of half-monthly payment;
- d. An order providing for the distribution of compensation among the dependants of a deceased workman, or disallowing any claim of a person alleging himself to be such dependent;
- e. An order allowing or disallowing any claim for the amount of an indemnity under the provisions of Section 12 (2);
- f. An order refusing to register a Memorandum of agreement of registering the same or providing for the registration of the same subject to conditions.

According to the first proviso to this section, no appeal lies against any order unless a substantial question of law is involved, and in the case of an order other than an order refusing to allow redemption of a half-monthly payment, the amount in dispute is not less than three hundred rupees.

An appeal will also not lie, if the parties have agreed to abide by the decision of the Commissioner, or in which the order of the Commissioner gives effect to an agreement between the parties.

No appeal by an employer under clause (a) above shall lie, unless the Memorandum of appeal is accompanied by a certificate by the Commissioner to the effect that the appellant has deposited with him the amount payable under the order appealed against.

The period of limitation for an appeal is 60 days, and the provisions of Section 5 of the Indian Limitation Act, 1908, will also apply to appeal under this section.

## **Penalties**

Section 18A of the Act prescribes penalties for the contravention of the provisions of the Act which include fine up to Rs.5,000. The following omissions attract this punishment under the Act:

- ▶ Whosoever fails to maintain a notice book which he is required to maintain under Section 10(3); or
- ▶ Whosoever fails to send to the Commissioner a statement of fatal accidents which he is required to send under Section 10A(1); or
- ▶ Whosoever fails to send a report of fatal accidents and serious bodily injuries which he is required to send under Section 10B; or
- ▶ Whosoever fail to make a return of injuries and compensation which he is required to make under Section 16.

No prosecution under Section 18A shall be instituted except by or with the previous sanction of the Commissioner and no court shall take cognizance of any offence under this section unless complaint is made within 6 months of the date on which the alleged commission of offence comes to the knowledge of the Commissioner.

### **Amended Provisions In The Act**

The minimum amount of compensation payable under the Workmen's Compensation Act, yet it has been enhanced from 50,000 to 80,000 in case of death and from 60,000 to 90,000 in case of permanent total disablement with effect from 08/12/2000. From the same date the ceiling of the maximum amount of compensation has been doubled from Rs. 2.28 lakh to 4.56 lakh in case of death and from Rs. 2.74 lakh to 5.48 lakh in case of permanent total disablement.

The 39th session of Indian Labour Conference was held on 16-18 October 2003 and deliberated various issues like child labour, bonded labour, women labour, etc.

### **Summary**

India's first social security legislation was passed in 1923. The Workmen's Compensation Act was to provide injury compensation to industrial workers. The Act imposes obligation on the employer to pay compensation for accidents arising out of and in course of employment. The Act was amended in 1962 raising the wage limit to Rs.400 per month, and the 1976 amendment raised the wage limit to Rs.1, 000 per month, and a later amendment raised it to Rs.1, 600 per month.

The Compensation limits, in case of death, was raised from Rs.10,000 to 30,000 and for permanent and total disablement from Rs.14,000 to 40,000 by the same amendment. The term "workmen" in the Act refers to those employed in factories, mines, plantations, construction work and other hazardous occupations, except those covered by Employee State Insurance Act, 1948, and clerical employees.

The Compensation is related to the extent of the injury or circumstances of death. However, the employee cannot claim any compensation, if he sustains injuries under the influence of drugs, alcohol, etc. The Act provides for half-monthly payment for temporary disablement. The compensation cannot exceed half the monthly wages. A Commissioner appointed by the Government administers the Act. The employer is required to file annual return giving details of the compensation paid, number of injuries and other particulars.

If the workman contracts any occupational disease due to the employment in that particular job, it would be deemed to be an injury by accident arising out of and in the course of his employment for purposes of



the Act. In this case, the compensation will be payable, only, if the workman has been in service of the employer for more than six months.

If the employer does not pay the compensation within one month from the date it fell due, the Commissioner may order recovery of not only the amount of arrears but also a simple interest at the rate of six per cent per annum on the amount due. If there is no justification for the delay in the opinion of the Commissioner, an additional sum not exceeding 50 per cent of such amount may be recovered from the employer by way of penalty.

### Self-Assessment Questions

1. Workmen's Compensation Act is a boon offering social justices to workmen by speedy remedy without much cause and expense for their claims – Discuss.
2. Who are dependants and who can they claim compensation under the act?
3. Workmen's Compensation Act states the loss of earning capacity is not necessarily co-extensive with the loss of physical capacity. Explain.
4. Accident arising out of employment is deemed to have occurred in the course of employment, - Discuss.
5. State the three classified types of occupational diseases with illustrations.
6. State the methods and manner by which compensation under the Act is settled in the case of
  - i. Death
  - ii. Permanent total disablement
  - iii. Temporary total and partial disablement
7. State the procedure prescribed under the Act for claiming and disbursing compensation under the Workmen's compensations Act.
8. State the remedies provided under the Act to claim when the amounts settled are not acceptable to them. Has there been right of appeal for any aggrieved parties?
9. State the powers of the commissioner in the matter settling the claims of the employees under the Workmen's Compensation Act.

### Key Words

- ▶ **Social Welfare Activities:** Activities which will improve the living conditions of people (especially of manual workers)
- ▶ **Social Security Measures:** measures that will ensure protection by society to its members against economic and social distress.
- ▶ **Intra-mural:** within the boundaries of the establishment (factory/organisation)

- **Extra-mural:** Outside the establishment
- **Statutory:** required under law
- **Indian Labour Conference:** An apex body at the national level consisting of representatives of employees, employers and the government to discuss and recommend decisions relating to labour.

### **Further Reading**

1. sPatrick J. Cihon and James O. Castagnera, *Employment and Labor Law*, South-Western College.
2. Richard Schaffer, Beverley Earle and Filiberto Agusti, *International Business Law and Its Environment*, South-Western College, 2005.

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