



**SURESH**  
**GYAN VIHAR**  
**UNIVERSITY**  
Accredited by NAAC with 'A+' Grade

**Master of Business Administration**  
**(MBA)**

**BUSINESS AND CORPORATE**  
**Semester-I**

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**SURESH GYAN VIHAR UNIVERSITY**  
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## **Learning out comes**

Students will be able to understand:

### **Unit-1**

- Define a contract as a legally binding agreement between two or more parties that creates mutual obligations enforceable by law.
- Understand the significance of each essential element in forming a legally enforceable contract.
- Analyze the acceptance of an offer and the conditions for acceptance to create a binding contract.

### **Unit-2**

- Define a contract as a legally binding agreement between two or more parties that creates mutual obligations enforceable by law.
- Analyze the differences between a contract of sale and an agreement to sell, including the transfer of ownership and risk.
- Understand the remedies available to an unpaid seller, such as lien, stoppage in transit, resale, and damages.

### **Unit-3**

- Understand the significance of companies in modern business organizations, including limited liability, perpetual succession, and separate legal personality.
- Analyze the steps involved in company formation and the role of promoters, directors, and shareholders in the process.
- Define shareholder democracy as the principle that gives shareholders the right to participate in the management and decision-making of the company.

### **Unit-4**

- Understand the importance of consumer protection in promoting fair trade practices, ensuring product safety, and resolving disputes.
- Define key terms and concepts related to consumer protection laws, such as "consumer," "goods," "services," "deficiency," "unfair trade practices," and "complaint."

### **Unit-5**

- Understand the importance of IP laws in promoting innovation, creativity, and economic development by providing incentives for creators and inventors.
- Identify and analyze the procedures and requirements for registering copyrights under the Copyright Act, including the application process, documentation, and fees.

# SYLLABUS

## BUSINESS AND CORPORATE LAW

### UNIT I

#### INDIAN CONTRACT ACT, 1872

Introduction, Essentials of Valid Contract, offer (or Proposal) and Acceptance, Role of communication in a contract, Consideration, Competence to Contract, Free Consent, Unlawful consideration or object, Types of Contracts, Discharge of a contract, Performance of a Contract, Breach of Contracts, Special types of Contracts, Contract of Indemnity, Contract of Guarantee, Contract of Bailment, Contract of Pledge, Contract of Agency

### UNIT II

#### SALES OF GOODS ACT 1930 AND NEGOTIABLE INSTRUMENTS ACTS, 1981

Introduction, Contract of Sale, Contract of Sale Vs Agreement to Sell, Goods, Price, Transfer of Ownership, Rights of an Unpaid Seller, Conditions and Warranties, Doctrine of "Caveat Emptor", Sale by Auction, what is a Negotiable Instrument, Negotiation, Promissory note, Bill of exchange, Cheque, Classification of Instruments, Parties to a Negotiable Instrument, Crossing, Endorsement, Paying Banker, Collecting Banker, Bouncing of a Cheque

### UNIT III

#### THE COMPANIES' ACT 2013

Introduction, Important Definitions, Meaning and features of a company, Classification of companies, Formation of a Company, Memorandum of Association, Articles of Association, Prospectus, Share capital, Shareholder democracy, Management and Administration, Meetings, Board of Directors, Independent directors, Financial Reports, Audit, Dividend, Compromises, arrangements and amalgamations, Revival and rehabilitation of sick companies, Corporate social responsibility, Acceptance of Deposits, Winding Up of a company

### UNIT IV

#### THE CONSUMER PROTECTION ACT-1986 AND INFORMATION TECHNOLOGY ACT 2000

Introduction, Rights of a consumer, Important Definitions, Consumer Protection Councils, Consumer Disputes Redressal Agencies, Penalties, meaning, Important Definitions, Electronic Commerce, Digital Signatures, The licensing process, Civil Wrongs under IT Act, Cyber Crimes, Overview of other relevant provisions

### UNIT V

#### LAWS RELATED TO INTELLECTUAL PROPERTY RIGHT, INDIAN PATENTS ACT, 1970 AND PARTNERSHIP LAWS

Introduction, The Trade Marks Act, 1999, Infringement of trade marks, Passing off of the Intellectual Property, Copyright Act, 1957, Term of copyright, Registration of Copyrights, Infringement of Copyrights, meaning, Important Definitions, what are not inventions, Application for Patent, Exclusive Marketing rights, Grant and sealing of patent, Patent office, Working of patented inventions, Infringement of a patent, Penalties, Patent agents, international arrangements, Important Amendments, The Indian Partnership Act, Rights, Authorities and Liabilities of Partners, Minor as a Partner, Reconstruction and dissolution of Partnership, Limited Liability Partnership Act, 2008, Incorporation by registration, Relationship of partners, Financial Disclosures, Investigation, Winding up and dissolution, Penalties

# INDIAN CONTRACT ACT, 1872

## STRUCTURE

- 1.1 Learning objective
- 1.2 Introduction
- 1.3 Essentials of Valid Contract
- 1.4 Offer (or Proposal) and Acceptance
- 1.5 Role of communication in a contract
- 1.6 Consideration
- 1.7 Competence to Contract
- 1.8 Free Consent
- 1.9 Unlawful consideration or object
- 1.10 Types of Contracts
- 1.11 Discharge of a contract
- 1.12 Performance of a Contract
- 1.13 Breach of Contracts
- 1.14 Special types of Contracts
- 1.15 Contract of Indemnity
- 1.16 Contract of Guarantee
- 1.17 Contract of Bailment
- 1.18 Contract of Pledge
- 1.19 Contract of Agency
- 1.20 Chapter Summary
- 1.21 Keywords
- 1.22 Review questions
- 1.23 Multiple Choice Questions



## 1.1 LEARNING OBJECTIVE

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After completing this unit, student will be able to:

- Explain Essentials of Valid Contract.
- List out Types of Contracts.
- Understand the Discharge of a contract.
- Describe Performance of a Contract.
- Seek remedy in case of Breach of Contracts.
- Learn the legal provisions of Special types of Contracts Structure.

## 1.2 INTRODUCTION

---

Every day most of us enter into one or the other contracts. Most of these contracts are implied contracts. Important and business-related contracts are in writing with detailed terms and conditions. Every person who is a party to a contract must know the legal formalities regarding a valid contract and the rights and obligations of the parties to the contract. It extends to the whole of except the State of Jammu and Kashmir; and it came into force on the first day of September, 1872.

## 1.3 ESSENTIALS OF VALID CONTRACT

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**What is a Contract?**

As per Section 2 (h) an agreement enforceable by law is a contract. It can be shown as under:

**Contract=Agreement + Enforceability.**

By Enforceability it is meant that the party to a contract can approach a Court of Law to enforce his rights under the contract provided he has fulfilled all the conditions of a valid contract.

As per Section 2(g) an agreement not enforceable by law is said to be void agreement.

**What is an Agreement?**

As per Section 2 (e) every promise and every set of promises, forming the consideration for each other, is an agreement. Agreement can be shown as under

**Agreement = Proposal (Offer) + Acceptance.**

As per Section 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 either to such act or abstinence, he is said to make a proposal.

**Promiser and Promise.**

As per Section 2 (c) the person making the proposal is called the “promisor”, and the person accepting the proposal is called “promise”

**Reciprocal promises.**

As per Section 2 (f) Promises which form the consideration or part of the consideration for each other, are called reciprocal promises. Therefore, in an agreement, both the parties are promisors as well as promises.

**Example:**

Mr. Shantilal offers to sell a car to Mr. Muruganathan for Rs.25,000 and Mr. Muruganathan conveys his acceptance to buy the car at this price, then it becomes an agreement.

As far as selling car is concerned, Mr. Shantilal is a promisor and Mr. Muruganathan is a promise. As far as payment of price is considered Mr. Muruganathan is a promisor and Mr. Shantilal is a promise.

**Essentials of a Valid Contract**

As per Section 1, all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.

Nothing herein contained shall affect any law in force in India by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of documents.

1. There should be two or more parties
2. There should be agreement (offer + acceptance) between the parties.
3. There should be intention to create legal relationship
4. There should be a lawful consideration
5. The parties should be competent to contract
6. There should be free consent of parties
7. There should be a lawful object
8. They should fulfil norms under any other applicable Acts in respect of witness,
9. documentation, registration and stamp duty etc.
10. Certainty of meaning
11. Possibility of Performance
12. The agreements are not hereby expressly declared to be void

**1.4 OFFER (OR PROPOSAL) AND ACCEPTANCE****Offer (or Proposal)**

As per Section 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 either to such act or abstinence, he is said to make a proposal. A proposal, when accepted, becomes a promise.





### Provisions about Offer (or Proposal)

1. Offer may be Express or Implied
2. Offer must be Capable of Giving Rise to Legal Consequences and Creating Legal Relation.
3. The Terms of Offer must be Certain and Definite; the Terms must not be Vague or Loose.
4. An Invitation to Place Offer is not an Offer.
5. An Offer may be General or Specific
6. Offer must not Contain a Term the Non-Compliance of which would Amount to Acceptance
7. Two Identical Cross-Offeres do not Make a Contract
8. A Counter Offer results in rejection of original offer.

### Lapse of an Offer

1. Due to lapse of specified time.
2. After reasonable time if no time mentioned
3. By rejection of offer by the offeree.
4. Not accepted in the prescribed mode
5. Counter offer.
6. Death or insanity of offeror
7. Revocation of offer

### Provisions about Acceptance

As per Section 2 (b) When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted.

- a. Acceptance must be given only by the person to whom the offer is made.
- b. Acceptance must be absolute and unqualified
- c. Acceptance must be communicated in some usual or reasonable manner unless the manner is prescribed in the offer itself.
- d. Acceptance must be made within reasonable time or before the offer is terminated.

### Lalman Shuklavs. Gauri Dutt (1913) 11 ALJ 489

The facts of the case are these: In January last the nephew of the defendant absconded from home and no trace of him was found. The defendant sent his servants to different places in search of the boy and among them was the plaintiff who was the munim of his firm. He was sent to Hardwar and money was given to him for his railway fare and other expenses. After this the defendant issued handbills offering a reward of Rs. 150 to anyone who might find out the boy. The plaintiff traced the boy to Rishikesh and found him there. He wired to the defendant who went to Hardwar and brought the boy back to Cawnpore. He gave to the plaintiff a reward of two sovereigns and afterwards on his return to Cawnpore



gave Rs. 20 more. The plaintiff did not ask for any further payment and continued in the defendant's service for about six months when he was dismissed. He then brought this suit, out of which this application arises, claiming Rs. 499 out of the amount of the reward offered by the defendant under the handbills issued by him. The record shows that the handbills were issued subsequently to the plaintiff's departure for Hardwar. It appears, however, that some of the handbills were sent to him there.

The court below having dismissed the claim, this application for revision has been made by the plaintiff and it is claimed on his behalf that as he traced out the boy he is entitled to the reward offered by the defendant.

The defendant contends that the plaintiff claim can only be maintained on the basis of a contract, that there must have been an acceptance of the offer and an assent to it, that there was no contract between the parties in this case and that in any case the plaintiff was already under an obligation to do what he did and was, therefore, not entitled to recover. On the other hand, it is contended on behalf of the plaintiff, that a privity of contract was unnecessary and neither motive nor knowledge was essential. In any opinion a suit like the present one can only be founded on a contract. In order to constitute a contract, there must be an acceptance of the offer and there can be no acceptance unless there is knowledge of the offer. Motive is not essential but knowledge and intention are. In the case of a public advertisement offering a reward, the performance of the act raises an inference of acceptance. This is manifest from S. 8 of the Contract Act, which provides that "Performance of the conditions of a proposal is an acceptance of the proposal."

In the present case the claim cannot be regarded as one on the basis of a contract. The plaintiff was in the service of the defendant. As such servant he was sent to search for the missing boy. It is true that it was not within the ordinary scope of his duties as a minim to search for a missing relative of his master but he agreed to go to Hardwar in search of the boy and he undertook that particular duty. Being under that obligation, which he had incurred before the reward in question was offered, he cannot, in my opinion, claim the reward. There was already a subsisting obligation and therefore, the performance of the act cannot be regarded as a consideration for the defendant's promise. For the above reasons hold that the decision of the Court below is right and I dismiss the application with cost.

Revision Application dismissed.

### **Carlill vs. Carbolic Smoke Ball Co (1893) 1 QB 256**

The Defendant, the Carbolic Smoke Ball Company of London (Defendant), placed an advertisement in several newspapers on November 13, 1891, stating that its product, "The Carbolic Smoke Ball", when used three times daily, for two weeks, would prevent colds and influenza. The makers of the smoke ball additionally offered a 100£ reward to anyone who caught influenza using their product, guaranteeing this reward by stating in their advertisement that they had deposited 1000£ in the bank as a show of their sincerity. The Plaintiff, Lilli Carlill (Plaintiff), bought a smoke ball and used it as directed. Several weeks after she began using the smoke ball, Plaintiff caught the flu.

## NOTES



In the concurrences of Bowen L.J. and A.L. Smith, L.J., the notion of contractual consideration also becomes an issue of relevance. Both of these Judges note that while the Defendant could argue lack of consideration, Plaintiff, in buying the Carbolic Smoke Ball and using it as directed, provided adequate consideration through the inconvenience she experienced by using the product.

**Discussion:** This case stands for the proposition that while sales puffery in advertisements is generally not intended to create a contract with potential product buyers, in this case it did because the Defendant elevated their language to the level of a promise, by relying on their own sincerity.

### **Dickinson v. Dodds 2 Ch D 463 (1876)**

Plaintiff believed he had the power to accept until 9am on Friday. He learned that Defendant was negotiating with another party and immediately brought his acceptance to the house where Defendant was known to be staying and left written acceptance with his mother-in law. Defendant had sold the property to Allen on the day before, Thursday. Defendant, found him before 9am on Friday at the train station and handed him a copy of the acceptance.

The offer to be held open until Friday 9 o'clock was only an offer that was not supported by consideration or acceptance by Plaintiff. There was no binding agreement to keep the property unsold until 9 o'clock Friday morning.

**Concurrence:** The other party was free to make a more favourable offer to Defendant which he was free to accept. There was no binding agreement between Defendant and Plaintiff since Plaintiff had not accepted the offer. In addition, it was questionable whether Plaintiff could accept at all once he had knowledge that the person had sold the property to someone else.

**Discussion:** Consideration would have supported the agreement to keep the property unsold until 9 o'clock as an agreement separate from the offer to sell. Without that, it was a mere promise that Defendant was free to break. Since the other party, Allen, purchased the property before Plaintiff accepted there could not be any acceptance by Plaintiff.

## **1.5 ROLE OF COMMUNICATION IN A CONTRACT**

As per Section 3 the communication of proposals, the acceptance of proposals and the revocation of proposals and acceptances, respectively, are deemed to be made by any act omission of the party proposing, accepting or revoking, by which he intends proposal, acceptance, revocation, or which has the effect of:

### **Completion of communication of Offer and Acceptance**

As per Section 4 the communication of a proposal is complete when it becomes to the knowledge of the person to whom it is made.



### The communication of an acceptance is complete -

- As against the proposer, when it is put in a course of transmission to him so as to be out of the power of the acceptor;
- As against the acceptor, when it comes to the knowledge of the proposer.

### Role of communication in contracts.

#### Example

Mr. Shantilal from Pune has dispatched a letter to Mr. Vishal at Mumbai on 2-11 -2016 offering to sell 100 school bags for Rs. 1.00 lac.

- Mr. Vishal has received this letter on 4-11 -2016 at 11.00 AM. Mr. Vishal has dispatched his letter of acceptance on 5-11-16 at 10 am. The same is received by Mr. Shantilal on 7-11-2016 at 3 PM.
- When was the communication of a proposal complete?
- When was the communication of an acceptance complete?

#### Answer to the example

The communication of a proposal is complete on 4-11-2016 at 11.00 AM.

The communication of an acceptance is complete -

- As against Mr. Shantilal on 5-11 -2016 at 10.00 PM. It means Mr. Shantilal cannot ' revoke his offer after this time.
- The communication of an acceptance is complete -
- As against Mr. Vishal on 7-11-2016. It means Mr. Vishal cannot revoke his acceptance after this time.

#### An Exercise

Mr. Shantilal from Bangalore has dispatched a letter to Mr. Vishal at Mumbai on 29-11 - 2016 offering to sell 2000 KG Sugar for Rs. 1.00 lac.

Mr. Vishal has received this letter on 30-11-2016 at 11.00 AM. Mr. Vishal has dispatched his letter of acceptance on 1-12-16 at 11 am. The same is received by Mr. Shantilal on 3-12-2016 at 4 PM.

- When was the communication of a proposal complete?
- When was the communication of an acceptance complete?

#### Completion of communication of Revocation

As per Section 4, 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.
- Role of communication of Revocation in contracts.

## NOTES

**Example 1**

Mr. Shantilal from Pune has dispatched a letter to Mr. Vishal at Mumbai on 2-11-2016 offering to sell 100 school bags for Rs. 1.00 lac.

Mr. Vishal has received this letter on 4-11-2016 at 11.00 AM. Mr. Vishal has dispatched his letter of acceptance on 5-11-16 at 10 am. The same is received by Mr. Shantilal on 7-11-2016 at 3 PM.

On 6-11-2016 at 10.35 AM Mr. Shantilal received an offer from Mr. Shankar to buy the same goods for Rs. 1.10 Lacs.

Mr. Shantilal informed Mr. Vishal on 6-11-2016 at 10.45 AM about revocation of his offer of Rs. 1.00 lacs and sold goods to Mr. Shankar.

Decide the legality of the transaction with Mr. Shankar.

**Example 2**

Mr. Shantilal from Pune has dispatched a letter to Mr. Vishal at Mumbai on 2-11-2016! offering to sell 100 school bags for Rs. 1.00 lac.

Mr. Vishal has received this letter on 4-11 -2016 at 11.00 AM. Mr. Vishal has dispatched his letter of acceptance on 5-11 -16 at 10 am. The same is received by Mr Shantilal on 7-11-2016 at 3 PM.

On 6-11 -2016 at 10.15 AM Mr. Vishal received an offer from Mr. Shankar to sell the same goods for Rs.0.90 Lacs.

Mi. Vishal informed Mr. Shantilal on 6-11-2016 at 10.55 AM about revocation of his acceptance of Rs. 1.00 lacs and purchased the goods from Mr. Shankar.

Decide the legality of the transaction with Mr. Shankar.

**Solution to the examples**

The communication of an acceptance is complete -

- As against Mr. Shantilal on 5-11-2016 at 10.00 PM. It means Mr. Shantilal cannot revoke his offer after this time.

Hence, Revocation of offer by Mr. Shantilal on 6-11 -2016 at 10.45 AM is illegal

**The communication of an acceptance is complete—**

- As against Mr. Vishal on 7-11-2016.

It means Mr. Vishal can revoke his acceptance before this time. Hence, Revocation of acceptance by Mr. Vishal on 6-11 -2016 at 10.55 AM is legal.

**Communication of Revocation.**

As per Section 5 a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards.

An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Mode of communicating or revoking rescission of voidable contract. The rescission of a voidable contract may be communicated or revoked in the same manner, and subject to some rules, as apply to the communication or revocation of the proposal.

### Ways of Revocation

As per Section 6 a proposal is revoked-

1. By the communication of notice of revocation by the proposer to the other party;
2. By the lapse of the time prescribed in such proposal for its acceptance, or, if no time is so prescribed, by the lapse of a reasonable time, without communication of the acceptance;
3. By the failure of the acceptor to fulfil a condition precedent to acceptance; or
4. By the death or insanity of the proposer, if the fact of the death or insanity comes to the knowledge of the acceptor before acceptance.

## 1.6 CONSIDERATION

Benefit received by the parties to a contract is called consideration.

**Pollock:** An act or forbearance or promise of one party is the price for which the promise of the other is bought” Consideration mean Quid pro quo (Something in return).

As per Section 2(d), when at the desire of the promisor, the promisee or any other person has done or abstained from doing something, such act or abstinence or promise is called consideration.

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.

### Features of Consideration

- a. Consideration can be direct or indirect. You pay the money to a travelling agent but the bus, train or airline operators give you service.
- b. Consideration can be past, present or future. In case of advance payment, it is a past consideration for seller and a future consideration for buyer. In case of over-the-counter purchase in a shop, it is a present consideration for both seller and buyer. In case of credit sales, it is a future consideration for seller and a past consideration for buyer. What is “past consideration” for one party becomes “future consideration” for the other party.
- c. Consideration can be adequate or inadequate or high. If the reasonable price of Calculator is Rs.500. The owner may sell it for Rs.800 (Over pricing) or Rs.500



(adequate pricing) or Rs. 300/- (inadequate pricing). In all the three cases it is a valid consideration.

### **Chappell & Co. Ltd. vs. Nestle Co. Ltd. [1960] AC 8**

The Court in the instant case held that the consideration to a contract should be sufficient and need not be adequate. Nestle offered to sell a music record, whose copyright was possessed by Chappel, to anyone who bring in three wrappers of “6D” Chocolate bars. The court held that the wrappers, even though does not possess monetary consideration, was a sufficient consideration and thus the contract entered into by such consideration is binding upon the parties.

- a. Consideration can be cash or kind or something of value. Mr. Shantilal offers to sell a car to Mr. Muruganathan for Rs.25,000. In this case consideration from Mr. Muruganathan to Mr.Shantilal is in Cash and consideration from Mr. Shantilal to Mr. Muruganathan is in Kind. Mr. Vishal and Mr. Vithal are participating in an Auction. Mr. Vishal requests Mr. Vithal not to participate in an Auction and offers to pay Rs. 10,000. In this case nonparticipation in an Auction by Mr. Vithal is something of value to Mr. Vishal because he can get the auctioned property at a cheaper price.
- b. Doctrine of Constructive Consideration. A stranger to a contract can sue if he is a beneficiary. A management institute purchased a pay order from State Bank for Rs. 10,000 favouring Mr. Ashok a visiting faculty towards honorarium. The institute sent it by post to Mr. Ashok who forgot to present it within 3 months. Mr. Ashok requested State Bank to enhance the validity period of the pay order. State Bank told him that the management institute, i.e., the purchaser of the pay order should apply for revalidation. The management institute told Mr. Ashok that it was his fault to not present the pay order and hence he should directly deal with the bank. In this case Mr. Ashok is a stranger to a contract between the management institute and State Bank but he is a beneficiary. Hence, he can sue against State Bank as there is a Trusty and beneficiary relationship between the State Bank and Mr. Ashok.

### **An agreement made without consideration is void, unless –**

1. It is expressed in writing and registered under the law for the time being in force for the registration of documents, and is made on account of natural love and affection between parties standing in a near relation to each other; or unless.
2. 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; or unless.
3. It is a promise, made in writing and signed by the person to be charged therewith or by his agent generally or specially authorised in that behalf, to pay wholly or in part debt of which the creditor might have enforced payment but for the law for the limitation of suits.

### **When consideration is not necessary.**

- Natural Love and affection.

- Compensation for past voluntary services.
- Promise to pay a time barred debt.
- Gift.
- Contract of Agency.
- Contract of Guarantee.
- Charity/donation.
- Remission of performance.



### **Donoghue vs. Stevenson [1932] AC 562**

A man ordered ginger beer for her lady friend in a restaurant. The ginger beer came in a dark bottle and the contents of the bottle were not visible from outside. After drinking some of the beer, the lady friend poured the remaining into a tumbler where a snail in a decomposed condition fell. The lady friend complained of stomach pain and she filed a case against the manufacturer. The court ruled in her favour on the principle- The manufacturer owed a duty of care towards the final consumer even in the absence of a contract. The element of privity is not essential for a consumer to sue the manufacturer for negligence.

## **1.7 COMPETENCE TO CONTRACT**

As per Section 11 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.

Major, Sound mind and not disqualified are the three aspects of competence to contract.

A person is said to have attained majority if he has attained the age of 18 years.

Contract with a minor

A person below the age of 18 years is considered as minor. Any contract with a minor is void ab initio. It means right from the beginning; such contracts are invalid. Minor can be a beneficiary of a contract, but he cannot incur liability under the contract. A minor cannot ratify a contract after attaining majority. Principle of Estoppel is not applicable to a minor. It means if a minor represents himself as Major, even then he is not liable.

1. Minor is liable to pay out of his property for the necessities of life supplied to him.
2. Parents or guardians cannot be held for the liability of the minor.
3. Minor can be an agent, but he will not be liable for his acts. Only Principal will be liable for the acts of minor agent.
4. Minor cannot appoint agent.
5. Minor is not liable for the guarantee given by him.
6. Minor cannot be adjudged insolvent.





### **Mohoribibi vs. Dharmodas Ghose 30IA11 4:30 Cal 539 (1903)**

A minor mortgaged his property in favour of the defendant and took some money in advance. He thereafter went on to file an action to cancel this mortgage. However, defendant pleaded that he should be allowed his money back relying upon Section 64 of Indian Contract Act 1872 which deals with voidable contracts. The Court held that the contract entered by a minor was void ab initio and not voidable. Therefore, the minor is not liable to pay any sum of money already advanced to him.

### **Sound mind**

As per Section 12 a person is said to be of sound mind for the purposes 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 interests.

If a person is in a state of drunkenness, then temporarily, he is of unsound mind since he is not capable of understanding the consequences of a contract. Therefore, you should not deal with a person when he is under the influence of alcohol. The burden of proof lies on the person claiming that he was not of sound mind when the contract was made.

Mr. X invited Mr. Y to his residence for a party. Mr. X offered alcoholic drinks to Mr. Y. Mr. Y was heavily drunk. Mr. X obtained the signature of Mr. Y on certain contract papers. In this case Mr. Y will not be bound by the contract if he can prove that he was under the state of intoxication while signing the documents.

### **Persons disqualified to contract:**

1. Alien enemies.
2. Foreign Ambassadors enjoy privileges and immunity.
3. Convicts.
4. Companies beyond the provisions of memorandum of association.
5. Undischarged insolvent.

## **1.8 FREE CONSENT**

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As per Section 13, two or more persons are said to consent when they agree upon the same thing in the same sense.

**As per Section 14, 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

### **Coercion**

As per Section 15, "Coercion" is the committing, or threatening to commit, any act forbidden by the Indian Penal Code (45 of 1860) 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 an agreement.

NOTES



### Undue influence

As per Section 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.
2. A person is deemed to be in a position to dominate the will of another-
  - a. where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other; or
  - b. where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress

### Examples of Relations:

Parent and Child, Teacher and Student, Guardian and Ward, Husband and Wife, Master and Servant, Employer and Employee, Police and Thief, Income Tax Officer and an assessed etc.

### Misrepresentation

As per Section 18, “Misrepresentation” means and includes-

1. The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
2. Any breach of duty which, without an intent to deceive, 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;
3. 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.

### Example:

A builder informs his customer that GST has been implemented with effect from 1st September and the customer has to pay 18% extra. Later on, it was found that the GST was not applicable to the projects completed on or before 31<sup>st</sup> August, 2017. It was a misrepresentation on the part of the builder though he did not have intention to cheat. Customer will be entitled to refund of GST if already paid by him.

### Fraud

As per Section 17, “Fraud” means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

## NOTES



1. the suggestion as a fact, of that which is not true, by one who does not believe it to be true;
2. the active concealment of a fact by one having knowledge or belief of the fact;
3. a promise made without any intention of performing it;
4. any other act fitted to deceive;
5. any such act or omission as the law specially declares to be fraudulent.

**Example:**

A builder enters into an agreement to sell a particular flat to Mr. A. Again he sells the same flat to Mr. B. He collects money from the both. In this case the builder has committed a fraud on Mr. B.

**Philips vs. Brooks (1919) 2 KB 243**

A person named North went to a jewellery shop and purchased some ring in the name of another person Sir George Bullough and also issued the cheque in favour of him by this name. After verifying the address told by North of George in the directory, the shopkeeper allowed North to take a ring with him. After some time, when the shopkeeper discovered of the fraud, North has already pledged the ring in favour of some other person. The shopkeeper filed a case against that other person for his ring. It was observed by the Court that- The minds of the parties met upon the terms of the sale. The fact that the seller was induced to sell by the fraud of the buyer made the sale voidable and not void. The sale could not be avoided because there was intention to sell the product to the person present.

**Mistake**

A belief resulting from a misunderstanding or a faulty judgment. There are two types of mistakes a) Mistake of Law, b) Mistake of Fact.

**a. Mistake of Law**

A contract is not voidable because it was caused by a mistake as to any law in force in India; but mistake as to a law not in force in India has the same effect as a mistake of fact.

**b. Mistake of Fact.**

It may pertain to Identity, Existence, Quantity, Quality.

An Agreement is void where both parties are under mistake as to matter of fact. An erroneous opinion as to the value of the things which forms the subject-matter of the agreement, is not be deemed a mistake as to a matter of fact. A contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact.

**Example:**

In the film "Hum Aapke Hai Kaun". Alok Nath has two sons. Manish and Salman. Anupam Kher has two daughters Renuka and Madhuri. Renuka is married to Manish. Madhuri

loves Salman. Renuka died in an accident. Aloknath requests Madhuri to marry his son. Here Aloknath meant Manish but Madhuri meant Salman. This is an example of mistake of Identity.

**Example:**

Mr. X enters into an agreement to sell his car to Mr. Y. In the meantime, Mrs. X has already sold the same car to Mr. X. This is an example of mistake of Existence

If consent is not free

As per Section 19, when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused. If X has sold goods to Y through misrepresentation, then the contract is voidable at the option of Y.

## 1.9 UNLAWFUL CONSIDERATION OR OBJECT

As per Section 23, the consideration or object of an agreement is lawful, unless - It is forbidden by law; or is of such nature that, if permitted it would defeat the provision 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.

Every agreement of which the object or consideration is unlawful is void. If any part of a single consideration for one or more objects, or any one or any part of any one of several consideration of a single object, is unlawful, the agreement is void.

**Reciprocal promise to do things legal, and also other things illegal**

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 promise is a contract, but the second is a void agreement.

**Alternative promise, one branch being illegal**

In the case of an alternative promise, one branch of which is legal and other illegal, the legal branch alone can be enforced.

**The following is the list of Unlawful consideration or object**

1. It is forbidden by law.
2. It would defeat the provision of any law.
3. It is fraudulent.
4. It involves or implies, injury to the person or property of another.
5. The court regards it as immoral, or opposed to public policy.
6. Void Agreements.
7. Restraint of marriage.
8. Restraint of Trade.





9. Restraint of Legal proceedings.
10. Uncertain meaning.
11. Wagering (Betting) agreements.
12. Contingent on impossible events.
13. Impossible Acts.

### 1.10 TYPES OF CONTRACTS

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The contracts can be categories into the following types

1. Void Agreement
2. Void Contract
3. Voidable Contract
4. Illegal or Unlawful Contract
5. Express contract Vs. Implied contract
6. Contingent Contract
7. Quasi contract
8. Executed and Executory Contract
9. Social Contract

#### 1. Void Agreement:

Following is the list of Void Agreements

- a. An agreement not enforceable by law is called a Void Agreement.
- b. An agreement is void where both parties are under mistake as to matter of fact.
- c. If any part of a single consideration for one or more objects, or any one or any part of any one of several consideration of a single object, is unlawful, the agreement is void.
- d. Every agreement of which the object or consideration is unlawful is void.
- e. An agreement made without consideration is void subject to certain exceptions.
- f. Every agreement in restraint of the marriage of any person, other than a minor, is void.
- g. Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.
- h. 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 the extent.
- i. Agreements, the meaning of which is not certain, or capable of being made certain, are void. Agreements by way of wager (betting) are void. An agreement to do an act impossible in itself is void.

- j. An agreement to do an act impossible in itself is void.
- k. Contract to do act afterwards becoming impossible or unlawful: A contract to do an act which, after the contract is made, becomes impossible or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.
- l. Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to agreement at the time when it is made.

When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore, it, or to make compensation for it, to the person from whom he received it.

### 1. Void Contract

These are the contract valid at the time of making but subsequently become void due to certain new developments after making the contract

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

### 2. Voidable Contract:

An agreement enforceable at the option of one or more parties thereto, but not at the option of the other or others. Example: Consent obtained by fraud.

#### Example:

If X has obtained the consent of Y by fraud, then the contract is voidable at the option of Y and not at the option of X.

### 1. Illegal or Unlawful Contract

These are the contract valid at the time of making but subsequently become illegal due to certain new developments or new enactments after making the contract. A contract to do an act which, after the contract is made, becomes impossible or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

### 2. Express contract Vs. Implied contract

In so far as the proposal and acceptance of any promise is made in words, the contract is said to be express. In so far as such proposal and acceptance is made otherwise than in words, the contract is said to be implied.

### 3. Contingent Contract

A contract maybe (a) absolute or unconditional or (b) conditional or contingent.

As per Section 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.



**Examples:**

Contracts of insurance, contracts of indemnity and contracts of guarantee are all contingent contracts.

Contingent contracts to do or not to do anything in an uncertain future event happens, cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.

Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to agreement at the time when it is made.

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

When contracts may be enforced, which are contingent on specified event not happening within fixed time: Contingent contract to do or not to do anything, if a specified uncertain event does not happen within a fixed time, may be enforced by law when the time fixed has expired and such event has not happened, or before the time fixed has expired, if it became certain that such event will not happen.

**1. Quasi Contracts.**

Law creates a contractual relation between two parties who never had any intention of entering into contract with each other. Such contracts are known as 'quasi-contracts.'

- a. Claim for necessities supplied to a person incapable of contracting or on his account.
- b. If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessities 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.
- c. Reimbursement of person paying money due by another, in payment of which he is interested.
- d. 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.
- e. Obligation of person enjoying benefit of non-gratuitous act.
- f. Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the former is bound to make compensation to the latter in respect of, or to restore, the thing so done or delivered. Responsibility of finder of goods.
- g. A person who finds goods belonging to another, and takes them into his custody, is subject to the same responsibility as a bailee. Liability of person to whom money is paid or thing delivered by mistake or under coercion.

- h. A person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return it.

NOTES



### **Damodar Murlidhar vs. Secretary of State of India (1894) 18 Madras 88**

Government carried out some repairs in the irrigation tank the benefit of which was enjoyed by the villagers as well as some zamindars. The repairs made by the government were done for its preservation and was a result of non-gratuitous act. The court held that government is entitled to the proportional contribution towards the expenses of repairs on the principle- Even though the party making payment or rendering services was personally interested in the matter, he can recover proportional representation from the parties enjoying the benefits.

### **2. Executed and Executory Contract**

A contract in which both the parties have performed their part is called an executed contract. A contract in which either or both the parties have not performed their part is called an executory contract.

### **3. Social Contract**

The casual contracts between the members of the family or between friends and acquaintances which are of social nature, where both or either of the parties have no intention to form a legal relationship are called Social Contracts

**Example: X promises to give a party to Y if he passes an examination.**

## **CHECK YOUR PROGRESS**

1. Define Contract. Explain the ingredients of Via id Contract.
2. Explain the different types of Contracts.
3. Explain the various methods of discharge of a contract.
4. Explain the various remedies in case of breach of a contract.
5. List some of Unlawful consideration or object.

## **1.11 DISCHARGE OF A CONTRACT**

By discharge of a contract, it is meant an end of a contract. The normal course of discharge is performance of their part by each party to a contract.

1. Discharge by Performance.
  - a. Performance may be actual performance, or Attempted performance or Tender.
2. Discharge by mutual consent or agreement.
  - a. Novation, b) Alteration, c) Remission, d) Rescission.
3. Discharge by subsequent or supervening impossibility or illegality.
4. Discharge by lapse of time.





5. Discharge by operation of law.
6. Discharge by breach of contract.

Breach of contract may be of two kinds: a) Actual breach; and b) Anticipatory breach

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

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

When a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is the promisor. The party rescinding a voidable contract shall, if he has received any benefit thereunder from another party to such contract restore such benefit, so far as may be, to the person from whom it was received.

### 1.12 PERFORMANCE OF A CONTRACT.

As per Section 37, 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 of any other law.

Promises bind the representatives of the promisor in case of the death of such promisors before performance, unless a contrary intention appears from the contract.

#### **Attempted Performance (Effect of refusal to accept offer of performance)**

As per Section 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. Mr. X has requested Y to take the delivery of goods but Y has not come forward to take delivery.

#### **Every such offer must fulfil the following conditions-**

1. It must be unconditional;
2. It must be made at a proper time and place, and 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;
3. If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver. An offer to one of several joint promisees has the same legal consequences as an offer to all of them.

If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to non-performance caused thereby.

**Who can Perform?**

As per Section 40, if it appears from the nature of the case that it was the intention of the parties to any contract that any promise contain in it should be performed by the promisor himself, such promise must be performed by the promisor. In other cases, the promisor or his representatives may employ a competent person to perform it.

**Example:**

If you have appointed Mr. Harshal as driver for your lorry, it is expected that Mr. Harshal himself should drive the vehicle, because it involves personal skill. If you have a contract with Shah Rukh Khan to inaugurate your show room then SRK should personally perform. If you have a contract with Lata Mangeshkar to sing in a concert then she should personally perform.

When a promise accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor.

If you have a contract with Lata Mangeshkar to sing and she has deputed Asha Bhosle in her place and if you accept the performance by Asha Bhosle, then you cannot take action against Lata Mangeshkar. You have a right to refuse the performance by Asha Bhosle. In this case you can take action against Lata Mangeshkar for non-performance.

**Part Performance:**

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

**Example:** Mr. X has to pay Rs. 10,000 to Mr. Y. He offered to pay Rs.4,000. This is a case of part performance. Mr. Y can refuse to accept Rs.4,000 or he can accept Rs.4,000 and consider breach of contract for Rs. 6,000

**When to Perform?**

Where, by the contract, a promisor is to perform his promise without application by the promise, and no time for performance is specified, the engagement must be performed within a reasonable time.

A reasonable time differs from case to case, time to time and place to place. Mr. X has booked a ticket on 1st November 2017 with a travel agent for a flight at 6 PM on 2nd November, 2017. In this case, travel agent should inform Mr. X on 1st November 2017 about the availability or not about the ticket. There is no point in giving the ticket after 2nd November, 2017.

When a promise is to be performed on a certain day, and the promisor has undertaken to Perform it without the application by the promise, 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.

## NOTES



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 the performance at a proper place within the usual hours of business.

The performance to any promise may be made in any manner, or at any time which the promise prescribes or sanctions.

When a contract consists of reciprocal promises to be simultaneously performed, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

### **Order of performance of reciprocal promises**

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 transaction requires.

When a contract consists of reciprocal promises, such that one of them cannot 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 to the contract for any loss which such other party may sustain by the non-performance of the contract.

### **Liability of party preventing event on which contract is to take effect**

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; and he is entitled to compensation from the other party for any loss which he may sustain in consequence of the non-performance of the contract.

### **Effect of failure to perform at or before a fixed time, in contract in which time is essential**

When a party to a contract promises to do a certain thing at or before a specified time, and fails to do such thing at or before a specified time, contract or so much of it as has not been performed, becomes voidable at the option of the promisee, if the intention of the parties was that time should be of essence of the contract.

**Effect of such failure when time is not essential:** If it was not the intention of the parties that time should be of 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.

### **Effect of acceptance of performance at time other than agreed upon:**

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 agreed, the promisee cannot claim compensation of any loss occasioned by the non-

performance of the promise at the time agreed, unless, at the time of acceptance, he give notice to the promisor of his intention to do so.

### **Effect of neglect or promise to afford promisor reasonable facilities for performance**

If any promise neglects or refuses to afford the promise reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to non-performance caused thereby.

### **Novation, rescission, and alteration of contract.**

If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed. Every promise may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit.

When a person at whose option a contract is voidable rescinds it, the other party thereto need to perform any promise therein contained in which he is the promisor. The party rescinding a voidable contract shall, if he has received any benefit there under from another party to such contract restore such benefit, so far as may be, to the person from whom it was received.

## **1.13 JOINT PROMISORS AND PROMISES**

### **Joint Promisers:**

As per Section 42, when two or more person have made a joint promise, then, unless a contrary intention appears by the contract, all such persons, during their joint lives, and, after the death of any of them, his representative jointly with the survivor or survivors, and, after the death of the last survivor the representatives of all jointly, must fulfil the promise.

### **Example:**

It there are three partners in a firm A, B & C and if they have taken finance from the Bank, then they are called as joint promisors. If A dies, legal heirs of A along with B & C will be liable to the Bank.

As per Section 43, when two or more persons make a joint promise, the promise may, in the absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole promise.

### **Example:**

In the earlier example, Bank can recover the money from either A or B or C.

This is called Joint and Several Liability. It means they are jointly liable and also, they are individually liable for full amount.

Each promisor may compel contribution: Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.



## NOTES



If A pays full amount he can recover proportionately from B and C. If total liability is Rs.30,000 paid by A, A can recover 10,000 each from B and C Sharing of loss by default in contribution: If any one of two or more joint promisors make default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares. In the above example, if he cannot pay Rs. 10,000 A and B should bear the loss of Rs.5,00 each. It means their overall contribution will be 15,000 each.

#### **Effect of release of one joint promisor**

Where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor, neither does it free the joint promisor so released from responsibility to the other joint promisor or joint promisors.

#### **Joint Promises (Devolution of joint rights)**

As per Section 45, when a person has made a promise to two or more persons jointly, then unless contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and, after the death of any one of them, with the representative of such deceased person jointly with the survivor or survivors, and, after the death of the last survivor, with the representatives of all jointly.

#### **Example:**

If a partnership firm has kept fixed deposit with the bank, they are called as joint promises. If they have three partners A, B and C they have to jointly receive the amount. Signature of all the three are required. If A dies, then the legal heirs of A jointly with B and C have to receive the money from Bank. To avoid such complications, Banks obtain "Either or Survivor", "Anyone or Survivor, jointly or Survivor" intinctions for making payment on maturity.

#### **Application of payment towards Debt**

Where a debtor, owing several distinct debts to one person, makes a payment to him, either with express intimation, or under circumstances implying, that the payment is to be applied to the discharge of some particular debt, the payment if accepted, must be applied accordingly.

Where the debtor has omitted to intimate, and there are no other circumstances indicating to which debt the payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him from the debtor, whether its recovery is or is not barred by the law in force for the time being as to the limitations of suits.

Where neither party makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether they are or are not barred by the law in force for the time being as to the limitation of suits. If the debts are of equal standing, the payment shall be applied in discharge of each proportionately.

**Example:**

Mr. X has purchased a cloth on credit for Rs. 1,000 from Y on 10th October, 2017. Mr. X gave the cloth to Y (who is also a tailor) for stitching on 11th October, 2017. The stitching charges are Rs. 500.

On 25th October Mr. X pays Rs.500 to Mr. Y. In this case

- a. If Mr. X asks Y to adjust it towards stitching charges Y must act accordingly.
- b. If Mr. X did not say anything, Y can adjust either to cloth price or stitching charges
- c. If both Mr. X and Mr. Y did not act, then the payment must be adjusted towards the cloth price.

Thus, the payment must be appropriated as per the discretion of the payer and if he has not exercised his discretion then at the discretion of the receiver and if both have not exercised discretion, then as per the order of time.

## 1.12 BREACH OF CONTRACTS

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Not fulfilling a promise under a contract is called as Breach of Contract.

**Remedies for Breach of Contract**

- a. Rescission of contract
- b. Suit for damages
- c. Suit for specific performance of the contract
- d. Suit for injunction.
- e. Suit for Quantum Meruit. "Proportionate to work done" As much as earned.

**Compensation of loss or damage caused by breach of contract**

When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it. Such compensation is not to be given for any remote and indirect loss of damage sustained by reason of the breach.

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

When a contract has been broken, if a sum is named in the contract as the amount be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss or proved to have been caused thereby, to receive from the party who has broken the contract



reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.

A person who rightfully rescinds a contract is entitled to consideration for any damage which he has sustained through the non-fulfillment of the contract.

#### **Dunlop Pneumatic Tire Co Ltd vs. Selfridge & Co UKHL1, AC 847**

The plaintiff Co. sold tires to Dew & Co. with an undertaking that they shall not sell the product to anyone below the list prices. Dew & Co. sold some tires with the similar undertaking that they shall not sell it below the list price. However, the defendant company sold the tires below the list price and the plaintiff brought an action against them. The doctrine of privity was applied in this case and it was held that there was no contract between the plaintiff and the defendant and therefore plaintiff cannot sue the defendants for breach of contract as there was no contract between them.

### **1.14 SPECIAL TYPES OF CONTRACTS.**

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The following are the special types of contracts. All the usual legal provisions apply to these contracts.

- a. Contract of Indemnity,
- b. Contract of Guarantee,
- c. Contract of Bailment,
- d. Contract of Pledge and
- e. Contract of Agency

### **1.15 CONTRACT OF INDEMNITY**

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As per Section 124, a contract by which one party promises to save the other from loss caused to him by the contract of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity".

Insurance service is another example of contract of indemnity. There are two parties in a contract. Indemnifier and indemnified.

#### **Rights of indemnity-holder**

As per Section 125, rights of indemnity-holder when sued are as under: -

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor-

- a. All damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
- b. All costs which he may be compelled to pay in any such suit, if in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit;

- c. All sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promise to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

NOTES

**Example:**

Mr. X has lost a Demand Draft for Rs. 10,000 purchased from a Bank. He obtained duplicate DD by submitting an Indemnity bond. The original DD was presented by Y but Bank refused to pay since the original DD was lost and duplicate was issued. Y went to Court and got decision in his favor. Now the Bank can recover the money paid to Y from X.

## 1.16 CONTRACT OF GUARANTEE

As per Section 126, a “contract of guarantee” is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the “surety”, the person in respect of whose default the guarantee is given is called the “principal debtor”, and the person to whom the guarantee is given is called the “creditor”.

**Consideration for Guarantee:**

As per Section 127, anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

**Example:**

X takes a loan from Bank and Y gives guarantee. In this case Bank is the Creditor, X is the Principal Debtor and Y is the guarantor (Surety). If X does not pay to Bank Y will have to pay.

**Indemnity Vs Guarantee**

INDEMNITY	GUARANTEE
2 parties. Indemnifier and indemnified	3 parties. Creditor, Principal Debtor and Surety
One contract	3 contracts. Creditor and Principal Debtor, Creditor and Surety and Surety and Principal Debtor
Indemnifier primarily liable	Liability of surety is secondary
Indemnifier has to bear the loss	Surety can recover loss from Debtor

**Liabilities of a surety**

As per Section 128 the liability of the surety is co-extensive with that of the principal debtor. It means the Guarantor is liable for the same sum for which the borrower is liable. Here the liability includes not only the principal but also interest and other charges payable by the debtor.



## NOTES



As per Section 137 mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him, does not discharge the surety.

As Per Section 138, where there are co-sureties, a release by the creditor of one of them does not discharge the others neither does it free the surety so released from his responsibility to the other sureties.

Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

When a Contingent act to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged. Principal Debtor and Guarantors are jointly and severally liable to the Principal Creditor.

**Example:** A is the Borrower. B and C are guarantor for a due of Rs.10,000. Bank can recover full amount jointly from A, B and C or individually from A or B or C. If C pays 10,000, B is liable to pay Rs.5,000 to C.

Where a Contingent act to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged. Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him, does not, in the absence of any provision in the guarantee to the contrary, discharge the surety. Where there are co-sureties, a release by the creditor of one of them does not discharge the others neither does it free the surety so released from his responsibility to the other sureties. Liability of two persons, primarily liable, is not affected by arrangement between them that one shall be surety on other's default.

**Example:**

A is the Borrower. B and C are guarantor for a due of Rs.10,000. There is an arrangement between them that C shall be surety on B's default. Bank can recover full amount jointly from A B and C or individually from A or B or C. An arrangement between them is not binding on the bank.

**Right to information**

Surety is entitled to all information pertaining to the loan. As per Section 142, any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid. As per Section 143, any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid

**Right of consultation:**

Creditor should consult surety if he wants to change the terms and conditions of the loan.

As per Section 133, any variance made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.



As per Section 134, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

As per Section 135, a contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract

**Right of subrogation: (Rights against Creditor)**

After the Surety pays the amount to Creditor he will step into the shoes of the creditor and he will be entitled to all the benefits to which the creditor was entitled.

As per Section 140, where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

As per Section 141, a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship entered into, whether the surety knows of the existence of such security or not; and if the creditor loses, or without the consent of the existence of such security or not; and if the creditor loses, or without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

**Example:**

A is the borrower B is the guarantor. Upon default by A, B has paid the dues to the Bank.

Now the Bank has to hand over to B all the documents and securities given by A to the Bank.

Now B, the guarantor will become Creditor for all the practical purposes. On payment on behalf of the debtor, guarantor steps into the shoes of the creditor.

**Right to Indemnity. (Right against Debtor)**

As per Section 145, in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee.

**Right against Co-sureties.**

As per Section 146, where two or more persons are co-sureties for the same debt or duty, the co-sureties are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.

**Example:**

A is the Borrower. B and C are guarantor for a due of Rs.20,000.

If C pays 20,000, C has right to recover Rs. 10,000 from B or Rs.20,000 from A.



Also, C has right to all the securities given by A to the Bank.

### **Continuing guarantee**

As per Section 129, a guarantee which extends to a series of transaction, is called, a continuing guarantee. If you are guarantor to a cash credit or Overdraft facility availed by your friend then it is a case of continuing guarantee. As per Section 130, a continuing guarantee may be revoked by the surety, as to future transactions, by notice to the creditor.

### **Example:**

A has availed a cash credit limit of Rs.50,000 from a Bank. B is the guarantor. It is a running account. Both credits and debits keep on taking place. The Balance keeps on changing. B is liable for Rs.50,000 or balance whichever is less. When the Debit Balance is Rs. 10,000, B can revoke his guarantee. In this case B will be liable for only Rs. 10,000 and not Rs. 50,000. If the Bank allows A to withdraw beyond Rs. 10,000 B is not liable for amount exceeding Rs. 10,000. If there are credits in the account of Rs. 12,000 after the revocation of guarantee, then the liability of B is cancelled. B is no more liable even if the bank allows withdrawals afterwards.

### **Revocation of Guarantee**

Guarantee for a loan cannot be revoked. A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor. Guarantee is revoked if the surety is discharged.

### **Guarantee is evoked and the surety is discharged in the following circumstances**

- a. Discharge of Surety
- b. Death of surety

The death of the surety operates, in the absence of any contract to the contrary, as a revocation of the continuing guarantee, so far as regards future transactions.

#### **a. Variance in terms of contract**

Any variance made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

#### **b. Release of Principal Debtor by Creditor**

The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

#### **c. Compromise between debtor and creditor without surety's consent.**

A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract. Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

**d. Impairment of surety's remedy due to an act of creditor**

If the creditor does any act which is inconsistent with the right of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

- Loss of security given by debtor.
- Invalidation of contract of guarantee

Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid. Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

When the Guarantee is invalid?

Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join

## 1.17 CONTRACT OF BAILMENT

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**According to section 148.** A "bailment" is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them. The person delivering the goods is called the "bailor". The person to whom they are delivered is called the "bailee".

If a person already in possession of the goods of other contracts hold them as a bailee, he thereby becomes the bailee, and the owner becomes the bailor of such goods, although they may not have been delivered by way of bailment.

The examples of Contract of Bailment are as under:

- Borrowing books from library or a friend.
- Cloak room facility at the railway station/bus stand
- Handing over of documents to bank towards application of loan or for safe custody
- Good hired for use

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

**Duties of the Bailor**

The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risk; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.



## NOTES



Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration, the bailors shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment.

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

### **Rights of the Bailor**

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

A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment. The lender of a thing for use may at any time require its return, if the loan was gratuitous, even though he lent it for a specified time or purpose. But if, on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him losses exceeding the benefit actually derived by him from the loan, the lender must, if he compels the return, indemnify the borrower for the amount in which the loss so occasioned exceeds the benefits so derived.

### **Duties of the Bailee**

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

The bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described.

It is the duty of the bailee to return, or deliver according to the bailor's directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished.

In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

### **Liabilities of the bailee**

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

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



If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division, and any damage arising from the mixture.

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

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

### **Rights of the bailee**

If several joint owners of goods bail them, the bailee may deliver them back to, or according to the directions of, one joint owner without the consent of all in the absence of any agreement to the contrary.

If the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to the directions of the bailor, the bailee is not responsible to the owner in respect of such deliver.

If a person, other than the bailor, claims goods bailed he may apply to the court to stop delivery of the goods to the bailor, and to decide the title to the goods.

### **Bailee's particular lien -**

Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labor or skill in respect of the goods bailed he has in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services, he has rendered in respect of them.

### **General lien of bankers, factors, wharfingers, attorneys and policy brokers -**

Bankers, factor, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain as a security for a general balance of account, any goods bailed to them; but no other person have a right retain, as a security for which balance, goods, bailed to them, unless is an express contract to that effect.

### **Termination of Contract of Bailment**

A gratuitous bailment is terminated by the death either of the bailor or of the bailee.

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

### **Finder of lost goods.**

Finder of lost goods will become an implied bailee and the owner of goods become bailor.

## NOTES



The finder of goods has no right to sue the owner for compensation for trouble and expense, voluntarily incurred by him to preserve the goods and to find out the owner; but he may retain the goods against the owner until he receives such compensation; and where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found, or if he refuses upon demand, to pay the lawful charges of the finder, the finder may sell it -

- a. when the thing is in danger of perishing or of losing the greater part of its value, or
- b. when the lawful charges of the finder, in respect of the thing found, amount to two-thirds of its value.

### 1.18 CONTRACT OF PLEDGE

**According to section 172.** The bailment of goods as security for payment of a debt or performance of a promise is called "pledge". The bailor is in this case called "pawnor". The Bailee is called "pawnee".

#### **Rights of the Pawnee**

The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interests of the debt, and all necessary expenses incurred by him in respect to the possession or for the preservation of the goods pledged.

The pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise of other than the debtor's promise to which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.

The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him to the preservation of the goods pledged.

If the pawnor makes default in payment of the debt, or performance, at the stipulated time, or the promise, in respect of which the goods were pledged, the pawnee may sue as against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale.

If the proceeds of such sale are less than the amount due in respect of the debt or promise the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

If a third person wrongfully deprives the bailee of the use or possession of goods bailed or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment has been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

**Duties of the pawnor**

If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them; but he must, on that case pay in addition, any expenses which have arisen from his default.

**Pledge by mercantile agent**

Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorized by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not authority to pledge.

**Pledge by person in possession under voidable contract**

When the pawnor has obtained possession of the other goods pledged by him under a contract voidable, but the contract has not been rescinded at the time of the pledge the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title. Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest.

**1.19 CONTRACT OF AGENCY**

When a business man is doing the business very often, he will be acting as agent of some body and also very often he will be dealing with the agents. He may be also acting as agent since he appoints agents to do certain things on his behalf.

When you deposit a cheque in a bank, the bank is acting as your agent. When you ask your supplier to send the documents through the bank, the post man is acting as an agent. Transport operator is acting as an agent. People acting under power of attorney or mandate are also agents. It is very essential to understand the legal provisions of contract of agency. When one person is authorized to act on behalf of another it is called a Contract of Agency.

As per Section 182, an "agent" is a person employed to do any act for another in dealings with third persons. The person for whom such act is done, or represented, is called the "principal".

As per Section 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.

Minor can be an agent but he will not incur personal liability in case of any default by him. Hence, it is better not to appoint a minor as an agent.

**Rights/Authorities of an Agent.**

The authority of an agent may be express or implied.



## NOTES



As per Section 187, an authority is said to be express when it is given by words spoken or written. 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, may be accounted circumstances of the case. An agent, having an authority to do an act, has authority to do every lawful thing which is necessary in order to do such act.

As per Section 188, an agent having an authority to carry on a business, has authority to do every lawful thing necessary for the purpose, or usually done in the course, of conducting such business.

As per Section 189, an agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss and would be done by a person of ordinary prudence, in his own case, under similar circumstances.

As per Section 190, an agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally.

As per Section 217, an agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such remuneration as may be payable to him for acting as agent.

As per Section 221, in the absence of any contract to the contrary, an agent is entitled to retain goods, papers, and other property, whether movable or immovable of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him.

As per Section 222, the employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him.

As per Section 230, in the absence of any contract to that effect an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them

#### **Duties of an Agent.**

As per Section 211, an agent is bound to conduct the business of his principal according to the directions given by the principal, or in the absence of any such directions according to the customs which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal and if any profit accrues, he must account for it.

As per Section 212, an agent is bound to conduct the business of the agency with as much skill as is generally possessed by person engaged in similar business unless the principal has notice of his want of skill, flic agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill, or misconduct, but not in respect

of loss or damage which are indirectly or remotely caused by such neglect, want of skill, or misconduct.

As per Section 213, an agent is bound to render proper accounts to his principal on demand. As per Section 214, it is the duty of an agent in case of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions.

As per Section 216, if an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account to his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction

As per Section 218, subject to such deductions, the agent is bound to pay to his principal all sums received on his account.

As per Section 227, when an agent does more than he is authorized to do, and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority is binding as between him and his principal.

When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him Sub-Agent.

As per Section 191, a “sub-agent” is a person employed by, and acting under the control of, the original agent in the business of the agency.

As per Section 192, where a sub-agent is properly appointed, the principal is, so far as regards third persons, represented by the sub-agent, and is bound by and responsible for his acts, as if he were an agent originally appointed by the principal.

**Agent’s responsibility for sub-agents:** The agent is responsible to the principal for the acts of the sub-agent.

**Sub-agent’s responsibility:** The sub-agent is responsible for his acts to the agent, but not to the principal. The termination of the authority of an agent causes the termination (subject to the rules herein contained regarding the termination of an agent’s authority) of the authority of all sub-agents appointed by him.

#### **Agency by Ratification:**

As per Section 196, where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority.

As per Section 197, ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done



### Agency by Estoppel:

If a person acts as an agent even though he is not appointed as an agent for a considerable time then he cannot take a stand that he is not an agent.

### Example:

If you have taken finance from a bank against the security of your stock, the bank debits insurance premium to insure your stock on your behalf. After doing this for say five years, in the 6th year the bank forgets to renew the insurance policy. Now the bank cannot take a stand that it is not an agent of its borrower. The Bank is stopped from denying the agency.

### Types of Agents:

S.No. Type of Agent	Activity
1. Mercantile Agent	Traders who sell goods of another person on commission basis.
2. Sub Agent	An agent appointed by an agent.
3. Co-agent	When principal appoints two or more agents, the agents are called co-agents.
4. Substituted Agent	A new agent appointed in place of an old agent.
5. Consignee	A stockiest of owner of goods to dispose of them as per his order.
6. Forwarding Agent	Agent involved in forwarding the export goods
7. Clearing Agent	Agent involved in clearing imported goods.
8. Commission Agent	An agent who sells goods of another on commission basis
9. Mandate holder	A person holding a letter of mandate (authority) from another person to do certain acts on his behalf.
10. PA Holder	A person who is appointed through a Power of Attorney to do certain acts on behalf of the principal.

### Termination of agency

As per Section 201, an agency is terminated by the principal revoking his authority, or by the agent renouncing the business of the agency; or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated an insolvent under the provisions of any Act for the time being in force for the relief of insolvent debtors.

The principal may, save as is otherwise provided by the last preceding section, revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal. The principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations as arise from acts already done in the agency.



Where there is an express or implied contract that the agency should be continued for any period of time, the principal must make compensation to the agent, or the agent to the principal, as the case may be, for any previous revocation or renunciation of the agency without sufficient cause.

Reasonable notice must be given of such revocation or renunciation; otherwise, the damage thereby resulting to the principal or the agent, as the case may be, must be made good to the one by the other.

Revocation and renunciation may be expressed or maybe implied in the conduct of the principal or agent respectively.

The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.

As per Section 224, where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon an express or an implied promise to indemnify him against the consequences of that Act

## 1.20 CHAPTER SUMMARY

As per Section 2 (h) an agreement enforceable by law is a contract. It can be shown as under: -

**Contract=Agreement + Enforceability.**

As per Section 2 (e) every promise and every set of promises, forming the consideration for each other, is an agreement. Agreement can be shown as under: -

**Agreement = Proposal (Offer) + Acceptance.**

**Essentials of a Valid Contract is as under**

- a. There should be two or more parties.
- b. There should be agreement (offer + acceptance) between the parties.
- c. There should be intention to create legal relationship.
- d. There should be a lawful consideration.
- e. The parties should be competent to contract.
- f. There should be free consent of parties.
- g. There should be a lawful object.
- h. Certainty of meaning.
- i. Possibility of Performance.
- j. The agreements are not hereby expressly declared to be void.

Consent is said to be free when it is not caused by (1) coercion, or (2) undue influence, or (3) fraud, or (4) misrepresentation, or (5) mistake

## NOTES



A 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. A person below the age of 18 years is considered as minor. Any contract with a minor is void ab initio.

A person is said to be of sound mind for the purposes 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 interests.

**The following is the list of Unlawful consideration or object**

- a. It is forbidden by law.
- b. It would defeat the provision of any law.
- c. It is fraudulent.
- d. It involves or implies, injury to the person or property of another.
- e. The court regards it as immoral, or opposed to public policy.
- f. Void Agreements.
- g. Restraint of marriage.
- h. Restraint of Trade.
- i. Restraint of Legal proceedings.
- j. Uncertain meaning.
- k. Wagering (Betting) agreements.
- l. Contingent on impossible events.
- m. Impossible Acts.

**The contracts can be categories into the following types**

- a. Void Agreement.
- b. Void Contract.
- c. Voidable Contract.
- d. Illegal or Unlawful Contract.
- e. Express contract Vs. Implied contract.
- f. Contingent Contract.
- g. Quasi contract.
- h. Executed and Executory Contract.
- i. Social Contract.

**By discharge of a contract, it is meant an end of a contract. The normal course of discharge is performance of their part by each party to a contract.**

1. Discharge by Performance.
  - a. Performance may be actual performance, or Attempted performance or Tender.

2. Discharge by mutual consent or agreement.
  - a. Novation, b) Alteration, c) Remission, d) Rescission.
3. Discharge by subsequent or supervening impossibility or illegality.
4. Discharge by lapse of time.
5. Discharge by operation of law.
6. Discharge by breach of contract.

### Remedies for Breach of Contract

1. Rescission of contract.
2. Suit for damages.
3. Suit for specific performance of the contract.
4. Suit for injunction.
5. Suit for Quantum Meruit. “Proportionate to work done” As much as earned.

### The following are the special types of contracts.

1. Contract of Indemnity,
2. Contract of Guarantee,
3. Contract of Bailment,
4. Contract of Pledge and
5. Contract of Agency.

**Contract of indemnity:** A contract by which one party promises to save the other from loss caused to him by the contract of the promisor himself, or by the conduct of any other person.

**Contract of Bailment:** The delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions.

**Contract of Guarantee:** A contract to perform the promise, or discharge the liability, of a third person in case of his default.

An “agent” is a person employed to do any act for another in dealings with third persons. The person for whom such act is done, or represented, is called the “principal”.

### 1.21 KEYWORDS

<b>Acceptance assent thereto</b>	When the person to whom the proposal is made signifies his
<b>Agent</b>	An “agent” is a person employed to do any act for another, who is so in dealings with third persons. The person for whom such act is done, or represented, is called the “principal”.



<b>Agreement</b>	Every promise and every set of promises forming the consideration for each other, is an agreement.
<b>Bailee</b>	The person to whom the goods are delivered in a contract of bailment.
<b>Bailor</b>	The person delivering the goods in case of bailment.
<b>Coercion</b>	The committing, or threatening to commit, any act forbidden by the Indian Penal Code
<b>Communication</b>	Communication of proposals, their acceptance, revocation and acceptance, respectively are deemed to be made by an act or omission of the party proposing, accepting or revoking by which that party intends to communicate such proposals, acceptance or revocation or which has the effect of communicating it.
<b>Communication of acceptance completed</b>	Against the proposer: it is complete when it is put in a course of transmission to him as to be out of the power of the acceptor. As against the Acceptor: When it comes to the knowledge of the proposer.
<b>Communication of a proposal</b>	Is complete when it comes to the proposal completed knowledge of the person to whom it is made
<b>Communication of Revocation completed</b>	As against the person who makes it: it is complete when the same is put into a course of transmission to the person to whom it is made, so as to be out of power of the person who makes it. As against the person to whom it is made: - when it comes to his knowledge.
<b>Competence to Contract</b>	Every person is competent to contract I) who is of the age of majority ii) who is of sound mind iii) who is not disqualified from contracting.
<b>Consent</b>	Two or more persons are said to have consented when they agree upon the same thing in the same sense.
<b>Consideration:</b>	When at the desire of the promisor, the promisee or any other person has done or abstained from doing something, such act or abstinence or promise is called consideration.
<b>Contingent contract</b>	A contract to do or not to do something, if some event, collateral to such contract, does or does not happen.
<b>Continuing guarantee</b>	A guarantee which extends to a series of transactions.
<b>Contract</b>	An agreement enforceable by law.



<b>Contract of Bailment</b>	The delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions.
<b>Contract of Guarantee</b>	A contract to perform the promise, or discharge the liability, of a third person in case of his default.
<b>Contract of indemnity</b>	A contract by which one party promises to save the other from loss caused to him by the contract of the promisor himself, or by the conduct of any otherdom
<b>Express proposal</b>	In so far as the proposal or acceptance of any promise is made in words, the promise is said to be express.
<b>Fraud suggesting</b>	a fact which is not true, active concealment of a fact etc. with intent to deceive.
<b>Free consent</b>	The consent is said to be free when it is not caused by coercion, Undue Influence, Fraud, Misrepresentation and Mistake.
<b>General lien</b>	Right of Bankers etc to retain as a security for general balance of account, any goods bailed to them.
<b>Implied proposal</b>	In so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied.
<b>Insolvent</b>	A person who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due.
<b>Lawful consideration</b>	The consideration which is not forbidden by law.
<b>Mercantile agent</b>	An agent having in the customary course of business as such agent authority either to sell/ buy/consign goods.
<b>Misrepresentation</b>	Saying something as tine which is not true but the person believes that it is true
<b>Pawnee</b>	The bailee in a pledge.
<b>Pawner</b>	The bailor in a pledge.
<b>Pledge</b>	The bailment of goods as security for payment of a debt or performance of a promise.
<b>Principal</b>	The person for whom agent works or represents.
<b>Principal debtor</b>	The person in respect of whose default the guarantee
<b>Promise</b>	A proposal when accepted becomes a promise
<b>Promise</b>	The person to whom the proposal is made
<b>Promisor</b>	The person who makes the proposal





<b>Proposal</b>	When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent to such act or abstinence, he is said to make a proposal
<b>Reciprocal promises</b>	Promises which form the consideration or part of the consideration for each other are called reciprocal promises.
<b>Sound mind</b>	A person is said to be of sound mind for the purposes 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 interests.
<b>Surety</b>	The person who gives the guarantee.
<b>Undue influence</b>	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.
<b>Void agreement</b>	An agreement not enforceable by law.
<b>Voidable contract</b>	An agreement enforceable at the option of one or more parties thereto, but not at the option of the other or others.

## 1.22 REVIEW QUESTIONS

### SHORT ANSWER TYPE QUESTIONS

1. Explain the legal provisions regarding Performance of a Contract.
2. Explain the legal provisions regarding communication of offer and acceptance.
3. Explain the legal provisions regarding contract of Bailment.
4. Explain the legal provisions regarding contract of Guarantee.
5. Explain the rights and liabilities of Surety.

### LONG ANSWER TYPE QUESTIONS

1. Explain the different types of agents.
2. Explain the different modes of creating contract of agency.
3. Explain the rights, duties and responsibilities of Principal and Agent.
4. Explain the legal provisions regarding contract of Indemnity.
5. Explain special types of contracts.

## 1.23 MULTIPLE CHOICE QUESTIONS

1. As per Section 2 (h) an agreement enforceable by law is a \_\_\_\_\_.
  - a. Contract



- b. Rule
  - c. Law
  - d. None of these
2. \_\_\_\_\_ = Proposal (Offer) + Acceptance.
- a. Rule
  - b. Agreement
  - c. Both A and B
  - d. None of the above
3. The person making the proposal is called the \_\_\_\_\_.
- a. “Stator”
  - b. “Mediator”
  - c. “Promisor”
  - d. None of these
4. Benefit received by the parties to a contract is called \_\_\_\_\_.
- a. Profit
  - b. Tax
  - c. consideration.
  - d. None of these
5. There are \_\_\_\_ aspects of competence to contract.
- a. 2
  - b. 3
  - c. 4
  - d. 5
6. An agent appointed by an agent is \_\_\_\_\_.
- a. Junior agent
  - b. Sub agent
  - c. Head assistant
  - d. None of these
7. According to section \_\_\_\_\_ The bailment of goods as security for payment of a debt or performance of a promise is called “pledge”. The bailor is in this case called “pawnor”. The bailee is called “pawnee”.
- a. According to section 172
  - b. According to section 171
  - c. According to section 173
  - d. According to section 176



8. According to section \_\_\_\_\_ A “bailment” is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them. The person delivering the goods is called the “bailor”. The person to whom they are delivered is called the “bailee”.
- According to section 141
  - According to section 145
  - According to section 148
  - None of these
9. \_\_\_\_\_=Agreement + Enforceability.
- Contract
  - Rule
  - Law
  - None of these
10. Acceptance must be absolute and \_\_\_\_\_.
- Qualified
  - Unqualified
  - Disqualified
  - None of these

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# SALES OF GOODS ACT 1930 AND NEGOTIABLE INSTRUMENTS ACTS, 1981

## STRUCTURE

- 2.1 Learning objective
- 2.2 Introduction
- 2.3 Contract of Sale
- 2.4 Contract of Sale Vs Agreement to Sell
- 2.5 Goods
- 2.6 Price
- 2.7 Transfer of Ownership
- 2.8 Rights of an Unpaid Seller
- 2.9 Conditions and Warranties
- 2.10 Doctrine of “Caveat Emptor”
- 2.11 Sale by Auction
- 2.12 Concept of negotiable instruments act, 1981
- 2.13 What is a Negotiable Instrument?
- 2.14 Negotiation
- 2.15 Promissory note
- 2.16 Bill of exchange
- 2.17 Cheque
- 2.18 Classification of Instruments
- 2.19 Parties to a Negotiable Instrument
- 2.20 Crossing
- 2.21 Endorsement
- 2.22 Paying Banker
- 2.23 Collecting Banker
- 2.24 Bouncing of a Cheque
- 2.25 Chapter Summary
- 2.26 Keywords
- 2.27 Review questions
- 2.28 Multiple choice questions



## 2.1 LEARNING OBJECTIVE

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After completing this unit, student will be able to:

- Understand the Contract of Sale.
- Differentiate between Contract of Sale Vs Agreement to Sell.
- Describe the legal provisions regarding goods.
- Explain the Transfer of Ownership.
- Explain the features of Negotiable Instalment.
- Explain the features of Promissory note.
- Explain the features of Bill of exchange.
- Explain the features of Cheque.
- State the rights and liabilities of Parties to a Negotiable Instrument.

## 2.2 INTRODUCTION

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The law relating to sale and purchase of goods, prior to 1930 were dealt by the Indian Contract Act, 1872. In 1930, Sections 76 to 123 of the Contract Act was repealed and a separate Act known as the Sale of Goods Act, 1930 was passed This act lays down special provisions governing the contract of sales of goods. The general law of contract is also applicable to the contracts for the sale of goods unless they are inconsistent with the express provisions of the Sale of Goods Act.

## 2.3 CONTRACT OF SALE

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According to Section 4 of the Act, a contract of Sale means “a contract where the seller transfers or agrees to transfer the property in goods to the buyer for price” Contract of Sale may be of two types a) SALE b) AGREEMENT TO SELL

### Sale

It is a contract where the ownership in the goods is transferred by seller to the buyer immediately at the conclusion contract

**EXAMPLE:** A sells his house to B for Rs. 10,00,000. It is a sale since the ownership of the house has been transferred from A to B.

### Agreement to Sell

It is a contract of sale where the transfer of property in goods is to take place at a future date or subject to some condition thereafter to be fulfilled.

**EXAMPLE:** A agreed to buy from B a certain quantity of nitrate of soda. The ship carrying the nitrate of soda was yet to arrive. This is ‘an agreement to sale’. In this case, the ownership of nitrate of soda is to be transferred to A on the arrival of the ship containing the specified goods (i.e., nitrate of soda).



## ESSENTIALS OF CONTRACT OF SALE

**Two parties:** There must be two parties- a buyer and a seller to constitute a contract of sale.

**Goods:** Contract of sale relates to goods i.e., movable property. Transaction involving purchase and sale of immovable property are out of the purview of the Sale of Goods Act.

**Transfer of general property:** The object of the contract must be the transfer of general property as distinguished from the special property in the goods by one person to another. The term 'general property' refers to ownership of goods.

**Price:** The consideration for the contract of sale called price must be money.

**Essential elements of a valid contract:** All the essential elements of a valid contract must be present in the contract of sale.

## 2.4 CONTRACT OF SALE AND AGREEMENT TO SELL

BASIS	SALE	AGREEMENT TO SELL
Transfer of property	The property of goods passes from the seller to the buyer immediately. So, the seller is no more owner of the goods sold.	The transfer of property of the goods is to take place at a future time or subject to certain conditions to be fulfilled.
Type of Contract	It is an executed contract	It is an executory contract
Type of goods	A sale can only be in case of existing and specific goods only	agreement to sell is mostly in case of future and contingent goods
Risk of loss in a sale if the goods are destroyed	the loss falls on the buyer even though the goods are in the possession of the seller	if the goods are destroyed the loss falls on the seller even though the goods are in the possession of the buyer.
Consequences of the breach Right to re- sell	If the buyer fails to pay the price of goods (or) if there is a breach of contract by the buyer the seller can sue for the price even though the goods are still in his possession the seller cannot re-sell the goods.	If there is a breach of contract by the buyer the seller can only sue for the damages and not for the price.
General and particular property	The sale of contract plus conveyance and creates 'Jus in rem', gives right to the buyer to enjoy the goods as against the world and large including the seller	An agreement to sell is merely a contract pure and simple and creates 'Jus in persona' i.e., gives a right to the buyer against the seller to sue for the damages

*SALES OF GOODS ACT 1930 AND NEGOTIABLE INSTRUMENTS ACTS, 1981*

## NOTES



Insolvency sale	if the buyer becomes insolvent of buyer before he pays for goods, the seller in the absence of the lien over the goods, must return them to the official receiver or assignee. He can only claim the retable dividend for the price of the goods.	If the buyer becomes insolvent and has not yet paid the price the seller is not bound to part with the goods until he is paid for.
Insolvency	Insolvency the buyer being the owner is entitled of the seller to recover the goods from the official receiver of the assignee.	If the buyer who has paid the price, finds that the seller has become insolvent he can only claim a retable dividend and not the goods because property in them has not yet passed to him.

## 2.5 GOODS

### Definition

The subject matter of a contract of a sale must be goods. According to Section 2(7) the term 'goods' means "every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale"

### Types of goods

Types of goods include Existing goods Future goods Contingent goods Specific Ascertained Unascertained.

- **Existing goods:**

These are the goods which are owned or possessed by the seller at the time of sale. Only existing goods can be the subject of a sale. The existing goods may be Specific Ascertained or Unascertained.

- Specific goods:** Goods identified and agreed upon at the time of making of the contract of sale of goods.
- Ascertained goods:** Goods identified subsequent to the formation of the contract of sale. The terms ascertained and specific, are commonly used for same kind of goods.
- Unascertained or generic goods:** Goods not identified or agreed upon at the time of making of the contract of sale. They are the goods defined for description only.

### Example:

'A' who wants to buy a television set goes to a showroom where four sets of Janta model of Sony television are displayed. He sees the performance of a particular set, which he agrees

to buy. The set so agreed to be bought is a specific set. If after having bought one set he marks a particular set, the set so marked becomes ascertained. Till this time all sets are unascertained.

- **Future goods:**

Goods to be manufactured, produced or acquired after making of the contract are called future goods. Example: 'A' contract, on 1st January, to sell B 50 shares in Reliance Ltd., to be delivered and paid for on the 1<sup>st</sup> March of the same year. At the time of making of the contract, A is not in possession of any shares. The contract is a contract for the sale of future goods.

- **Contingent goods:**

Goods, the acquisition of which by the seller, depends upon an uncertain contingency are called 'contingent goods'. They are also a type of future goods. Example. A agrees to sell 100 units of an article provided the ship which is bringing them, reaches the port safely. This is an agreement for the sale of contingent goods.

- **Perishing of Goods**

Perishing of goods before making of the contract (Sec. 7). 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 to become so damaged as no longer to answer to their description in the contract.

**Example:** Facts. A agrees to sell to B a certain horse. It turns out that the horse was dead at the time of bargain, though neither party was aware of the fact. Discuss the validity of the contract.

**Solution:** The agreement is void. In case part of goods is perished, the following rule applies: (a) if contract is indivisible, it shall be void; and (b) if contract is divisible, it will not be void and the part available in good condition must be accepted by the buyer

### **Goods perishing before sale but after agreement to sell (Sec. 8)**

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.

**Example:** Facts: A buyer took a horse on a trial for 10 days on condition that if found suitable for his purpose the bargain would become absolute. The horse died on 5th day without any fault of either party. Discuss the position of both parties.

**Solution:** The contract, which was in the form of an agreement to sell, becomes void and the seller shall bear the loss.

## **2.6 PRICE**

Sec. 2(10) defines price "as money consideration for a sale of goods". It forms an essential part of the contract. It must be expressed in terms of money. It is not essential that the price





## NOTES



should be fixed at the time of sale. It must, however, be payable, though it may not have been fixed. Ascertainment of price. Price in a contract of sale may be fixed by the contract itself, or left to be fixed in an agreed manner, or determined by the course of dealing between the parties [Sec. 9(1)]

In the absence of ascertainment of price, the buyer must pay to seller a reasonable price. What is the reasonable price is a question of fact dependent on the circumstances of each particular case [Sec. 9(2)] Agreement to sell at valuation Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party cannot or does not make such valuation, the agreement is thereby avoided? Provided that, if the goods or any part thereof have been delivered to, and appropriated by, the buyer, he shall pay a reasonable price there for. Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in fault.

### CHECK YOUR PROGRESS

1. What is contract of sale?
2. Distinguish between sale and agreement to sell.
3. Define goods and its types.
4. What is price?
5. Write a brief note on existing goods and future goods.

## 2.7 TRANSFER OF OWNERSHIP

A contract of sale of goods involves transfer of ownership from the seller to the buyer. Transfer of ownership or property in goods is in fact the main object of making a contract of sale. It is important to know the precise moment of time at which the property in goods passes from the seller to the buyer for the following reasons:

1. Risk prima facie passes with ownership: In case of destruction of or damage to the goods, it is the owner who has to bear the loss because the general rule is 'res perit domino' risk follows ownership or whosoever is the owner must bear the loss. The payment of the price or possession of goods is immaterial.

#### Example:

'A' contract to purchase 30 tons of apple juice from 'B'. B crushes the apple, puts juice in casks and keeps them ready for delivery. A, however, delays to take the delivery and the juice goes putrid and has to be thrown away. A is liable to pay the price [Demby Hamilton & Co. Ltd. v. Barden, (1949) All E R. 435]

2. Action against third parties: In case the goods have damaged by a third party, it is the only the owner who can take action against him.
3. Insolvency of the seller or the buyer: In the event of insolvency of either the seller or the buyer, the question whether the Official Receiver or Assignee can take over the goods or not depends on whether the property in the goods has passed from the seller to the buyer.



### Rules regarding Transfer of Ownership

Goods must be ascertained. Property passes when intended to pass. For Specific goods (Sec. 20 to 22) Passing of property at the time of contract (Sec.20) Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made.

#### Example:

B offers A for his watch a sum of Rs. 1, 000. The watch is to be delivered to B on a fixed day and the price is to be paid on another fixed day. A accepts the offer. The watch becomes B's property as soon as the offer is accepted.

Passing of property delayed beyond the date of the contract Goods not in a deliverable state (Sec.21) Where there is a contract for sale of specific goods not in a deliverable state, i.e., the seller has to do something to the goods to put them into the deliverable state, the property does not pass until such thing is done and the buyer has notice of it. When the price of goods is to be ascertained by weighing (Sec. 22) Where there is a contract for sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

For unascertained/ 'future' goods Sec.23 In the case of a contract for a sale of unascertained or future goods by description, property will pass from the seller to the buyer when the goods of the same description, in a deliverable state, are unconditionally appropriated to the contract by one party with the consent of the other. Goods sent on approval or 'sale or return' Sec.24 When the goods are delivered to the buyer on 'approval' or on 'sale or return' basis, the property in the goods will pass from seller to the buyer, when any of the following conditions are satisfied. The buyer accepts the goods, or the buyer does something which is similar to his act of accepting the goods, e.g., pledges the goods or sells away the goods, or the buyer retains the goods without giving notice of rejection beyond the period fixed or reasonable period if no time is fixed.

### Transfer of Title by Non-Owners

GENERAL RULE - NEMO DAT NON HABET No one can give that which he has not.

To protect property rights.

#### EXCEPTIONS:

- a. Transfer of title by Estoppel. (Sec.27)
- b. Sale by Mercantile Agent. (Sec. 27)
- c. Sale by joint owner/co-owner. (Sec.28)
- d. Sale by person in possession under voidable contract. (Sec.29)
- e. Sale by a seller in possession after sale. (Sec.30(1))



- f. Sale by a buyer in possession of goods. (Sec.30(2))
- g. Sale by an Unpaid Seller. (Sec. 54)

## 2.8 UNPAID SELLER AND HIS RIGHTS

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### Seller:

A person who sells the goods or agrees to sell the goods is called seller. Unpaid It means payment is not made or without payment. In simple words, “Unpaid seller” means a person who has sold the goods for a price but price has not been paid to him.

### Unpaid Seller is a Person:

- a. To whom the whole price has not been paid or tendered.
- b. And where a bill of exchange or other negotiable instruments has been accepted by him as a condition on which it was received has not been fulfilled by reason of dishonor of the instrument or otherwise.

### Example:

Party A sells goods on a cash basis to party B and the price has not been received yet.

### Rights of Unpaid Seller

#### A. Right against the goods.

- 1. When the property in the goods has been transferred
  - a. RIGHT OF LIEN [Sec 46(1)(a) and 47 to 49]
  - b. RIGHT OF STOPPAGE IN TRANSIT [Sec. 50 to 52]
  - c. RIGHT TO RE-SALE
- 2. When the property in the goods has not been transferred. RIGHT OF WITHHOLDING DELIVERY

#### B. Right against the Buyer Personally

- a. Suit for Price.
- b. Suit for damages.
- c. Suit for special damages and interest

### Right against the goods

#### A. When the property in the goods has been transferred?

- 1. Right to Lien [Sec 46(1)(a) and 47 to 49] The right of lien means lawfully right to retain the goods possession until the full price is received. An unpaid seller can exercise his right of lien in following cases. Sec47-49
  - a. Where the goods have been sold on the cash basis.
  - b. Where the goods have been sold on credit basis and the term of credit has expired.
  - c. Where the buyer has become insolvent even if the period of credit has not been expired.



### Other rules to satisfy the conditions for this right are

- a. The unpaid seller must be in actual possession of the goods sold.
- b. It can be exercised even If the documents of title have been delivered to the buyer.
- c. It can be exercised for the price and not for other expenses.
- d. If the seller delivers some goods, it can be exercised on the remaining.

### Termination of right of lien

Seller's right of lien is terminated in following cases.

- a. When he delivers the goods to the carrier or other bailey for transmission to the buyer
- b. When the buyer or his agent lawfully obtains the possession of the goods.
- c. When seller waives his right of lien on the goods.
- d. The right of lien once lost will not be restored.
- e. When the buyer further sells the goods and the seller agrees.

### Example:

A seller "S" sells a TV set to "B" and delivers it to "B" and since the TV set was not functioning properly, "B" delivered it back to "S" for the repairs. It was held that "S" cannot exercise his right of lien over TV set.

### Right to stoppage in transit

[Sec. 50 to 52] It means stoppage of goods while they are in transit to take possession until the price is paid (sec.50-52) Unpaid seller can stop the goods in transit in the following cases.

1. While the buyer becomes insolvent.
2. While the goods are out of actual possession of seller, but have not reached buyer's possession i.e., goods are in transit with carrier.
3. The unpaid seller can stop the goods in transit only for payment of the price of the goods and not for any other charges.

### The unpaid seller cannot stop goods in transit in following cases.

- a. When the goods reach the destination.
- b. While the buyer or his agent takes possession of delivery even if it is not reached destination.
- c. In case the carrier is agent of the buyer, the transit comes to an end the instance carrier receives the goods and seller cannot stop the transition.
- d. Carrier's wrongful refusal to deliver goods to the buyer.

**Example:** A sells TV set to B. "A" delivers the TV to the carrier to carry it to "B". Later on, gets news that "B" has become insolvent; "A" can stop delivery.

## NOTES

**1. Right to Re-sale**

If a buyer fails to pay or offer the price within a reasonable time, the unpaid seller has the right to resell the goods in the following circumstances.

- a. Where the goods are of perishable nature.
- b. Where the unpaid seller has exercised his right of lien or stoppage in transit and gives a notice to buyer of his intension of resell the goods.
- c. Where the unpaid seller has expressly reserved his right of resale.

Where seller gives notice to the buyer of his intension to resell and the buyer does not pay within a reasonable time, he can

- a. Recover loss on resale of the goods, if any
- b. Retain any surplus on resale of goods, if any However if the seller sells without the notice to the buyer, he cannot recover any loss of the goods, if any
- c. Retain any surplus on the resale of the goods, if any

**Example:**

M sells 100 blankets to “N” and gives him one week for payment. “N” does not pay. “M” can resell those to any other person.

**B. When the property in goods has not been transferred?****Right of Withholding delivery**

If the property in the goods has not passed to the buyer, the unpaid seller cannot exercise right of lien, but gets a right of withholding the delivery of goods, similar to and co-extensive with lien.

**Rights against the buyer personally.**

There are some rights which an unpaid seller may enforce against the buyer personally. These rights are called RIGHTS IN PERSONAM.

**Suit for Price [Sec. 55]**

Where ownership of the goods has passed to the buyer and the buyer refuses to pay the price according to the terms of the contract, the seller can sue the buyer for price, irrespective of delivery of the goods.

**Suit for Damages for Non-Delivery [Sec.56]**

Where the buyer refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance. The seller can recover damages only and not the full price.

**Suit for Damages and Interest [Sec.611]**

The seller can sue the buyer for special damages where the parties are aware of such damages at the time of contract. The unpaid seller can recover interest at a reasonable rate on the total unpaid price of goods, from the time it was due until it is paid.



### Remedies for Breach of Contract of Sale

The Sale of Goods Act gives the following remedies to a seller and buyer for a breach of a contract of sale:

- a. Seller's suits Suit for price (Sec. 55).
- b. Suit for damages for non-acceptance of the goods (Sec.56).
- c. Suit for interest [Sec. 61(2) (a)].
- d. Buyer's suits Suit for damages for non-delivery of the goods (Sec. 57).
- e. Suit for specific performance (Sec.58).
- f. Suit for breach of warranty (Sec.59).
- g. Suit for interest [Sec.61 (2)(a)].

## 2.9 CONDITIONS AND WARRANTIES

A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty [Sec. 12(1)].

**Condition:** A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated. [Sec 12(2)]

**Warranty:** A warranty is a stipulation collateral to the main purpose of the contract, breach of which gives rise to a claim for damages, but not a right to reject the goods and treat the contract as repudiated. [Sec 12(3)]

When condition to be treated as warranty [Sec. 13]

Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty, [section 13(1)]. Where a contract of sale is not severable and the buyer has accepted the goods or part thereof the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty, unless there is a term of the contract, express or implied, to that effect. [Section 13(2)]. Nothing in this section shall affect the case of any condition or warranty fulfillment of which is excused by law by reason of impossibility or otherwise. [Section 13(3)].

### Difference between Condition and Warranty

BASIS	CONDITION	WARRANTY
Nature	Fundamental nature	Subsidiary or inferior character
Value	Essential to the main purpose of the contract. The main purpose of the contract cannot be fulfilled without the prior fulfilment of this stipulation.	Only collateral to the main purpose of the contract. Fulfilment of the main purpose of the contract does not depend up on the fulfilment of the warranty

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<b>Breach</b>	The aggrieved party can repudiate the contract.	The aggrieved party can claim damages only
<b>Treatment of Breach</b>	A breach of condition may be treated as a breach of warranty. This would happen where the aggrieved party is contented with damages only.	A breach of warranty, however, cannot be treated as a breach of condition.
<b>Example</b>	X sells food-stuff to Y. The contract between X and Y states that the food to be sold should be fit for consumption and this is the essential term in the contract. So, if it contains any poisonous substance, Y is entitled to reject the food-stuff and to repudiate the contract This essential term is called a condition	If the contract stipulates that the food-stuff should be packed in 1 kilo box but the seller packs it in half-kilo box, only an auxiliary or minor term of the contract is broken, Y may be able to claim compensation in respect of its breach, but not avoid the contract. Such an auxiliary term is called warranty.

### Express and Implied Condition and Warranties

Conditions and warranties may be express or implied. Express condition and warranties. Express condition and warranties are those which have been expressly agreed upon by the parties at the time of contract of sale Implied condition and warranties. Implied condition and warranties are those which the law incorporates into the contract unless the parties stipulate to the contrary.

### Implied conditions

Title, Description, Sample, Quality or Fitness, Merchantability Wholesomeness

### Condition as to title [Sec. 14(a)]

In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is an implied condition on the part of the seller that - a). In the case of a sale, he has a right to sell the goods, and b) In the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass.

**Example:** R bought a car from D and used it for 4 months. D had no title to the car and consequently R had to hand it over to the true owner. Held, R could recover the price paid [Rowland v. Divall (1923)2 K.B. 500]

### Condition a to description (Sec. 15)

In sale by description there is an implied condition that the goods shall correspond with description. This means “if you contract to sell peas, you cannot oblige the party to take beans.” Hence if the description of the article tendered is different than the buyer may not buy the goods.



**Example:** A want to sell his typewriter. He says to B, intending buyer who has not have seen the machine, that it is a brand-new machine. B agrees to purchase it. On delivery B finds that the machine is old and repaired. B can repudiate the contract.

### Condition as to sample (Sec. 17)

A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect. In a sale by sample, the following are the implied conditions:

- a. The bulk shall correspond with the sample in quality;
- b. That the buyer shall have a reasonable opportunity of comparing the bulk with the sample;
- c. That the goods shall be free from any defects rendering them un-merchantable, which would not be apparent on reasonable examination of the sample.

### Example:

Certain shoes were sold by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. Held, the buyer was entitled to the refund of price plus damages.

### Condition as to quality or fitness [Sec. 16 (1)]

Normally, in a contract of sale there is no implied condition as to quality or fitness of the goods for a particular purpose. The buyer must examine the goods thoroughly before he buys them in order to satisfy himself.

**Example:** An order was placed for some lorries to be used “for heavy traffic in a hilly area”. The lorries supplied were unfit and breakdown. There is a breach of condition as to fitness.

### Condition as to merchantability [Sec. 16(2)]

Where goods are bought by description from a seller who deals in goods of that description there is an implied condition that the goods are of merchantable quality. This means goods should be such that they are commercially saleable, as per the description by which they are known in the market at their full value.

### Condition as to wholesomeness

In the case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the good shall be wholesome. Example: X purchased milk from Y, a milk dealer. The milk contained typhoid germs. X’s wife, on taking the milk, got infection and died. Held, X can be entitled for damages.

### Implied Warranties

Quiet Enjoyment, Freedom from Encumbrance, Usage of Trade, Dangerous Nature

- a. **Warranty of quiet possession [Sec. 14(b)].**

In a Conti act of sale, unless there is a contrary intention, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. If the buyer



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is in any way disturbed in the enjoyment of the goods in consequence of seller's defective title to sell, he can claim damages from the seller.

**b. Warranty of freedom from encumbrances [Sec. 14(c)].**

The goods are not subject to any change or right in favor of a third party.

**c. Warranty as to quality or fitness by usage of trade [Sec. 16 (4)].**

An implied warranty as to quality or fitness for a particular purpose may be annexed by the usage of trade.

**d. Warranty to disclose dangerous nature of goods**

Where a person sells goods, knowing that the goods are inherently dangerous or they are likely to be dangerous to the buyer and that the buyer is ignorant of the danger, he must warn the buyer of the probable danger, otherwise he will be liable in damages.

## 2.10 DOCTRINE OF "CAVEAT EMPTOR"

Caveat Emptor is a Latin phrase meaning "let the buyer beware". Let the buyer beware: the principle that the seller of a product cannot be held responsible for its quality unless it is guaranteed in a warranty. For example, you buy a used car which you are told is in perfect condition, but it immediately breaks down OR you buy a house, but it has termites. Under this doctrine the buyer takes the risk on an item he purchases and cannot complain of a defect. Unless there is either fraud or warranty (guarantee) by the seller, the rule applies to the sale of personal property.

The buyer and seller have equal access to information about the item and the buyer is able to make personal inspection.

**Example:** Suppose Ram bought 10 cows from a cattle broker. Out of those 10, 2 cows had defects. However, Ram did not know this because he didn't check all 10 cows though he paid for them. Guess what happened? The 2 infected cows died within three days of the purchase. Now, as there was no tacit condition that the cows would be in great health at the time of the sale, Ram cannot hold the cattle broker as responsible or having sold him those infected cows. It was Ram's basic duty to check the health of those cows and not expect the cattle broker to state all the defects.

**Case study:** Jones vs. Padgett the buyer bought cloth for making uniforms. However, the seller was not aware of the purpose of buying the cloth. Later, the Buyer found that the cloth is not fit making uniforms. It was, however, fit for other nominal purposes. The seller was not found guilty as the principle of 'caveat emptor' applied in this case.

### EXCEPTION OF CAVEAT EMPTOR

**Implied condition as to quality or fitness.**

Where the buyer has made known to the seller the purpose for which he requires the goods and depends on the seller's skill and judgment, there is an implied condition that the seller will supply the goods which are fit for that purpose. Section 16(1)

**Example:** A buys a black yam from B and finds that it has been damaged by white ants. The condition as to meet merchantable quality is broken and therefore, the doctrine of broken and therefore, the doctrine of caveat emptor does not hold good.

### Sale of goods by description.

Where the goods are purchased by description from a seller, who deals in such class of goods, there will be an implied condition that the goods shall be of merchantable equality.

**Example:** English sainfoin seeds, duly exhibited by a sample, are sold. The bulk corresponds to the sample but the seeds supplied are giant sainfoins and not English sainfoin. There is a breach of condition as to description of goods. So, the doctrine of caveat emptor is not applicable.

### Usage of trade

An implied condition or warranty as to quality or fitness for a particular purpose may be annexed by the usage of trade and if the seller deviates from that, the rule of caveat emptor does not hold good.

**Example:** A dealer sells a refrigerator to Mohit. The refrigerator performs all other functions except making ice. This would amount to breach of an implied condition and thus the doctrine of caveat emptor will not work.

### Consent by fraud.

When the buyer relies on false representation of the seller and suffers damages, i.e., in a contract where the buyer's consent was obtained by the seller by fraud, the doctrine of caveat emptor will not hold good.

**Example:** A bought 3000 tons of preserved milk from U.S.A. The tins were labeled in such a way as to infringe the Nestle's trademark. As a result, they were detained by the custom authorities. To get the clearance certificate from the customs, A had to remove the labels and sell them at a loss. Now A can hold the seller responsible for fraud and claim damages.

## 2.11 SALE BY AUCTION

Sale by auction is the public sale where the goods are generally sold to the highest bidder. Rules of Auction Sale. The law on auction sales is contained in Sec.64 of the Sale of Goods Act.

According to it, in the case of a sale of auction the following rules apply: Where goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale;

The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner; and, until such announcement is made, any bidder may retract his bid; A right to bid may be reserved expressly by or on behalf of the seller and, where such right is expressly so reserved, but not otherwise, the seller or any





one person on his behalf may, subject to the provisions hereinafter contained, bid at the auction;

Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person; and any sale contravening this rule may be treated as fraudulent by the buyer;

The sale may be notified to be subject to a reserved or upset price; If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

## 2.12 CONCEPT OF NEGOTIABLE INSTRUMENTS ACT,1981

Negotiable Instrument Act 1881 is one of the oldest Acts in India. The various properties/ assets can be classified as under:

- a. Immovable Properties. E.g., Land and Building.
- b. Movable Goods. E.g., Vehicles, Furniture.
- c. Actionable Claims. E.g., Book Debts, Fixed Deposits in Banks, LIC Policies.
- d. Currency Notes. E.g., 100 Rupees Note.
- e. Negotiable Instruments: E.g., Cheques.

## 2.13 WHAT IS A NEGOTIABLE INSTRUMENT?

Negotiable Instrument is not defined by NI Act. We can try to define it as under. Negotiable Instrument is a written document which creates some rights in favor of some person and which is freely transferable notwithstanding any defect in the title of the transferor. As per Section 13, a “negotiable instrument” means a promissory note, bill of exchange or cheque payable either to order or to bearer.

### **Examples of Negotiable Instruments**

The following are variations of cheques. Hence, they are also treated as Negotiable Instruments.

Demand Draft, Banker’s Cheque, Pay Order, Traveler’s Cheque, Gift Cheque, Dividend Warrant, Interest Warrant. Commercial Paper and Certificate of Deposit are variations of Promissory notes.

The following documents are transferred by endorsement and delivery. They are called as “Quasi Negotiable Instruments” Bill of Lading, Lorry Receipt, Railway Receipt, Ware House Receipt

### **Instruments which are not NI**

The following documents are not Negotiable Instruments and hence, they are not covered by Negotiable Instruments Act. Fixed Deposit Receipt. National Savings Certificate, Postal Order, Money Order, Share Certificate, Airway Bill, Stock Invest, Dock Warrant and Withdrawal Slip

**Characteristics of a Negotiable Instrument**

- a. It is a written document.
- b. It is signed by the Maker/Drawer.
- c. It creates some rights in favor of some person usually called as payee.
- d. It creates some liabilities on the part of some other person.
- e. It is Freely Transferable.
- f. There are certain presumptions to the NI.
- g. It is payable to order or bearer.
- h. Transferee gets better title not withstanding any defect in the title of the transferor.

**Difference between Negotiable Instrument and other types of Properties**

“Nemo data quota non-habit” Means Transferee obtains the document with the same privileges, obligations and liabilities of the transferor. If transferor has defective title transferee gets defective title. Negotiable Instrument is an exception to this rule.

In case of other types of Properties Transferee gets same title as that of Transferor. In case of Negotiable Instrument Transferee gets good title even if the Transferor has defective title.

**Example of Difference**

Mr. X lost a gold ring worth Rs. 10,000 and a bearer cheque favoring “Mr. X” for Rs.10,000/-

Mr. Y found both of them and gave them to a jewelers’ shop and purchased gold ornaments worth Rs.20,000.

Mr. X lodged a Police complaint. Police can recover the gold ring from jewelers’ shop and give it to Mr. X. But Police cannot recover the cheque or its equivalent from jewelers’ shop. Haribhavandas Parasaran and Co. v. A.D. Thakur. The Court held that it is mandatory that the presumption under Section 118(a) of the negotiable instrument Act, 1881 should be made until the contrary is proved.

**2.14 NEGOTIATION****What is Negotiation?**

As per Section 14, When a promise note, bill of exchange or cheque is transferred to any person, so as to continue the person the holder thereof, the instrument is said to be negotiated. It is a transfer of ownership in a Negotiable Instrument. It is like a sale of Negotiable Instrument.

**How is a Negotiable Instrument Negotiated?**

A Bearer Negotiable Instrument is negotiated by Delivery. Merely by handing over the instruments by one person to another, it gets transferred. An Order Negotiable Instrument is negotiated by Endorsement & Delivery. We will study the meaning of Endorsement in the forthcoming slides.

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**What is the meaning of “Payable to Order”?**

A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable.

**Examples.**

Pay to Mr. Vishal.

Pay to Mr. Vishal or Order

Pay to the order of Mr. Vishal.

**What is the meaning of “Payable to Bearer”?**

A promissory note, bill of exchange or cheque is payable to bearer which is expressed to be so payable or on which the only or last endorsement is an endorsement in blank.

**Examples.**

Pay to Bearer.

Pay to Mr. Vishal or Bearer!

**Negotiation Back:**

If payee or endorser becomes endorsee/holder in due course, it is called Negotiation back. In this case all the intervening parties are not liable in case of dishonor of the instrument.

**Example:**

Mr. A issues a cheque to B who endorses it to C. C endorses it to A. In this case B & C are not liable if the cheque is bounced.

Mr. A issues a cheque to B who endorses it to C. C endorses it to D, D endorses it to E and E endorses it to C. In this case D & E are not liable if the cheque is bounced. A & B continue to be liable.

**2.15 PROMISSORY NOTE**

According to Sec. 4 Promissory note is an instrument in writing containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of a certain person, or to the bearer of the instrument.

**Characteristics of a Promissory note**

- a. It is an instrument in writing.
- b. It contains an unconditional promise to pay.
- c. It is signed by the maker/promiser.
- d. Maker/promiser is a certain person
- e. Payee is a certain person

- f. The order is to pay a certain sum of money
- g. It is payable only to the order of a certain person or to the bearer of the instrument.
- h. It is stamped as per Indian Stamp Act if applicable.

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What is the format of a Promissory note?

<b>Date: 26-09-2017</b>	<b>Rs. 10,000/-</b>
On demand I, Mr. Vithalsingh Hajeri, promise to pay Bank of Maharashtra, Pune Branch or order a sum of Rs. 10,000/- (Rs. Ten thousand only) at Pune or wherever demanded at a rate of interest of 12% per annum.	
<b>Revenue Stamp</b> <b>(Signature)</b>	

### Parties in a Promissory note

There are 2 parties in a Promissory note 1) Promisor (Maker) 2) Promisee (Payee). In the previous examples, Mr. Vithalsingh Hajeri is the Promisor (Maker) and Bank of Maharashtra, Pune Branch is the Promisee (Payee).

### Types of Promissory note

There are 2 types of Promissory note

- a. Demand Promissory Note (e: Promise to pay on demand.
- b. Usance Promissory Note: Promise to pay on a future date

## 2.16 BILL OF EXCHANGE

According to the Negotiable Instruments Act 1881, a bill of exchange is defined as “an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument”.

### FEATURES OF BILL OF EXCHANGE

- It is important to have a bill of exchange in writing.
- It must contain a confirm order to make a payment and not just the request.
- The order should not have any condition.
- The bill of exchange amount should be definite.
- Fixed date for the amount to be paid.
- The bill must be signed by both the drawee and the drawer.
- The amount stated on the bill should be paid on-demand or on the expiry of a fixed time.
- The amount is paid to the beneficiary of the bill, specific person, or against a definite order.

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## TYPES OF BILLS OF EXCHANGE

- **Documentary Bill-** In this, the bill of exchange is supported by the relevant documents that confirm the genuineness of sale or transaction that took place between the seller and buyer.
- **Demand Bill-** This bill is payable when it demanded. The bill does not have a fixed date of payment; therefore, the bill has to be cleared whenever presented.
- **Usance Bill-** It is a time-bound bill which means the payment has to be made within the given time period and time.
- **Inland Bill-** An Inland bill is payable only in one country and not in any other foreign country. This bill is opposite to the foreign bill.
- **Clean Bill-** This bill does not have any proof of a document, so the interest is comparatively higher than the other bills.
- **Foreign Bill-** A bill that can be paid outside India is termed as a foreign bill. Two examples of a foreign bill are an export bill and import bill.
- **Accommodation Bill-** A bill that is sponsored, drawn, accepted without any condition is known as an accommodation bill.
- **Trade Bill-** This kind of bill is specially related only to trade.
- **Supply Bill-** The bill that is withdrawn by the supplier or contractor from the government department is known as the supply bill.

## ADVANTAGES OF BILL OF EXCHANGE

**Legal Document-** It is a legal document, and if the drawee fails to make the payment, it will be easier for the drawer to recover the amount legally.

**Discounting Facility-** In cases where the drawer is in immediate need of money, the bill can be converted into cash by discounting it from a bank by paying some nominal charges.

**Endorsement Possible-** This bill of exchange can be exchanged from one individual to another for the adjustment of the debt.

## CHARACTERISTICS OF A BILL OF EXCHANGE

**In writing:** It must be in writing.

**Express order to pay:** There must be an express order to pay and not a mere request to pay.

**Definite and unconditional order:** The order must be definite and unconditional.

**Order to pay certain sum:** The order must be to pay a certain sum.

**Order to pay money only:** The order must be to pay money only.

**Certain three parties:** The three parties (i.e., drawer, drawee and payee) must be certain and must be mentioned in the instrument. It may be noted that the drawer and payee can be the same person but the drawer and drawee cannot be the same person.

**Signed by the drawer:** It must be signed by the drawer.

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### FORMAT OF A BILL OF EXCHANGE

Bangalore 1st June, 2018	
₹4,00,000	
Two months after date, pay to me or my order, the sum of Rupees Four lakh only, for value received	
STAMP	
Accepted (Signed)	(Signed)
Raj Kiran 14, Bangalore	Kunal Singh Lal Bagh, Bangalore

### PARTIES IN A BILL OF EXCHANGE

**Drawer:** The person who draws the bill

**Drawee:** The person on whom the bill is drawn and who has to make payment

**Payee:** The person to whom the sum is payable.

### Bill In Sets (Sec 132)

A Bill of Exchange may be drawn in sets each part being numbered and containing a provision that it shall continue payable so long as other parts are unpaid.

### DIFFERENCE BETWEEN PROMISSORY NOTE AND BILL OF EXCHANGE

S. NO.	CRITERIA	PROMISSORY NOTE	BILL OF EXCHANGE
1	No of parties	2	3
2	Nature of payment	Promise to pay	Order to pay
3	Acceptance	Not necessary	Necessary in case of usance bill
4	Maker's liability	Primary	Secondary
5	Notice of dishonour	Not required	required
6	Payable to Bearer	Not allowed	Allowed in case of usance bill

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## 2.17 CHEQUE

As per Section 6, a “cheque” is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

### A cheque in the electronic form

“A cheque in the electronic form” means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system.

### A truncated cheque

“A truncated cheque” means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

### The characteristics of a Cheque

- a. It is an instrument in writing or electronic form.
- b. It contains an unconditional order.
- c. It is signed by the drawer i.e., account holder or his authorized agent.
- d. Drawee is always a branch of a bank.
- e. The order is to pay a certain sum of money.
- f. It is payable only to the order of a certain person or to the bearer of the instrument.
- g. It is valid for 3 months if nothing is mentioned on the cheque from the date written on cheque.
- h. In case of Postdated cheque, status of the cheque will be that of a usance bill till the date comes. From the date appearing on the cheque, it becomes cheque.

### Parties in a Cheque.

**Drawer:** The person who issues the cheque i.e., Account Holder.

**Drawee:** The Branch of a Bank on whom the cheque is drawn and who has to make payment

**Payee:** The person to whom the sum is payable.

### In the above example:

**Drawer:** Swaroopa Hajeri

**Drawee:** ICICI Bank, Shivajinagar Branch Pune

**Payee:** Vishal singh Hajeri

**DIFFERENCE BETWEEN CHEQUE AND BILL OF EXCHANGE**

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S.NO.	CRITERIA	CHEQUE	BILL OF EXCHANGE
1	Drawee	Always a Bank	Any body
2	Nature of payment	Payable on Demand	in case of usance bill payable on a future date.
3	Acceptance	Not necessary	Necessary in case of usance bill
4	Non presentment	Drawer not discharged	Drawer discharged
	Bearer cheque:	The words "Bearer" is printed after the space for writing payee's name	
	Order cheque:	The words "Order" is printed after the space for writing payee's name	
	Stale cheque:	The date written on the cheque is more than three months' old	
5	Notice of dishonour	Not required	Required
6	Payable to Bearer	Allowed	Allowed in case of usance bill
	Post-dated cheque (pdc)	The date written on the cheque is a future date	
	Validity of a Cheque	The cheque is valid for a period of three months from  The date written on the cheque	

**2.18 CLASSIFICATION OF INSTRUMENTS**

- a. Accommodation bill:
- b. Fictitious bills: both drawer and payee are fictitious
- c. Escrow: bill delivered conditionally
- d. Payable on demand
- e. Payable to bearer or order
- f. Inchoate instrument: incomplete

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- g. Ambiguous instrument: vague cannot identify whether promissory note or bill
- h. Inland instruments
- i. Foreign instruments

## 2.19 PARTIES TO A NEGOTIABLE INSTRUMENT

As per Section 7, the maker of a bill of exchange or Cheque is called the “Drawer”; the person thereby directed to pay is called the “Drawee”.

**“Drawee in case of need “:** When the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need such person is called a “drawee in case of need”.

**“Acceptor”:** After the drawee of a bill has signed his assent upon the bill, or, if there are more parts thereof than one, upon one of such part, and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the “acceptor”.

**“Acceptor for honour”:** When a bill of exchange has been noted or protested for non-acceptance or for better security, and any person accepts it supra protest for honour of the drawer or of any one of the endorsers, such person is called an “acceptor for honour”.

**“Payee”:** The person named in the instrument, to whom or to whose order the money is by the instrument directed to be paid, is called the “payee”.

As per Section 8, the “holder” of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.

Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

### Holder in due course

As per Section 9, “Holder in due course” means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or indorse thereof, if payable to order before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

### Liabilities of parties to a Negotiable Instrument.

**Liability of drawer.** As per Section 30, the drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer as hereinafter provided.

**Liability of prior parties to holder in due course.** - As per Section 36, every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.

## 2.20 CROSSING

NOTES



**The meaning and purpose of Crossing:** To prevent frauds in encashment of cheques, there is a system called Crossing. Crossing is an instruction to paying bank not to make cash payment to payee. Payment should be made only through an account. Even if there is a fraud, the culprit can be traced, because he has an account, he has given photograph, introduction and address proof.

### Types of Crossing.

- a. General Crossing.
- b. Special Crossing.
- c. Not Negotiable Crossing.
- d. Account Payee Crossing.
- e. Double Crossing.

### General Crossing

General Crossing is defined under Section 123 of NI Act. “Where a cheque bears across its face an addition of the words “and company” or any abbreviation thereof, between two parallel transverse lines, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally.

### Example:

&Co

### Consequences of General Crossing

As per Section 126, where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker.

- a. It means the payee or holder in due course has to deposit the cheque into his account with a banker and his banker can collect this cheque from drawee bank. The drawee bank cannot pay the cash to payee against this cheque
- b. The payee or holder in due course needs to have an account with any bank.
- c. The amount of the cheque will be first credited to his account. There after the customer can withdraw cash from his account. If the original payee does not have an account in any bank, he can endorse the cheque to some other person who has an account

### Example of General Crossing

Mr. Hajeri has issued a cheque bearing General Crossing to Mr. Shrinivasan drawn on Bank of Maharashtra. Bank of Maharashtra cannot pay the cash to Mr. Shrinivasan. Mr. Shrinivasan will deposit this cheque into his account with Canara Bank. The amount of the cheque will be first credited to his account. There after he can withdraw cash from his account.



### What if the payee does not have an account?

Mr. Hajeri has issued a cheque bearing General Crossing to Mr. Shrinivasan drawn on Bank of Maharashtra. If Mr. Shrinivasan does not have an account in any bank, he can endorse the cheque to Mr. Vishal who has a Current Account with any Bank. Mr. Vishal can deposit this cheque in his Current Account. Third party cheques are not collected in SB accounts.

### Special Crossing

It is defined under Section 124 of NI Act. "Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable", that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker."

#### Example:

Bank of Maharashtra, Pune Branch

### Payment of cheque crossed specially.

Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection. Special Crossing is normally done by the Collecting Bank after receiving a cheque for collection. The purpose of Special Crossing is that, if this cheque is misplaced after receiving the same from the customer any other bank cannot collect the same. This acts as a safeguard for fraudulent encashment of the cheque

#### Example.

Mr. Hajeri has issued a cheque bearing General Crossing to Mr. Shrinivasan drawn on Bank of Maharashtra. Bank of Maharashtra cannot pay the cash to Mr. Shrinivasan. Mr. Shrinivasan will deposit this cheque into his account with Canara Bank. Canara Bank will put its stamp on this cheque which is called as Special Crossing. After this special crossing, only Canara Bank can collect this cheque. Other Bank cannot collect this cheque.

### "Not negotiable" Crossing.

As per Section 130, a person taking a cheque crossed generally or specially, bearing in either case the words "not negotiable", shall not have and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had.

#### Example:

### Not Negotiable

Mr. Hajeri has issued a cheque bearing Not Negotiable Crossing to Mr. Shrinivasan. This cheque was lost by Mr. Shrinivasan. The cheque was found by Mr. Ashok. Mr. Ashok endorsed it to Mr. Subhas. Now Mr. Subhas will not get a good title to this cheque because Mr. Ashok was not the true owner of the cheque. Mr. Ashok had defective title to the cheque, Mr. Subhas will also get defective title.

**Account Payee Crossing:**

This type of crossing is not defined by Negotiable Instruments Act. It is very much in practice. It increases the safety of a cheque and prevents frauds. It is an instruction to collecting bank to collect the amount of cheque only if the payee is having account with him. If the payee does not have an account with any bank, he cannot encash the cheque. There is no difference between bearer or order once the account payee crossing is done.

Account Payee Only

**Safest Crossing**

Account Payee and Not Negotiable Crossing are used in Combination to have highest safety.

Account Payee Only and Not Negotiable

**The combinations of various crossings.**

- a. Uncrossed Bearer Cheque.
- b. Uncrossed Order Cheque.
- c. Crossed Bearer Cheque.
- d. Crossed Order Cheque.
- e. Account Payee Bearer Cheque.
- f. Account Payee Order Cheque.
- g. Specially Crossed Bearer Cheque.
- h. Specially Crossed Order Cheque.
- i. Not negotiable crossed bearer cheque.
- j. Not negotiable crossed Order cheque.
- k. Account Payee Not Negotiable Crossed Order Cheque.

**2.21 ENDORSEMENT**

Endorsement is defined under Section 15. When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to indorse the same, and is called the endorser.

**Types of Endorsements:**

- a. Endorsement in blank or General Endorsement.
- b. Endorsement in full or Special Endorsement.
- c. Per Pro Endorsement.
- d. Sans Recourse Endorsement.
- e. Restrictive Endorsement.



### Endorsement in blank or General Endorsement

As per Section 16(1), if the endorser signs his name only, the endorsement is said to be “in blank”.

#### Example of Blank Endorsement.

If the cheque is payable to Mr. Vishal or order.

Vishal simply signs on the back of the cheque without naming anybody.

“Vishal”.

### Endorsement in full or Special Endorsement

As per Section 16(1), if the endorser signs his name and if he adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is said to be “in full”, and the person so specified is called the “endorsee” of the instrument.

#### Example of Full or Special Endorsement.

If the cheque is payable to Mr. Vishal or order.

Vishal signs on the back of the cheque names Swaroopa as under: Pay to Swaroopa or order “Vishal”.

Other types of Endorsement Per Pro Endorsement: Endorsement “For or on behalf of” a payee or endorser. Pay to Swaroopa or order For Shantilal “Vishal”.

**Sans Recourse Endorsement:** Endorser is not responsible in the instrument is dishonoured.

Without recourse to me. Pay to Swaroopa Only “Vishal”.

**Restrictive Endorsement: Endorsee cannot further endorse.**

Pay to Swaroopa Only “Vishal”.

## 2.22 PAYING BANKER

The banker on whom the cheque is drawn or the banker who is required to pay the cheque drawn on him by a customer is called the Paying Banker or Drawee Banker

### Precautions to be taken by Paying Banker

- a. He should see that the cheque is drawn in proper form and satisfies all the requirements of a valid cheque.
- b. He Should verify whether the cheque is dated or not.
- c. He should satisfy himself that the amount payable is certain.
- d. He should see whether there is sufficient amount in the bank account.
- e. The banker should see whether the cheque is signed by the drawer.

- f. The banker should see whether the cheque is drawn on the same branch of the bank in which the drawer has his account.
- g. When a cheque is presented to him at the counter, the paying banker must verify whether it is an open (i.e., Uncrossed Cheque or Crossed Cheque).
- h. The Banker should see whether there is any material alteration in the cheque.
- i. When a cheque presented for payment is mutilated, he should check whether it is intentional or accidental.

NOTES



### Liability of drawee of cheque i.e., Paying Banker

As per Section 31, the drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default. Returning a cheque without a valid reason is called “Wrongful dishonour of Cheque” and the drawee banker is liable to pay damages to the drawer.

#### Example:

Suppose you issue a cheque for Rs. 1,000/- favouring BSNL. In this case, Model Bank, Pune branch is called a drawee bank or a paying bank. If you have balance of more than Rs. 1,000/- in your account, and the cheque is in order in other respects, Model Bank, Pune branch must pass this cheque. If the bank returns a cheque unpaid due to a mistake on its part, then it is called wrongful dishonour. In such case, Model Bank is liable to the drawer.

The amount of compensation depends upon the factors like the amount of financial loss and loss of reputation.

It must be noted that, if the cheque is returned due to a mistake on the part of the bank, the payee will be the immediate sufferer. Yet payee cannot claim compensation from Paying Bank. Right to claim compensation from bank is only with the account holder and not the payee. In the previous example, BSNL cannot claim damages/compensation from Model Bank.

#### Paying Banker is liable

If the customer’s signature is forged and hence cannot debit the amount to the customer’s account.

- a. Endorsement of the payee or the indorse subsequently turns out to be forged and there is apparent irregularity in endorsement.

#### Protection to Paying Banker

The paying banker is given some statutory protection in respect of risks or difficulties faced by him. The protection to the paying banker is laid down in Section 85(1), 16(2), 85(2), 85A, 89 and 128 of the Negotiable Instruments Act of 1881. The responsibility and liability of the paying banker is far greater than that of the collecting banker.

As per Section 85(1), where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course.



## NOTES



As per Section 85 (2), where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing thereon, and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.

As per Section 85A., where any draft purports to be endorsed by or behalf of the payee, the bank is discharged by payment in due course.

This means, it is not the duty of paying banker to verify the genuineness of the endorsement.

Even if the endorser signature is forged, the paying bank is not liable if he pays the cheque bearing a forged endorsement.

**Example:**

Mr. Vishal has issued an order cheque to Mr. Harshal. Mr. Rahul has stolen it and forged the signature of Mr. Harshal and endorsed it to Mr. Shankar. Mr. Shankar has presented it to the paying bank. The paying bank does not know that Mr. Rahul has forged the signature of Mr. Harshal on the endorsement. Hence, the paying bank will not be held liable if it passes the cheque.

**What is “payment in due course”?**

As per Section 10, “Payment in due course” means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

**Essentials of “Payment in due course”**

- a. Payment in accordance with the apparent tenor of the instrument. (As it appears perifascial)
- b. Payment in good faith. Person alleging lack of good faith has to prove it. Otherwise, good faith is normally presumed
- c. Payment without negligence. (Example not verifying the signature of the drawer while passing the cheque.)
- d. Payment when there are no suspicious circumstances about the title of the payee or holder in due course.

**Instrument on which alteration is not apparent.**

As per Section 89(1), where a negotiable instrument has been materially altered but does not appear to have been so altered, payment thereof by a person or banker liable to pay and paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such person or banker from all liability thereon, and such payment shall not be questioned by reasons of the instrument having been altered.

As per Section 89 (2), where the cheque is an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image and the truncated cheque shall be a

material alteration and it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image.

As per Section 89 (3), any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same.

**Payment made in due course of crossed cheques: (Sec. 128)**

When the paying banker, makes payment in the due course, it is discharged from liability if

- a. The cheque is forged due to customer's default.
- b. Endorsement of the payee or the endorsee subsequently turns out to be forged and the banker has paid in good faith and without negligence.

**Payment of bearer cheques:** Payment of these cheques at the counter on presentation discharges the banker from liability.

**Payment of order cheques:** The banker is discharged from liability if the payment is made in due course.

**Rightful dishonour of a cheque**

- a. There are no sufficient funds in the account of the drawer.
- b. The cheque is undated, post-dated or irregularly dated.
- c. The cheque is stale or out of date, i.e., Validity period (3 months) is over
- d. The cheque is not signed.
- e. The signature does not tally with the specimen signature.
- f. Material Alteration is not confirmed with full signature of the drawer.
- g. Endorsements are irregular or faulty.
- h. Amount in words and figures differs.
- i. Eland writing is illegible.
- j. Tn case of joint operation, the cheque is signed by only one person.
- k. The drawer has deceased.
- l. Payment stopped by the drawer.

**Canara Bank vs. Canara Sales Corporation & others**

The court observed that the when customer's signature is forged, there is no mandate to the bank to pay. And hence, as such the bank is not entitled to debit customers account on such forged note cheque.

**2.23 COLLECTING BANKER**

Payee's Banker is called a collecting banker. A bank where the payee maintains his account and deposits the cheques received by him is called collecting banker.

## NOTES



When a person receives a cheque drawn on any other banker, he has two options before him:

- a. Either to receive the payment personally or through his agent at the counter of the drawee bank or
- b. To send it his banker for the purpose of the collection from the drawee bank, (collecting bank) While collecting cheques on behalf of the customer, a banker acts either as holder for value or as agent of the customer. Collecting of cheques takes some time in case of outstation cheques. If the collecting banker pays to the customer the amount of the 'cheque or credits such amount to his account and allows him to draw it, before the amount of the cheque is actually realized from the drawee banker (paying banker), the collecting banker is deemed to be its 'holder for value'.

**The banker would be regarded as a holder for value in the following ways:**

- a. If bank allows his customer to withdraw money before cheque paid in for.
- b. collection is actually collected and credited.
- c. If any open cheque is accepted and the value is paid before collection.
- d. If there is a reduction in the overdraft amount of the customer before the cheque is collected and credited in the respective account.
- e. If he gives its value to the customer by lending further on the strength of the cheques.
- f. If he gives its value to the customer by paying over the amount of the cheque or part of it in cash or in account before it is cleared.
- g. If he gives cash over the counter for the cheque at the time it is paid in for collection.

**Collecting banker as holder for value**

1. If the bank acts as a holder, his rights will be the same as of holder in due course. Hence, the collecting banker enjoys all the rights and liabilities of a holder and hence, a holder in due course. Note that the title of holder in due course is superior to the title of true owner.
2. If there is a forged endorsement on the back of the cheque then the paying banker is liable to compensate the damage caused to the true owner and the collecting banker possesses the right to recover this damage from the last endorser. So, in case of an instrument containing forgery the title of true owner is superior. If the last endorser i.e., the customer is unable to meet the liability then the banker will have to bear the burden.
3. If the cheque sent for collection is dishonoured, then the collecting banker can sue all previous parties after giving them notice of dishonour. It is however essential that the amount of cheque is paid to the customer in good faith A collecting banker acts as an Agent of the customer when the customer's cheque is collected and actually realized from the drawee banker. The customer is entitled to draw the amount from his account when the amount of cheque has been credited to his account.

Thus, the bank is acting as an agent of the customer and charges him the commission for collecting the amount from outstation bank.

If the cheque collected by the bank does not belong to his customer, he will be held liable for Conversion of money'. Conversion means wrongful meddling or interference with the goods of others. Here, goods include Bill of Exchange, Cheque or Promissory note. It can be committed innocently. Conversion is the act which renders the person liable committing it.

This liability exists even when the person is merely acts as an agent to his principal. Therefore, a banker however innocently may have converted the goods of another, bank will be held personally liable. This liability exists because the banker is acting as an agent and not as a holder for value. If it is so, no banker will be in a position to collect cheques for his customer.

Hence the collecting banker should take due precautions to avoid the risk of conversion involved therein. It is a difficult task for collecting banker to examine the validity of the title of his customer, when one has to collect so many cheques daily in ordinary course of his business. Protection to the collecting banker Section 131 of the Negotiable Instrument Act 1881 provides the protection to the collecting banker against the risk of conversion as follows:

A banker who has in good faith and without negligence received payment of a cheque for a customer, crossed generally or specially to himself, shall not, in case of the title to the cheque proves defective, incur any liability to the true owner of the cheque, by reason only of having received such payment.”

**The protection will be available to the collecting banker if the following conditions are satisfied:**

- a. The cheque must be crossed cheque.
- b. The payment must be received for a customer.
- c. Payment must be received in good faith and without negligence.

**Crossed Cheques only:**

To avail the protection under section 131, the collecting banker should only accept crossed cheques. Open or bearer cheques generally do not require the service from the collecting bank. (Drawee bank becomes the collecting bank)

The banker cannot cross the cheque afterwards; it must be a crossed cheque before it is presented at the counter for encashment.

Payment collected must be for a customer: Section 131 provides protection to the banker if he is working as an agent of the banker and not a holder for value.

If the banker is having interest in the collection of cheque and is acting as a holder, i.e., not collecting cheque as an agent then the banker cannot avail protection against the conversion.



The payment procedure must be with good faith and without any negligence.

#### **Grounds of Negligence:**

1. Opening of account without proper introduction without following KYC norms.
2. Irregularity of Endorsement.
3. No enquiry is being made in doubtful case.
4. Failure to take note of 'Not Negotiable' crossing.
5. Collection of 'Account Payee' cheque for any other person.

#### **Negligence**

There is no specific meaning being clarified by the banking laws, but on the basis of circumstances aroused, court of law have given judgments and that is why the meaning and scope of Negligence is ever expanding based on new circumstances. Even to avail the protection under section 131 of the Negotiable Instrument Act, the collecting banker has to prove that the act was made without any Negligence. This is because the true owner's case is complete, as soon as conversion is proved against the banker. Negligence under section 131 is more or less artificial as there is no contractual relationship between the true owner and the collecting banker "Negligence is doing of that which a reasonable man under all the circumstances of a particular case which he is acting, would not do, or the failure to do something, which a reasonable man under those circumstances would do." As the word Negligence cannot be determined with some specific and concrete grounds for all the cases, the study constitutes.

#### **The following probable heads under which Negligence should be divided:**

1. Gross Negligence
2. Negligence connected with immediate collection.

#### **Complete carelessness at the time of collection of cheque.**

- a. Collecting an 'A/C payee cheque for other than payee's account: Payment to the person other than payee.
- b. Failure to verify the correctness of Endorsement: If banker omits to verify the correctness of the endorsement on an order cheque.
- c. Failure to verify the existence of authority in case of stamp and signature together.
- d. If any cheque contains warning regarding misappropriation of money, the collecting bank should not disregard such warning, and should make necessary enquiry. It should be paid only after receiving a satisfactory explanation.

#### **Collecting a cheque drawn against the Principal's Account to the Private Account of the Agent without enquiry.**

1. Collecting a cheque payable to the firm to the private account of a partner without enquiry.
2. Collecting a cheque payable from the company to the private account of a director or any other officer without enquiry.

3. Cheque payable from employer to the private account of employee.
4. Cheque payable from Trust's A/C to the private account of the person operating the trust's account.

#### Duties of a collecting banker

1. Collecting cheques with due care and presenting it to drawee banker in reasonable time.
2. Presenting the cheque to drawee banker on next working day in case if both the banks are located in same area.
3. Sending the cheque through clearing house or post to drawee bank in case of outstation bank.
4. Taking due care and precaution for the interest of true owner of a cheque.
5. Verify the endorsement properly on order cheque.
6. Proper investigation of 'Per Pro' endorsements to avoid negligence on the part of collecting banker and to avail statutory protection.
7. Providing the information of dishonour of the cheque to the customer without delay. In case of failure, any consequent loss will have to borne by bank.
8. Obtaining introduction of the customer, in case if the account is being open without proper introduction.
9. In case of open cheque, the collecting banker should cross the same to avail the protection under section 131.
10. Verifying the detail in case of any doubt regarding the true ownership of the cheque.

#### The duties and responsibilities of a collecting banker are discussed below:

##### 1. Due Care and Diligence in the Collection of Cheques:

The collecting banker is bound to show due care and diligence in the collection of cheques presented to him. In case a cheque is entrusted with the banker for collection, he is expected to show it to the drawee banker within a reasonable time. According to Section 84 of the Negotiable Instruments Act, 1881, "Whereas a cheque is not presented for payment within a reasonable time of its issue, and the drawer or person in whose account it is drawn had the right, at the time when presentment ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage, through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer or person is a creditor of the banker to a large amount than he would have been if such cheque had been paid."

In case a collecting banker does not present the cheque for collection through proper channel within a reasonable time, the customer may suffer loss. In case the collecting banker and the paying banker are in the same bank or where the collecting branch is also the drawee branch, in such a case the collecting banker should present the cheque by the next day. In case the cheque is drawn on a bank in another place, it should be presented on the day after receipt.





## 2. Serving Notice of Dishonour:

When the cheque is dishonoured, the collecting banker is bound to give notice of the same to his customer within a reasonable time.

It may be noted here, when a cheque is returned for confirmation of endorsement, notice must be sent to his customer. If he fails to give such a notice, the collecting banker will be liable to the customer for any loss that the customer may have suffered on account of such failure.

Whereas a cheque is returned by the drawee banker for confirmation of endorsement, it is not called dishonour. But in such a case, notice must be given to the customer. In the absence of such a notice, if the cheque is returned for the second time and the customer suffers a loss, the collecting banker will be liable for the loss.

## 3. Agent for Collection:

In case a cheque is drawn on a place where the banker is not a member of the 'clearing-house', he may employ another banker who is a member of the clearing-house for the purpose of collecting the cheque. In such a case the banker becomes a substituted agent. According to Section 194 of the Indian Contract Act, 1872, "Whereas an agent, holding an express or implied authority to name another person to act in the business of the agency has accordingly named another person, such a person is a substituted agent. Such an agent shall be taken as the agent of a principal for such part of the work as is entrusted to him".

## 4. Remittance of Proceeds to the Customer:

In case a collecting banker has realized the cheque, he should pay the proceeds to the customer as per his (customer's) direction. Generally, the amount is credited to the account of the customer on the customer's request in writing, the proceeds may be remitted to him by a demand draft. In such circumstances, if the customer gives instructions to his banker, the draft may be forwarded. By doing so, the relationship between principal and agent comes to an end and the new relationship between debtor and creditor will begin.

## 5. Collection of Bills of Exchange:

There is no legal obligation for a banker to collect the bills of exchange for its customer. But generally, bank gives such facility to its customers. In collection of bills, a banker should examine the title of the depositor as the statutory protection under Section 131 of the Negotiable Instruments Act, 1881.

Thus, the collecting banker must examine very carefully the title of his customer towards the bill. In case a new customer comes, the banker should extend this facility to him with a trusted reference.

### **Risk involved in collection**

The "Doctrine of conversion" which intervenes in the negotiable instrument's operation is one such risk. Conversion is an unauthorized interference with another person's property inconsistent with the owner's right of possession. Any person who however, innocently

obtains possession of the goods of a person who has been fraudulently deprived of them and disposes of them whether for his own benefit or that of some other person is guilty of conversion.

The Collecting Banker runs the risk when he collects the cheques of customers which have defective titles, the true owner of the cheque may sue the banker and collect the money already collected by the banker and paid to the person who presented the cheque for collection.

The banker has to present the cheque for collection within a reasonable time. If any instruction is given by the customer regarding the appropriation of collection proceeds, he should strictly follow such instruction otherwise Collecting Banker is liable.

From the above discussion, there is no doubt to say that the banker is acting as a mere agent for collection and not in the capacity of a banker. If the customer allows his banker to use the collecting money for its own purpose at present and to repay an equivalent amount on a fixed date in future the contract between the banker and the customer will come to an end.

## 2.24 BOUNCING OF A CHEQUE

Cheque is a negotiable instrument. Normally, cheques are issued either for the reason of statutory requirement or for the reason of securing proof of payment. Crossed and account payee cheques are not negotiable by any person other than the payee. It has to be deposited into his bank account. In legal parlance, author of the cheque is called 'drawer', the person in whose favour it is drawn is called 'payee' and the bank who is directed to pay the amount is called 'drawee'. It is always safe to issue crossed "Account Payee Only" cheques in order to avoid its misuse. Blank cheques are not safe. It is better to date the cheque invariably. A cheque is valid for payment only for three months from the date mentioned in the cheque. After the period of three months, such a cheque is called 'stale cheque'.

### **Bouncing**

A cheque becomes due for payment on the date mentioned on it. Before issuing a cheque author of the cheque should ensure that he has sufficient funds in his account. Lest, it would bounce with remarks 'insufficient funds'. Bouncing in common parlance is referred to dishonour of cheques.

Bouncing of a ball is a fun but bouncing of a cheque is a criminal offence. The Negotiable Instruments Act, 1881 is applicable for the cases of dishonour of cheque. This Act has been amended many times since 1881 and I am going to discuss the provisions of this Act as it stands today.

### **What happens when a cheque is dishonoured?**

Immediately upon dishonour the drawee bank issues a 'Cheque Return Memo' to the banker of the payee citing the reason for non-payment. In turn the payee's banker shall handover the dishonoured cheque and the memo to the payee.





## NOTES

**What is to be done, then?**

The payee has an option open to him either to re-present the cheque if and when he thinks the cheque could be honoured but within six months from the date of the cheque or proceed legally to prosecute the drawer. The payee may prosecute the drawer for dishonour of cheque only if the amount mentioned in the cheque is towards discharge of a debt or any other legal liability of the drawee towards payee. Mere issuance of a cheque says for the purposes of gift, or towards lending a loan or for unlawful purposes would not amount to legal liability and the drawer cannot be prosecuted in such cases.

**To proceed legally**

If he decides to proceed legally, then the drawer should be given an opportunity of making good the cheque amount immediately. Such an opportunity has to be afforded only by means of a notice in writing.

**Legal Provisions**

Under Section 138 of the Negotiable Instruments Act, 1881 as amended up to date, the notice has to be sent by the payee to the drawer in writing within thirty days from the date of receiving. Cheque Return Memo from the bank and demand the cheque amount to be paid to him within fifteen days from the date of receipt of such a notice by the drawer.

**Conditions of Prosecution**

Law prescribes certain conditions to be fulfilled in order to attract provisions of Section 138.

- a. The cheque should have been drawn by the drawer on an account maintained by him.
- b. It should have been returned unpaid either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank.
- c. Cheque must have been issued towards discharge of a debt or legal liability.
- d. If after receiving the notice, the drawer does not make payment within fifteen days from the date of receiving such a notice, then he commits an offence punishable under Section 138 of the Negotiable Instruments Act.

**Punishment**

Punishment prescribed for such an offence is fine which may extend to twice the amount of the cheque or imprisonment for a term which may be extended to two years or both.

**Filing Complaint**

If the drawer makes payment of the cheque amount within fifteen days from the date of receipt of the notice, then drawer does not commit any offence. Otherwise, the payee may proceed to file a complaint in the court of the jurisdictional magistrate within one month from the date of expiry of fifteen days prescribed in the notice.

If the payee fails to file the complaint within thirty days, the complaint becomes barred by limitation of time. The jurisdictional magistrate court may refuse to entertain such a belated complaint. However, if the payee has sufficient reasons to justify delay in filing the complaint, he may make an application before the magistrate along with the complaint, to explain the reasons for delay and seek condoning of delay. Cognizance of the complaint may be taken if the Court is satisfied that the payee had sufficient cause for not making the complaint within the prescribed period. After the complaint is filed and taken on record the proceedings against the drawer being.

### Civil Action

The payee may also initiate money recovery procedure in a jurisdictional civil court apart from prosecuting the drawer for criminal offence. It is essential in this case to consult an advocate who is well versed and experienced in this area of practice to proceed further in the matter.

### Finer Points

The procedure of filing complaint and prosecuting the drawer in a court of magistrate involves certain finer points like cause of action, preparation of legal notice and complaint in accordance with legal requirements, modes of sending the written legal notice, service of summons and non-bailable warrants, conducting the criminal case etc. It is advisable to consult an advocate who is well versed and experienced in this area of practice.

### K. Bhaskaran Vs. Sankaran Vaidhyan Balan and Anr

The Court in paragraph 12 of the judgment presented that “Under Section 177 of the Code “every offence shall ordinarily be inquired into and tried in a court within whose jurisdiction it was committed.

Considering and reproducing the constituents of section 138 of NI Act and section 178(d) of the Code, held:

- Drawing of the cheque,
- Presentation of the cheque to the bank,
- Returning the cheque unpaid by the drawee bank,

Giving notice in writing to the drawer of the cheque demanding payment of the cheque amount,

failure of the drawer to make payment within 15 days of the receipt of the notice. It is to be noted that concatenation of all the above five constituents are a sine qua non for the completion of the offence under Section 138.

### Prem Chand Vijay Kumar v. Yashpal Singh

In his case, the apex court held that upon a notice under Section 138 of the Negotiable Instrument Act being issued, a subsequent presentation of a cheque and its dishonour would not create another cause of action’ which could set the Section 138 machinery in motion.



## 2.25 CHAPTER SUMMARY

A contract of Sale means “a contract where the seller transfers or agrees to transfer the property in goods to the buyer for price”. The money consideration for a sale of goods is called the price. Where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

Every kind of moveable property other than actionable claims and money is called goods. Any document used in the ordinary course of business as proof of the possession or control of goods is called as Document of title to goods.

Transfer of ownership or property in goods is in fact the main object of making a contract of sale. Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made. Risk prima facie passes with ownership.

Unpaid Seller Is a Person. To whom the whole price has not been paid or tendered, and where a bill of exchange or other negotiable instillments has been accepted by him as a condition on which it was received has not been fulfilled by reason of dishonor of the instrument or otherwise.

### Rights of Unpaid Seller

#### A. Right against the goods

1. When the property in the goods has been transferred
  - a. RIGHT OF LIEN [Sec 46(l)(a) and 47 to 49]
  - b. RIGHT OF STOPPAGE IN TRANSIT [Sec. 50 to 52]
  - c. RIGHT TO RE-SALE
2. When the property in the goods has not been transferred. RIGHT OF WITHHOLDING DELIVERY

#### B. Right against the Buyer Personally

- a. Suit for Price
- b. Suit for damages
- c. Suit for special damages and interest

A stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated is called Condition. A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.

Caveat Emptor is a Latin phrase meaning “let the buyer beware”. Under this doctrine the Buyer takes the risk on an item he purchases and cannot complain of a defect. Sale by auction is the public sale where the goods are generally sold to the highest bidder.

A “negotiable instrument” means a promissory note, bill of exchange or cheque payable either to order or to bearer. Promissory note is an instrument in writing containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of a certain person, or to the bearer of the instrument.

An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money is called as Bill of Exchange. Bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand is called as a Cheque. Signature of the maker or holder of a negotiable instrument for the purpose of negotiation on the back or face thereof. Drawer’s Banker is called a paying banker. Payee’s Banker is called a collecting banker.

## 2.26 KEY WORDS

<b>Agreement to Sell</b>	Where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.
<b>Buyer</b>	A person who buys or agrees to buy goods;
<b>Condition</b>	A stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated.
<b>Contract of Sale</b>	“A contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.
<b>Delivered State</b>	The goods are in such state that the buyer would be bound to take delivery of them;
<b>Delivery</b>	Voluntary transfer of possession from one person to another;
<b>Document of title to goods</b>	Any document used in the ordinary course of business as proof of the possession or control of goods.
<b>Future goods</b>	Goods to be manufactured or produced or acquired by the seller after making of the contract of sale.
<b>Goods</b>	Every kind of moveable property other than actionable claims and money.
<b>Price</b>	The money consideration for a sale of goods.
<b>Property</b>	The general property in goods, and not merely a special property;
<b>Sale</b>	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.
<b>Seller</b>	A person who sells or agrees to sell goods;
<b>Specific goods</b>	Goods identified and agreed upon at the time a contract of sale is made.

## NOTES



Acceptance of a bill	The drawee of a bill has signed his assent upon the bill
Acceptor	The drawee after acceptance of a bill
Acceptor for Honour	Any person who accepts it supra protest for honour of the drawer or of any one of the endorsers
Accommodation Bill	Bill of exchange drawn without a real transaction to help payee to raise finance from a bank.
Account Payee Crossing	Direction to the collecting bank to credit the amount to the account of payee.
Allonge	A piece of paper attached to an instrument if the space is not sufficient for endorsement.
Bearer Cheque	Cheque payable to bearer. The word "Bearer" is written after the payee.
Bill of Exchange	An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money
Blank endorsement	If the endorser signs his name only without naming anybody.
Cheque	bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand
Days of Grace	3 days added to the arithmetical due date to arrive at actual due date.
Demand Bill	Bill payable on demand.
Demand Draft	An order by one branch of a bank to another branch of a bank to pay certain sum for value received.
Dishonour of Cheque	Cheque is returned by the drawee bank for any reason.
Drawee	The person directed to pay
Drawee in case of need	Name of any person which is given in addition to the drawee
Drawer	The maker of a bill of exchange or Cheque
Due Date	The date on which a bill is due for payment
Endorsee	The person to whom a negotiable instrument has been endorsed.
Endorsement	Signature of the marker or holder of a negotiable instrument for the purpose of negotiation on the back or face thereof.
Endorser	The marker or holder of a negotiable instrument signs for the purpose of negotiation on the back or face thereof.
Exceeds arrangement	The unutilised portion of a cash credit limit is not sufficient to pass a cheque.



Foreign Bill	A bill of exchange when any one or more of drawer/drawee/payee reside in a foreign country.
Full Endorsement	Endorser adds a direction to pay the amount to, or to the order of, a specified person
General Crossing	A cheque bears across its face an addition of the words “and company” or any abbreviation thereof, between two parallel transverse lines. It is a direction to paying banker to pay through an account.
Holder	Any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon
Holder in due course	Any person who for consideration became the possessor or the payee or indorse of an instrument without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title
Hybrid	Any security which has the character of more than one type of security
Inchoate instrument	Instrument which is incomplete except for signature
Inland Bill	A bill drawn and payable in India.
Kite plying	Issuing accommodation bills/cheques not supported by transactions for raising finance from bank.
Negotiable Instrument	Promissory note, Bill of Exchange or Cheque. An instrument in writing which creates rights and obligations and freely transferable.
Negotiation	Transfer of ownership of a Negotiable instrument
Negotiation Back	Drawer/Payee/endorsee becomes holder in due course. A cheque transferred by Mr. is again received by Mr. after passing through several hands.
Not Negotiable Crossing	A transferee does not get better title than the transferor.
Officer who is in default	Officers of the company, namely (a) the managing director or managing directors (b) the whole-time director or whole-time directors (c) the manager (d) the Secretary-
Order Cheque	Cheque payable to or to the order of a person named in it. The word “Order” is added after the name of payee.
Payee	The person named in the instrument, to whom or to whose order the money is directed to be paid.
Payment in due course	Payment in accordance with the apparent tenor, in good faith and without negligence under circumstances which do not afford a reasonable ground for believing that the payee is not entitled to receive payment of the amount therein mentioned

## NOTES



Per Pro endorsement	Endorsement in the capacity of an agent. i.e., for and on behalf of.
Promissory Note	An instrument in writing containing an unconditional undertaking to pay a certain sum of money
Restrictive Endorsement	Word Only is added to the name of endorsee. Endorsee cannot further transfer this cheque.
Sans Recourse endorsement	Endorser is not liable if the cheque is bounced
Special Crossing	A cheque bears across its face an addition of the name of a banker
Stale Cheque	A cheque which is more than 6 months old or validity period has expired
Stop payment of a Cheque	A request by drawer to bank not to make payment of the cheque
Validity of a Cheque	The period up to which a cheque can be presented for payment

## 2.27 REVIEW QUESTIONS

### SHORT ANSWER TYPE QUESTIONS

1. Explain the essentials of Contract of Sale.
2. Explain the legal provisions regarding transfer of ownership in a Contract of Sale.
3. Explain the legal provisions regarding goods under Sale of Goods Act.
4. Explain the different types of Endorsements.
5. Explain the legal provisions regarding Noting and Protesting.

### LONG ANSWER TYPE QUESTIONS

1. Explain the differences between Conditions and Warranties.
2. State the implied Conditions and Warranties.
3. Explain the rights and liabilities of a collecting banker.
4. Explain the legal provisions regarding Bouncing of a Cheque.
5. State the ingredients of Payment in Due Course.

## 2.28 MULTIPLE CHOICE QUESTIONS

1. In \_\_\_\_\_, Sections 76 to 123 of the Contract Act was repealed and a separate Act known as the Sale of Goods Act.
  - a. 1930
  - b. 1935
  - c. 1940
  - d. 1945

2. **Contract of Sale are of \_\_\_\_\_ types.**
  - a. 1
  - b. 2
  - c. 3
  - d. 4
3. **The subject matter of a contract of a sale must be \_\_\_\_\_.**
  - a. Willingness
  - b. Goods
  - c. Substance
  - d. None of the above
4. **There are \_\_\_\_\_ types of goods.**
  - a. 2
  - b. 3
  - c. 4
  - d. 5
5. **A contract of sale of goods involves \_\_\_\_\_ of ownership from the seller to the buyer.**
  - a. Transfer
  - b. Stable
  - c. Inferior
  - d. None of the above
6. **If the payee fails to file the complaint within \_\_\_\_\_ days, the complaint becomes barred by limitation of time.**
  - a. 27
  - b. 28
  - c. 29
  - d. 30
7. **The banker has to present the \_\_\_\_\_ for collection within a reasonable time.**
  - a. Cash
  - b. Cheque
  - c. Passbook
  - d. None of the above
8. **\_\_\_\_\_, a “negotiable instrument” means a promissory note.**
  - a. As per Section 13
  - b. As per Section 14

NOTES





## NOTES



- c. As per Section 15
  - d. As per Section 16
9. \_\_\_\_\_, “Holder in due course” means any person who for consideration became the possessor of a promissory note.
- a. As per Section 6
  - b. As per Section 7
  - c. As per Section 8
  - d. As per Section 9
10. It is important to have a bill of exchange in \_\_\_\_\_.
- a. Lingual
  - b. Writing
  - c. No need
  - d. None of the above

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# THE COMPANIES' ACT 2013

## STRUCTURE

- 3.1 Learning objective
- 3.2 Introduction
- 3.3 Important Definitions
- 3.4 Meaning and features of a company
- 3.5 Classification of companies
- 3.6 Formation of a Company
- 3.7 Memorandum of Association
- 3.8 Articles of Association
- 3.9 Prospectus
- 3.10 Share capital
- 3.11 Shareholder democracy
- 3.12 Management and administration
- 3.13 Meetings
- 3.14 Board of Directors
- 3.15 Independent directors
- 3.16 Financial Reports
- 3.17 Audit
- 3.18 Dividend
- 3.19 Compromises, arrangements and amalgamations
- 3.20 Revival and rehabilitation of sick companies
- 3.21 Corporate social responsibility
- 3.22 Acceptance of deposits
- 3.23 Winding Up of a company
- 3.24 Chapter Summary
- 3.25 Key Words
- 3.26 Review Questions
- 3.27 Multiple choice questions



### 3.1 LEARNING OBJECTIVE

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After completing this unit, student will be able to:

- Explain the Meaning and features of a company.
- Explain the procedure for Formation of a Company.
- Explain the Memorandum of Association.
- Explain the Articles of Association.
- Explain the Prospectus.
- Describe the legal provisions regarding Share capital.
- Describe the roles of Board of Directors.
- Describe the legal provisions regarding Meetings.
- Describe the legal provisions regarding Audit.
- Describe the legal provisions regarding Financial Reports.
- Explain the procedure for Winding Up of a company.

### 3.2 INTRODUCTION

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The word 'company' was derived from the Latin words Com=with or together Panis = bread. A company can be defined as an "artificial person", invisible, intangible created under law, with a discrete legal entity, perpetual succession and a common seal.

The Indian company law begun with the companies' act 1850, modelled on British companies' act 1844. The Indian Companies act of 1913 was based on the British Companies act of 1908. The Indian Companies act, 1956; April 1, 1956 the Indian Companies act, 2013.

The Companies Act 2013 got assent from the President of India on 29th August 2013. The Act comprises of 29 Chapters, 470 Sections with 7 Schedules. It is substantively a law based on Rules. The changing national and international economic environment, exponential growth of the Indian economy and changes in the stakeholders' expectations necessitated for a need for a new Companies Law.

The Ministry of Corporate Affairs has notified 98 sections of the Companies Act 2013 and made applicable from 12th September, 2013 and Section 135 and Schedule VII of the Companies Act along with the Rules pertaining to that section were notified in February, 2014. In addition to that, 183 sections and 13 subsections of the already notified sections and rest of the schedules of the Companies Act, 2013 have been notified by the Ministry on 26th March, 2014 and are made applicable from 1<sup>st</sup> April, 2014. As of now a total of 282 sections stand notified. Also, the Rules for 19 Chapters of the Companies Act have been notified by the Ministry of Corporate Affairs. It extends to the whole of India.

The 2013 Act introduces significant changes in the provisions related to governance, e-management, compliance and enforcement, disclosure norms, auditors and mergers and

acquisitions. Also, new concepts such as one-person company, small companies, dormant company, class action suits, registered valuers and corporate social responsibility have been included.

### Objectives of the Act

- a. To promote the development of the economy.
- b. To encourage transparency and accountability.
- c. To promote high standards of corporate governance.
- d. To recognize new concepts and procedures to support business while protecting interests of all the stakeholders.
- e. To set up institutional structure in the form of various authorities, bodies and panels (NCLT and NCLAT).
- f. To enforce stricter action against fraud and gross non-compliance with company law provisions.

## 3.3 IMPORTANT DEFINITIONS

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**Abridged prospectus**, means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf

**Associate company**, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

**Authorized capital or nominal capital** means such capital as is authorized by the memorandum of a company to be the maximum amount of share capital of the company

**Board of Directors or Board**, in relation to a company, means the collective body of the directors of the company

**Books of account includes records maintained in respect of:**

- a. All sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place.
- b. All sales and purchases of goods and services by the company.
- c. The assets and liabilities of the company.
- d. The items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

**Charge** means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

**Company** means a company incorporated under this Act or under any previous company law.





**Company limited by shares**, means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them control, shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner

**Debenture** includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not deposit, includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India

**Employees' stock option** means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price

**Financial statement, in relation to a company, includes:**

- a. A balance sheet as at the end of the financial year.
- b. A profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year.
- c. Cash flow statement for the financial year.
- d. A statement of changes in equity, if applicable; and any explanatory note annexed to, or forming part of.

**Financial year**, in relation to any company or body corporate, means the period ending on the 31<sup>st</sup> day of March every year.

**Foreign company** means any company or body corporate incorporated outside India which

- a. Has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- b. Conducts any business activity in India in any other manner.

**Free reserves**, means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend Provided that—

- a. Any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise.
- b. Any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

**Global Depository Receipt** means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorized by a company making an issue of such depository receipts.



**Government company** means any company in which not less than fifty-one per cent, of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a government company.

**Holding company**, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

**Independent director** means an independent director referred to in sub-section (5) of section 149.

**Indian Depository Receipt** means any instrument in the form of a depository receipt created by a domestic depository in India and authorized by a company incorporated outside India making an issue of such depository receipts.

**Interested director** means a director who is in any way, whether by himself or through any of his relatives or firm, body corporate or other association of individuals in which he or any of his relatives is a partner, director or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company.

**Issued capital** means such capital as the company issues from time to time for subscription;

**Key managerial personnel (KMP), in relation to a company, means—**

- a. The Chief Executive Officer or the managing director or the manager.
- b. The company secretary.
- c. The whole-time director.
- d. The Chief Financial Officer.
- e. Such other officer as may be prescribed.

**Listed company** means a company which has any of its securities listed on any recognized stock exchange.

**Manager** means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

**Managing Director (MD)** means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

**Net worth** means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of



the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

**Officer who is in default (OID)**, for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:

1. Whole-time director.
2. Key managerial personnel.
3. Where there are no key managerial personnel, such director or directors as specified by the board in this behalf and who has or have given his or their consent in writing to the board to such specification, or all the directors, if no director is so specified.
4. Any person who, under the immediate authority of the board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default.
5. Any person in accordance with whose advice, directions or instructions the board of directors of the company is accustomed to act, other than a person who gives advice to the board in a professional capacity.
6. Every director, in respect of a contravention of any of the provisions of this act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance.
7. In respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer.

**Official Liquidator** means an Official Liquidator appointed under sub-section (1) of section 359

**One Person Company** means a company which has only one person as a member;

**“Ordinary or special resolution”** means an ordinary resolution, or as the case may be, special resolution referred to in section 114;

**Paid-up share capital or. share capital paid-up.** means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called

**Private company** means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles,

- a. Restricts the right to transfer its shares.
- b. Except in case of one person company.
- c. Limits the number of its members to two hundred.

**Promoter**, means a person—

- a. Who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92?
- b. Who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise?
- c. In accordance with whose advice, directions or instructions the board of directors of the company is accustomed to act.

**Prospectus**, means any document described or issued as a prospectus and includes a red heiring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate public company means a company which:

- a. Is not a private company.
- b. Has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed.

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

**Recognized stock exchange** means a recognized stock exchange as defined in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956.

**Register of companies** means the register of companies maintained by the Registrar on paper or in any electronic mode under this Act.

**Related party**, with reference to a company, means—

- a. A director or his relative.
- b. Key managerial personnel or his relative.
- c. A firm, in which a director, manager or his relative is a partner.
- d. A private company in which a director or manager is a member or director.
- e. A public company in which a director or manager is a director or holds along with his relatives, more than two per cent, of its paid-up share capital.
- f. Anybody corporate whose board of directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager.
- g. Any person on whose advice, directions or instructions a director or manager is accustomed to act: provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity.







- h. Any company which is -
  - i. A holding, subsidiary or an associate company of such company; or
  - ii. A subsidiary of a holding company to which it is also a subsidiary

**Relative**, with reference to any person, means anyone who is related to another, if-

- i. They are members of a Hindu Undivided Family.
- ii. They are husband and wife.
- iii. One person is related to the other in such manner as may be prescribed.

**Remuneration** means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

**Share** means a share in the share capital of a company and includes stock.

**Small company** means a company, other than a public company,

- a. Paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees.
- b. Turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.

Provided that nothing in this clause shall apply to:

- a. A holding company or a subsidiary company.
- b. A company registered under section 8.
- c. A company or body corporate governed by any special Act.

**Subscribed capital** means such part of the capital which is for the time being subscribed by the members of a company.

**Subsidiary company** or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- a. Controls the composition of the Board of Directors.
- b. Exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

**Sweat equity shares**, means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called total voting power., in relation to any matter, means the total number of votes which may be cast in regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes.

**Turnover** means the aggregate value of the realization of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year.

**Voting right** means the right of a member of a company to vote in any meeting of the company or by means of postal ballot. Whole-time director includes a director in the whole-time employment of the company

**Director Identification Number (DIN)** means an identification number allotted by the Central Government to any individual, intending to be appointed as director or to any existing director of a company, for the purpose of his identification as a director of a company

**Electronic mode**, for the purposes of clause (42) of section 2 of the Act, means carrying out electronically based, whether main server is installed in India or not, including, but not limited to:

- a. Business to business and business to consumer transactions, data interchange and other digital supply transactions
- b. Offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India.
- c. Financial settlements, web-based marketing, advisory and transactional services, database services and products, supply chain management.
- d. Online services such as telemarketing, telecommuting, telemedicine, education and information research.
- e. All related data communication services, whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

**Total Share Capital**, for the purposes of clause (6) and clause (87) of section 2, means the aggregate of the:

- a. Paid-up equity share capital.
- b. Convertible preference share capital.

**List of relatives in terms of clause (77) of section 2.**-A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:

- a. Father: Provided that the term. Father, includes step-father.
- b. Mother: Provided that the term. Mother, includes the step-mother.
- c. Son: Provided that the term. Son. includes the step-son.
- d. Son's wife.
- e. Daughter.
- f. Daughter's husband.
- g. Brother: Provided that the term. Brother, includes the step-brother.
- h. Sister: Provided that the term. Sister includes the step-sister.



### 3.4 MEANING AND FEATURES OF A COMPANY

#### Meaning of a Company

Sec. 2 of The Companies Act 2013 defines that a Company means a company incorporated under this Act or under any previous company law.

A company refers to an “association of many persons who contribute money or money’s worth to a common stock and employ it in some trade or business and who share the profit and loss arising there from” **Lord Justice Lindlay**

Company is “an incorporated association which is an artificial person created by law, having separate legal entity with a perpetual succession and common seal” **Henry**

#### Features of a Company

##### a. Registration /Incorporated association

Every company needs to be registered with Registrar of Companies (ROC). ROC after scrutiny of the application issues Certificate of Incorporation (COI) which will be treated as a conclusive proof of existence of the company. COI can be compared with the Birth Certificate of an Individual.

Certificate of Incorporation (COI) is conclusive evidence that all the requirements have been complied with.

#### Moosa Goola Arif Vs Ibrahim Goola Arif

**Facts** - Company registered on the basis of MO A & AOA signed by two persons and a guardian on behalf of 5 minor members. Guardian signed separately for each of 5 members. The ROC however registered the company and issued under his hand a certificate of incorporation. **Petition** - Plaintiff contended that COI should be declared as void.

**Judgment**- The court held the certificate to be conclusive for all purposes.

#### Jubilee Cotton Mills Ltd.,

**Facts**- The ROC issued a COI on Jan 8th but dated it Jan 6th which was the date he received application. On Jan 6th the company made an allotment of shares to Lewis

**Judgment**- Court held that certificate was conclusive evidence of incorporation on Jan 6th and that the allotment was not void on the ground that it was made before the company was incorporated.

##### b. Separate legal entity

A company is in law regarded as an entity separate from its members. It has an independent corporate existence. Any of its members can enter into contracts with it in the same manner as any other individual can and he cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The company’s money and property belong to it and not to the shareholders (although the shareholders own the company). Under the law an incorporated company is

a distinct entity, and although all the shares may be practically controlled by one person.

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### Cases on separate legal entity

#### Kandoli tea company Ltd (1886)

**Facts** - Certain persons transferred their properties in the name of company on which tax was payable.

**Petition** - Petitioners claimed exemption from such tax on the ground that the transfer was from them individually to themselves in another name.

**Judgment** - Company is separate from its shareholders and this should be treated as transfer.

#### Saloman Vs. Saloman & Co. Ltd. (1895 - 99)

**Facts** - Saloman sold his business to a company named Saloman & Company Ltd., which he formed. Saloman took 20,000 shares. The price paid by the company to Saloman was £ 30,000, but instead of paying him, cash, the company gave him 20,000 fully paid shares of £ 1 each & £ 10,000 in debentures. The company wound up & the assets of the company amounted to £ 6,000 only. Debts amounted to £ 10,000 due to Saloman & Secured by debentures and a further £ 7,000 due to unsecured creditors. The unsecured creditors claimed that as Saloman & Co. Ltd., was really the same person as Saloman, he could not owe money to himself and that they should be paid their £ 7,000 first.

#### Judgment

- a. A Company is a “legal person” or “legal entity” separate from and capable of surviving beyond the lives of, its members.
- b. The company is not in law the agent of the subscribers or Trustee for them.
- c. Saloman was entitled to £ 6,000 as the company was an entirely separate person from Saloman.
- d. The unsecured creditors got nothing.

#### Lee V/s Lee’s Farming Co. Ltd. (1960)

**Facts** - Lee incorporated a company of which he was the managing director. In that capacity he appointed himself as a pilot of the company. While on the business of the company he was lost in a flying accident. His widow claimed compensation for personal injuries to her husband while in the course of his employment. It was argued that no compensation was due because L & lee’s Air Farming Ltd. were the same person.

#### Judgment-

- a. Lee V/s Lee’s Farming Co. Ltd. was separate person from the company he formed and compensation was payable.
- b. His widow recovered compensation under the Workmen’s Compensation Act
- c. A member of a company can contracts with a company of which he is a shareholder.



- d. The directors are not precluded from being an employee of the company for the purpose of workmen's compensation legislation.

#### **Macaura V/s Northern Assurance Co. Ltd. (1925)**

**Facts** - Macaura V/s Northern Assurance Co. Ltd. was the holder of nearly all the shares except one of a timber company. He was also a substantial creditor of the company. He insured the company's timber in his own name. The timber was destroyed by fire & M claimed the loss from Insurance Company.

#### **Judgment -**

- a. The Insurance Company was not held liable to him.
- b. A shareholder cannot ensure the company's property in his own name even if he is the owner of all or most of the company's shares.
- c. Lifting the corporate veil

As per Business entity concept a company is a separate legal entity different from its promoters, owners, managers or directors. Sometimes few fraudulent people may take undue advantage of this concept by floating a company. They use company as a veil or mask behind which they hide themselves. Under such circumstances it becomes necessary to lift the corporate veil to identify the people behind the company who are indulging in fraudulent activities. This is called Lifting the corporate veil. This is the opposite of separate entity concept.

#### **Circumstances under which the courts may lift the corporate veil:**

##### **A. Common law exceptions**

- a. Determination of character.
- b. Where company is a sham.
- c. Prevention of fraud or improper conduct.
- d. Where the company is acting as the agent of the shareholders.
- e. Protection of revenue.
- f. Avoidance of welfare legislation.

##### **B. Statutory exceptions**

- a. Number of members fall below statutory minimum
- b. Failure to refund application money
- c. Company not mentioned on a bill of exchange
- d. Group accounts
- e. Investigation into related activities
- f. Fraudulent trading

**Case Laws on Lifting of corporate veil****Gol Ford Motor Co. V/s. Horne (1933)****Facts**

- a. Mr Horne was a former managing director of Gilford Motor Home Co Ltd (Gilford).
- b. His employment contract prevented him from attempting to solicit Gilford's customers in the event that Horne left Gilford's employ.
- c. Horne was fired and he subsequently set up a competing company which undercut Gilford's prices.
- d. Gilford did not have any legal restraints upon Horne's company, only Horne himself.
- e. Gilford commenced proceedings against Horne individually, claiming that Horne's company was an attempt to evade legal obligation (not soliciting customers).

**Issues**

Had Horne violated his non-compete clause by setting up his competing company?

**Held**

- a. The English Court of Appeal held that the company was set up to evade Horne's contractual obligations.
- b. The Court "pierced the corporate veil" and ordered an injunction against Horne.
- c. Courts can "pierce the corporate veil" if a company is simply a mere device to evade legal obligations, though this is only in limited and discrete circumstances.

**Daimler Co. Ltd. V/s. Continental Tyre & Rubber Co. Ltd. (1916)****Facts:**

In the case of Daimler Co Ltd v Continental Tyre and Rubber Co Ltd [1916], the respondent company was incorporated in England in order to sell tyres made by a German company. It had 25,000 shares issued. A non-German national held only one share. The company's directors were German.

During the First World War against Germany, the appellant company, Daimler Ltd, claimed that it did not have to pay the money it owed to the respondent company. The appellant company argued that such payment would constitute 'trading with the enemy'.

**Issue:**

Whether Daimler Ltd was entitled to refuse the payment because the respondent company was controlled by the enemy?

**Held:**

The House of Lords reiterated the basic principle that the identity of a company's shareholders was immaterial to the company's separate legal personality. However, they allowed the possibility there will be occasions when the shareholders' identity does affect

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the corporate personality. This may occur in times of war, as in the present case. The respondent company was in de facto control of the company since all of its directors were German and most of its shareholders were also German.

**Judgement:**

At first instance, Scrutton J approved the decision of the master, that the contracts were valid, for summary judgment without proceeding to trial.

**Court of Appeal**

Lord Reading CJ, Cozens-Hardy LJ, Phillimore LJ, Pickford LJ and Kennedy LJ, affirmed the decision too, holding there would be no offence. They held the company did not change its character because of the outbreak of war. They say it, “remains an English company regardless of the residence of its shareholders or directors either before or after the declaration of war.” Mr Gore-Browne argued, for Daimler Co Ltd, that the technicality should be swept aside in time of war. But Lord Reading CJ replied that the fact of incorporation was not just a ‘technicality’. The company, he said, is a living thing with a separate existence which cannot be swept aside as a technicality. It is not a mere name or mask or cloak or device to conceal the identity of persons and it is not suggested that the company was formed for any dishonest or fraudulent purpose. It is a legal body clothed with the form prescribed by the legislature...’

He relied on *Janson v Driefontein Consolidated Mines*, where Lord McNaghten, Lord Brampton and Lord Lindley, holding that a foreign corporation does not become British because its means all are.

Buckley LJ delivered a dissenting judgment, would have held that though the company is a legal person existing apart from its incorporators, that it still had enemy character.

The artificial legal person called the corporation has no physical existence. It exists only in contemplation of law. It has neither body, parts, nor passions. It cannot wear weapons nor serve in the wars. It can be neither loyal nor disloyal. It cannot compass treason. It can be neither friend nor enemy. Apart from its incorporators it can have neither thought, wishes, nor intentions, for it has no mind other than the minds of the incorporators. These considerations seem to me essential to bear in mind in determining the present case.

**House of Lords**

The House of Lords unanimously reversed the decisions below, saying the secretary was authorised to commence no action. It held the company was capable of acquiring enemy character.

Lord Parker said,

I do not think, however, that it is a necessary corollary of this reasoning [*Salomon*] to say that the character of its incorporators must be irrelevant to the character of the company; and this is crucial, for the rule against trading with the enemy depends upon enemy character. Just like a natural person can have enemy character though born in the UK, so can a legal person.

I think that the analogy is to be found in control, an idea which, if not very familiar in law, is of capital importance and is very well understood in commerce and finance. The acts of a company's organs, its directors, managers, secretary, and so forth, functioning within the scope of their authority, are the company's acts and may invest it definitely with enemy character... it must at least be prima facie relevant... Certainly I have found no authority to the contrary.

The Earl of Halsbury LC, Lord Atkinson, Viscount Mersey, Lord Kinnear and Lord Sumner concurred. Lord Shaw and Lord Par moor concurred in the result but dissented on this point.

### **F.G. Films Ltd., case**

**Facts** - An American company produced a film in India actually in the name of British company wherein 90% of the share capital was held by the chairman of the American company which financed the production of the film.

**Judgment** - The contention of the sensor board of films refusing to register the film on the ground that British company has acted merely as an agent of British company was correct.

- **Common Seal**

Every company should have a common seal and the same should be affixed on all official documents where the authorized managers sign on behalf the company.

- **Perpetuity**

Being an artificial person, a company never dies, nor does its life depend on the life of its members. Members may come and go but the company can go on forever. It continues to exist even if all its members are dead. The existence of company can be terminated only by law. It means that a company's existence persists irrespective of the change in the composition of its membership. It is also called as perpetual succession.

- **Limited Liability**

A company may be a company limited by shares or a company limited by guarantee. In a company limited by shares, the liability of members is limited to the unpaid value of the shares.

- **Separation of ownership and management**

There is a distinct separation between the roles of ownership and management. Owner may be a part of Management and a Manager may be a part of owner but their roles will be different

- **Transfer ability of shares**

Shares of a Private company can be transferred with the permission of the Management and the shares of a public company can be transferred without any restrictions in the secondary market





- **Separate property**  
The property of the company belongs to the company and can be used for the purpose of the company as per the provisions of memorandum and articles. Shareholders cannot claim the proportionate right on the property of the company even though they are the owners.
- **Capacity to sue and to be sued**  
A company is an artificial person created by law. It can file case against others to enforce its rights under any contractual obligations and others can file a case against it to enforce their rights under any contractual obligations or legal provisions.

### 3.5 CLASSIFICATION OF COMPANIES

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#### On the Basis of the Number of Members

- a. Private Companies
- b. Public Companies

#### On the Basis of ownership

- a. Government Companies
- b. Non-Government Companies

#### On the Basis of Nationality

- a. Domestic Company
- b. Foreign Company

#### On the Basis of Control

- a. Holding Companies
- b. Subsidiary Companies

#### On the Basis of INCORPORATION

- a. Statutory companies
- b. Registered companies

#### On the Basis of LIABILITY

- i. Companies with limited liability:
  - b. LIMITED BY SHARES
  - c. LIMITED BY GUARANTEE
- ii. Companies with unlimited liability

#### On the Basis of NUMBER OF MEMBERS

- a. One Person Company: only one member
- b. PRIVATE COMPANY Number of members Minimum 2 Maximum 200
- c. PUBLIC COMPANY: Number of members Minimum 7 Maximum Unlimited



## PRIVATE COMPANY

Private company” means a company having a minimum paid up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles:

- a. Restricts the right to transfer its shares.
- b. Except in case of One Person Company, limits the number of its members to two hundred; Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member.
- c. Provided further that: (A) Persons who are in the employment of the company; and (B) Persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be include in the number of members.
- d. Prohibits any invitation to the public to subscribe for any securities of the company.

## PUBLIC COMPANY

Public company means a company which —

- a. Is not a private company.
- b. Has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as maybe prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

### Companies with limited liability

#### a. LIMITED BY SHARES

Where the liability of the members of a company is limited to the amount unpaid on the shares, it is known as company limited by shares. If the shares are fully paid, the liability of the members holding such shares is nil. It may be a public or a private company.

#### b. LIMITED BY GUARANTEE

Where the liability of the members of a company is limited to a fixed amount which the members undertake to contribute to the assets of a company in the event of its being wound up, the company is called a company limited by guarantee. These companies are not formed for the purpose of profit but for the promotion of art, science, charity, sports or for some similar purposes. They may or may not have a share capital.

### Companies with unlimited liability

Sec 12 specifically provides that any 7 or more persons may form an incorporated company with or without limited liability. In such case every member is liable for the debts of the

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company. An unlimited company may or may not have a share capital. If it has a share capital, it may be a public company or a private company. It must have its own Articles of Association.

**Statutory companies**

These are the companies which are created by a special Act of the legislature e.g. RBI, SBI, LIC, etc. These are mostly concerned with public utilities as railways, tramways, gas and electricity companies and enterprises of national level importance.

**Registered companies**

These are the companies which are formed and registered under the Companies Act, 1956 or 2013 or any other earlier Acts.

**Holding company**

A company is known as the holding company of another company if it has the control over that other company. A company is deemed to be the holding company of another if, but only if, that other is its subsidiary.

**Subsidiary company**

A company is known as a subsidiary of another company when control is exercised by the holding company over the former called a subsidiary company.

**ON THE BASIS OF OWNERSHIP****Government Company**

A government company means any company in which not less than 51 % of the paid-up share capital is held by

- a. The central government.
- b. Any state government, or governments.
- c. Partly by central government and partly by one or more state government.

Government is also called as Public Sector Company. If the shares held by Government is less than 50% it is called a Private Sector Company. People always confuse Public Sector Company with Public Limited Company and Private Sector Company with Private Limited Company.

	Government Share 51% or more	Government Share less than 50%
	Public Sector	Private Sector
Public Limited Company	1	3
Private Limited Company	2	4

1. Public Sector Public Limited Company.
2. Public Sector Private Limited Company.

3. Private Sector Public Limited Company.
4. Private Sector Private Limited Company.

**Examples:**

1. State Bank of India, Life Insurance Corporation of India.
2. Maharashtra State Finance Corporation.
3. Reliance Industries, Kotak Mahindra Bank, Yes Bank.
4. C Tech Engineers Pvt Ltd. All the unlisted Private companies.

**Foreign company**

It means any company incorporated outside India which has an established place of business in India. Where a minimum of 50% of the paid-up share capital of a foreign company is held by one or more citizens of India or/and by one or more bodies corporate incorporated in India, whether singly or jointly, such company shall comply with such provisions as may be prescribed as if it were an Indian company.

A company will be regarded as an Indian Company even if it is incorporated in India by promoters of foreign nationality. Gramophone Ltd. Vs. Tanley (1908)

**Dormant company:**

A company can be classified as dormant when it is formed and registered under this 2013 Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction. Such a company or an inactive one may apply to the ROC in such manner as may be prescribed for obtaining the status of a dormant company. [Section 455]

**One-person company**

An OPC means a company with only one person as its member [section 3(1)].

**Small company**

A company, other than a public company is

- a. Paid-up share capital of which does not exceed 50 lakh INR or such higher amount as may be prescribed which shall not be more than five crore INR.
- b. Turnover of which as per its last profit-and-loss account does not exceed two crore INR or such higher amount as may be prescribed which shall not be more than 20 crore INR.

**This section will not be applicable to the following:**

- a. A holding company or a subsidiary company.
- b. A company registered under section 8.
- c. A company or body corporate governed by any special Act [section 2(85)].





### 3.6 FORMATION OF A COMPANY

#### Formation of company - Section 3.

1. A company may be formed for any lawful purpose by
  - a. Seven or more persons, where the company to be formed is to be a public company;
  - b. Two or more persons, where the company to be formed is to be a private company; or
  - c. One person, where the company to be formed is to be one person company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this act in respect of J registration.

Provided that the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

Provided further that such other person may withdraw his consent in such manner as may be prescribed.

Provided also that the member of One Person Company may at any time change the name of such other person by giving notice in such manner as may be prescribed.

Provided also that it shall be the duty of the member of One Person Company to intimate the company the change, if any, in the name of the other person nominated by him by indicating in the memorandum or otherwise within such time and in such manner as may be prescribed, and the company shall intimate the Registrar any such change within such time and in such manner as may be prescribed.

Provided also that any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

- a. A company formed under sub-section (1) may be either-
- b. A company limited by shares; or
- c. A company limited by guarantee; or
- d. An unlimited company.

#### Incorporation of company. Section 7.

1. There shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the following documents and information for registration, namely:
  - a. The memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed.

- b. A declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this act and the rules made there under in respect of registration and matters precedent or incidental thereto have been complied with.
  - c. An affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this act or any previous company law during the preceding five years and that all the documents filed with the registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief.
  - d. The address for correspondence till its registered office is established.
  - e. The particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.
  - f. The particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the director identification number, residential address, nationality and such other particulars including proof of identity as may be prescribed.
  - g. The particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.
2. The Registrar on the basis of documents and information filed under sub-section (1) shall register all the documents and information referred to in that subsection in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act
  3. On and from the date mentioned in the certificate of incorporation issued under subsection (2), the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.
  4. The company shall maintain and preserve at its registered office copies of all documents and information as originally filed under sub-section (1) till its dissolution under this Act.
  5. If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action under section 447.





6. Without prejudice to the provisions of sub-section (5) where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under clause (b) of subsection (1) shall each be liable for action under section 447.
7. Without prejudice to the provisions of sub-section (6), where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants,
  - i. pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors.
  - ii. direct that liability of the members shall be unlimited.
  - iii. direct removal of the name of the company from the register of companies.
  - iv. pass an order for the winding up of the company.
  - v. pass such other orders as it may deem fit.

Provided that before making any order under this sub-section,

- a. the company shall be given a reasonable opportunity of being heard in the matter; and
- b. the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

#### **Formation of companies with charitable objects (Section 8)**

1. Where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered under this Act as a limited company
  - a. Has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;
  - b. Intends to apply its profits, if any, or other income in promoting its objects; and
  - c. Intends to prohibit the payment of any dividend to its members, the Central Government may, by license issued in such manner as may be prescribed, and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company under this section without the addition to its name of the word. Limited., or as the case may be, the words. Private



- Limited., and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section.
2. The company registered under this section shall enjoy all the privileges and be subject to all the obligations of limited companies.
  3. A firm may be a member of the company registered under this section.
    - a. A company registered under this section shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.
    - b. A company registered under this section may convert itself into company of any other kind only after complying with such conditions as may be prescribed.
  4. Where it is proved to the satisfaction of the Central Government that a limited company registered under this Act or under any previous company law has been formed with any of the objects specified in clause (a) of sub-section (1) and with the restrictions and prohibitions as mentioned respectively in clauses (b) and (c) of that sub-section, it may, by license, allow the company to be registered under this section subject to such conditions as the Central Government deems fit and to change its name by omitting the word .Limited., or as the case may be, the words Private Limited, from its name and thereupon the Registrar shall, on application, in the prescribed form, register such company under this section and all the provisions of this section shall apply to that company.
  5. The Central Government may, by order, revoke the license granted to a company registered under this section if the company contravenes any of the requirements of this section or any of the conditions subject to which a license is issued or the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest, and without prejudice to any other action against the company under this Act, direct the company to convert its status and change its name to add the word .Limited, or the words .Private Limited., as the case may be, to its name and thereupon the Registrar shall, without prejudice to any action that may be taken under sub-section (7), on application, in the prescribed form, register the company accordingly:
    - a. Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard:
    - b. Provided further that a copy of every such order shall be given to the Registrar.
  6. Where a license is revoked under sub-section (6), the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section: Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard.
  7. Where a license is revoked under sub-section (6) and where the Central Government is satisfied that it is essential in the public interest that the company registered



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under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

8. On the winding up or dissolution of a company registered under this section, there remains, after the satisfaction of its debts and liabilities, any asset, they may be transferred to another company registered under this section and having similar objects.

The 2013 Act mandates inclusion of declaration to the effect that all provisions of the 1956 Act have been complied with, which is in line with the existing requirement of 1956 Act.

Additionally, an affidavit from the subscribers to the memorandum and from the first directors has to be filed with the ROC, to the effect that they are not convicted of any offence in connection with promoting, forming or managing a company or have not been found guilty of any fraud or misfeasance, etc., under the 2013 Act during the last five years along with the complete details of name, address of the company, particulars of every subscriber and the persons named as first directors.

The 2013 Act further prescribes that if a person furnishes false information, he or she, along with the company will be subject to penal provisions as applicable in respect of fraud i.e. section 447 of 2013 Act [section 7(4) of 2013 Act; Also refer the chapter on other areas]

#### **Formation of a company with charitable objects**

One Person Company with charitable objects may be incorporated in accordance with the provisions of the 2013 Act. New objects like environment protection, education, research, social welfare etc., have been added to the existing object for which a charitable company could be incorporated.

As against the existing provisions under which a company's license could be revoked, the 2013 Act provides that the license can be revoked not only where the company contravenes any of the requirements of the section but also where the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest. The 2013 Act thus provides for more stringent provisions for companies incorporated with charitable objects [section 8 of 2013 Act].

#### **Documents to be filed with the Registrar**

- a. Memorandum of Association
- b. Articles of Association
- c. Agreement if any for appointment of M.D
- d. Statement of nominal capital
- e. Address of the Registered Office
- f. List of directors and sign

- g. Undertaking in writing to take and pay for his qualification shares
- h. Declaration



### 3.7 MEMORANDUM OF ASSOCIATION-MOA

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A Memorandum of Association (MOA) is a legal document prepared in the formation and registration process of a limited liability company to define its relationship with shareholders. The MOA is accessible to the public and describes the company's name, physical address of registered office, names of shareholders and the distribution of shares. The MOA and the Articles of Association serve as the constitution of the company. The MOA is not applied in the U.S. but is a legal requirement for limited liability companies in European countries including the United Kingdom, France and Netherlands, as well as some Commonwealth nations.

**Various Clauses in MOA are: -**

#### **Objectives of the Company**

The objective clause requires you to summarize the main objectives for establishing the company with reference to the requirements for shareholding and use of financial resources. You also need to state ancillary objectives; that is, those objectives that are required to facilitate the achievement of the main objectives. The objectives should be free of any provisions or declarations that contravene laws or public good.

#### **Liability of Shareholders**

The liability clause requires you to state the extent to which shareholders of the company are liable to the debt obligations of the company in the event of the company dissolving. You should show that shareholders are liable only their shareholding and/or to their commitment to contribute to the dissolution costs upon liquidation of a company limited by guarantee.

#### **Authorized Share Capital**

The capital clause requires you to state the company's authorized share capital, the different categories of shares and the nominal value (the minimum value per share) of the shares. You are also required to list the company's assets under this clause.

#### **Association and Formation of a Company**

The association clause confirms that shareholders bound by the MOA are willingly associating and forming a company. You require seven members to sign an MOA for a public company and not less than two people for a MOA of a private company. You must conduct the signing in the presence of witness who must also append his signature.

#### **Alteration of memorandum**

The 2013 Act imposes additional restriction on the alteration of the object clause of the memorandum for a company which had raised money from the public for one or more objects mentioned in the prospectus and has any unutilised money. The 2013 Act specifies



that along with obtaining an approval by way of a special resolution, a company would be required to ensure following if it intends to alter its object clause:

- a. Publishing the notice of the aforesaid resolution stating the justification of variation in two newspapers
- b. Exit option can be given to dissenting shareholders by the promoters and shareholders having control in accordance with the regulations to be specified by the Securities and Exchange Board of India (SEBI) [section 13 of 2013 Act],

### CASE LAWS REGARDING MENORANDUM

#### **Ewing V/s. Butter Cut Margarine Company Ltd. (1917)**

**Facts** - The plaintiff was an incorporated firm carrying on substantial business under the trade name of Butter Cap Dairy Company. The defendant company was registered to trade in similar commodities and selected the name bonafide believing that there was no other company in existence with a similar name. The plaintiff alleged that the name of the new company would lead to confusion and was detrimental to the plaintiff's business.

**Judgment** - Plaintiff was entitled to restrain the newly registered company from carrying on business on the ground dial the public might reasonably think that the registered company was connected with his business.

#### **Mackinnon Mackenzie & Co. Re, (1967)**

**Facts** - A Company desired to shift its registered office from the State of West Bengal to Bombay. The Company's petition was resisted by the state on the grounds of loss of revenue.

**Judgment** - Held that there is no statutory right of the state, as a state, to intervene in an application made u/s 17 for alteration of the place of the registered office of a company. To hold that the possibility of the loss of revenue is not only relevant, but of persuasive force in regard to the change is to rob the company of the statutory power. The question of loss of revenue to one state would have to be considered in the total conspectus of revenue for the Republic of India and no parochial consideration should be allowed to turn the scale in regard to change of registered office from one state to another within India.

#### **Re Cyclists Touring Club. (1907)**

**Facts** - The Company's business was to promote, assist & protect cyclists on the public roads. The company by altering the object clause desired to include among the persons to be assisted all tourists including motorists.

#### **Judgment-**

1. The club not allowed to undertake protection of motorists also, as cyclists had to be protected against motorists.
2. It was impossible to combine the two business as one of the objects of the company was to protect cyclists against motorists.



## Decided case on objects clause of MOA

### Crowns bank case

**Facts** - A company's objects clause enabled it to act as a bank and further to invest in securities and to underwrite issue of securities. The company abandoned its banking business and confined itself to investment activities.

**Judgment**- Court held that the company was not entitled to do.

### Doctrine of ultra vires

If a company acts beyond the scope of its objective, it is called ultra vires the Memorandum. Such actions cannot be ratified. The concerned director or manager who has acted beyond the scope of authority will be personally liable for the excess portion.

### Ashbury railways carriage & Iron Co Ltd Vs Riche

**Facts** - A railway company was formed with an object of selling railway wagons. The directors entered into a contract with Richie to finance the construction of railway line. The shareholders later rejected the contract as ultra vires.

**Judgment** - The court held that the contract was ultra vires and therefore null and void.

## 3.8 ARTICLES OF ASSOCIATION-AOA

Articles of Association (AOA) refer to the rules and regulations of a company framed for the purpose of internal management of its affairs. The AOA of a company are sub-ordinate to and are controlled by the MOA.

### Companies which must have their own articles-

1. Private companies limited by shares
2. Companies limited by guarantee
3. Unlimited companies

### Contents of AOA

1. Number and value of shares
2. Allotment of shares
3. Calls on shares
4. Lien on shares
5. Transfer and transmission of shares
6. Forfeiture of shares
7. Alteration of capital
8. Share certificates
9. Conversion of shares into stock
10. Voting rights and proxies
11. Meetings



12. Directors and their appointment
13. Borrowing powers
14. Dividends and reserves
15. Accounts and audit
16. Winding up

#### Articles of Association. Section 5.

- a. The articles of a company shall contain the regulations for management of the company.
- b. The articles shall also contain such matters, as may be prescribed: Provided that nothing prescribed in this sub-section shall be deemed to prevent a company from including such additional matters in its articles as may be considered necessary for its management.
- c. The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with.
- d. The provisions for entrenchment referred to in sub-section (3) shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.
- e. Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.
- f. The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company.
- g. A company may adopt all or any of the regulations contained in the model articles applicable to such company.
- h. In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.
- i. Nothing in this section shall apply to the articles of a company registered under any previous company law unless amended under this Act.

#### Case Laws on Articles

##### Hulton V/s. Scarborough Cliff Hotel Co. (1865)

**Facts** - A resolution passed at a general meeting of a company altered the articles by inserting the power to issue new shares with preferential dividend. The memorandum contained no such power.



**Judgment-** The alteration was inoperative.

### MOA & AOA distinguished

- a. MOA is a charter of the company defines scope and activities. AOA regulates internal mgmt.
- b. MOA defines relation to the outside world. AOA deals with rights of the members.
- c. MOA is the supreme document of the company. AOA is the subordinate to the memorandum.
- d. MOA is necessary for all the companies. AOA is not required for the company limited by shares.
- e. MOA cannot be altered except in the manner and extent provided by the Act. AOA can be altered through a special resolution.

## 3.9 PROSPECTUS

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### Definition -

Sec 2(36) defines prospectus as “any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate “

### Ingredients to be called prospectus -

- a. There must be an invitation offering to the public
- b. The invitation must be made by or on behalf of the company
- c. The invitation must be to subscribe or purchase
- d. The invitation must relate to shares or debentures

### Objective of Prospectus

- a. To inform the public about the formation of the company
- b. To induce the investors to invest in its shares and debentures
- c. To preserve the authentic record of the terms on which the investors have been invited and to make the directors responsible for the statements in the prospectus

The 2013 Act has introduced a new section [section 23] to explicitly provide the ways in which a public company or private company may issue securities.

**This section explains that a public company may issue securities in any of the following manners:**

- a. To public through prospectus
- b. Through private placement
- c. Through rights issue or a bonus issue.

For private companies, this section provides that it may issue securities through private placement, by way of rights issue or bonus issue.



Section 23 also provides that compliance with provisions of part I of chapter III is required for the issue of securities to public through prospectus. For private placement compliance, with the provisions of part II of chapter III are required.

The 2013 Act also introduces certain changes with respect to prospectus and public offers aimed at enhancing disclosure requirements as well as streamlining the process of issuance of securities.

### 1. Issue of prospectus

In the 2013 Act, the information to be included in the prospectus is specified in section 26 of 2013 Act. The 2013 Act mandates certain additional disclosures:

- a. Any litigation or legal action pending or taken by a government department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company
- b. Sources of promoter's contribution
- c. The report by the auditors on the assets and liabilities of business shall not be earlier than 180 days before the issue of the prospectus [section 26(1) (b)(iii) of 2013 Act]..

### Variation in terms of contract or objects

A special resolution is required to vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued [section 27 (1) of 2013 Act]. Dissenting shareholders shall be given an exit offer by promoters or controlling shareholders [section 27 (2) of 2013 Act].

### Offer of sale of shares by certain members of the company

Members of a company, in consultation with the board of directors, may offer a part of their holding of shares to the public. The document by which the offer of sale to the public is made will be treated as the prospectus issued by the company. The members shall reimburse the company all expenses incurred by it [section 28 of 2013 Act].

### Shelf prospectus

The 2013 Act extends the facility of shelf prospectus by enabling SEBI to prescribe the classes of companies that may file a shelf prospectus.

### Global depository receipts (GDRs)

The 2013 Act includes a new section to enable the issue of depository receipts in any foreign country subject to prescribed conditions [section 41 of 2013 Act]. In several aspects across the 2013 Act, it appears that the 2013 Act supplements the powers of SEBI by incorporating requirements already mandated by SEBI.

### Private placement

In order to make an offer or invitation of offer by way of private placement or through the issue of a prospectus certain specified conditions are complied with.



The offer of securities or invitation to subscribe securities in a financial year shall be made to such number of persons not exceeding 50 or such higher number as may be prescribed {excluding qualified institutional buyers, and employees of the company being offered securities under a scheme of employee's stock option in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed}. The allotments with respect to any earlier offer or invitation may have been completed. All the money payable towards the subscription of securities shall be paid through cheque, demand draft or any other banking channels but not by cash.

The offers shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name. The company offering securities shall not release any advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer [section 42 of 2013 Act].

### **The offer in prospectus should be made to public**

#### **Nash V/s Lynde**

**Facts** - Some copies of documents marked "strictly confidential" and containing particulars of a proposed issue of shares, were sent by the managing director to his relatives and friends. Thus the document was passed on privately through a small circle of friends of directors.

**Judgment** - The court held that there was no issue to public, and it does not amount to prospectus as it was not offered to public.

#### **Case Laws on Prospectus**

Who can sue on a false and misleading prospectus?

#### **Peek Vs Gurney**

**Facts** - A fraudulent prospectus was issued by the directors. Peek received a copy of it and did not take any shares. After several months Peek bought few shares from the stock exchange.

**Judgment** - His action against the directors for fraudulent prospectus was rejected as he took the shares through the secondary market. Only primary market allottees can sue on a false and misleading prospectus

## **3.10 SHARE CAPITAL**

The term share capital refers to the amount of capital raised by a company through the issue of shares. Section 2(46) of the companies Act of 1956 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" According to this definition a share is a fractional part or unit of the capital of a company.

The provisions are applicable to both public company and private companies. New shares capital should be issued only in the form of two kinds of shares, viz. Preference Shares and Equity Shares.





### Preference share capital

“Preference share capital” means that part of the share capital of the company which fulfils both the following requirements, namely: -

1. It carries a preferential right to be paid a fixed amount or an amount calculated at a fixed rate
2. It carries, on a winding up, a preferential right to be repaid the amount. Preference shares can be either Cumulative Redeemable Preference Shares or Non-Cumulative Redeemable Preference shares.

### Issue and redemption of preference shares

A company cannot issue preference shares with a redemption date of beyond 20 years. However, it gives an exemption for cases where preference shares have been issued in respect of infrastructure projects. Infrastructure projects have been defined in Schedule VI of the 2013 Act and these shares would be subject to redemption at such percentage as prescribed on an annual basis at the option of such preference shareholders.

Further, the 2013 Act adds another administrative requirement of obtaining special resolution with respect to the preference shares which could not be redeemed by a company. The 2013 Act states that where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue, it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal issue further redeemable preference shares equal to the amount due, including the dividend thereon, with respect to the unredeemed preference shares. On the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

### Equity share capital

Equity share capital means, all share capital which is not preference share capital. This capital does not have fixed rate of dividend. In the event of winding up of a company they will be paid last. Equity shareholders are also called as residual shareholders. It is commonly known as ordinary shares.

A private limited company can raise its capital from its promoters and through private placement. A public limited company can raise capital from public. But it has to follow the legal provisions.

### Prohibition on issue of shares at a discount

Companies would no longer be permitted to issue shares at a discount. The only shares that could be issued at a discount are sweat equity wherein shares are issued to employees in lieu of their services [section 53 and Section 54 of 2013 Act],

### Voting rights

The provisions of 2013 Act regarding voting rights are similar to the existing section 87 of the 1956 Act. The only change noted in the 2013 Act is the removal of distinction

provided by the 1956 Act with respect to the entitlement to vote in case the company fails to pay dividend to its cumulative and non-cumulative preference shareholders [section 47 of 2013 Act]

NOTES



### Variation of shareholder's rights

The proviso to section 48(1) of 2013 Act states that if the variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

### Features of Share capital:

- a. Face Value. The value of the share that is accounted for issued capital purpose. Dividends paid on Face Value.
- b. Share can be issued at par or at a premium but not at a discount. Share capital can be raised only by companies limited by shares and registered with share capital. Share capital can be raised by a company either at the time of its formation for starting its operations or later on for further expansion.
- c. Market price does not affect the books of accounts.
- d. Voting Rights.
- e. Permanent Capital. Share Capital (Except in the case of redeemable preference shares), once rose, and cannot be returned by the company to the shareholders as long as it continues to exist. It can be returned only at the time of the winding up of the company.
- f. Limited Liability up to the shares held by the shareholders. They are not personally liable for the liabilities of a company. In case of partly paid shares, they are liable up to the unpaid portion of the share.
- g. Variable Return based on Profit.
- h. Dividends Not Tax Deductible. It is a post-tax appropriation of profit.
- i. Residual Return.
- j. High Risk.
- k. Comparatively High Cost.

### Classes of Capital

- a. Nominal, Registered or Authorized Capital: Maximum Capital that a company can raise.
- b. Issued capital: Capital offered to public for subscription.
- c. Subscribed capital: Capital subscribed by public.
- d. Called up capital: Capital for which the issuing company has demanded payment.
- c. Paid up capital: Capital actually paid by the subscribers.
- f. Uncalled capital: Subscribed Capital less Called up capital.
- g. Reserve capital: Premium on shares and profit retained by the company.



### Methods of Issuing Shares

- a. Initial Public Offer (IPO): An offer to the public INVITING THEM to subscribe for the first time. Second time onwards it is called as Follow-on Public Offer FPO
- b. Book Building: An issue where shares are sold at a price fixed BETWEEN TWO RANGES (CALLED AS Price band) and allotment based on offers from investors. The gap between the two prices should not be more than 20% of the lower price.
- c. Private Placement: An issue where shares are sold privately to a select group of investors, usually large financial institutions.
- d. Rights Issue: The shares are offered to EXISTING SHARE HOLDERS usually at a price below the market price.
- e. Bonus Issue: A bonus issue is an issue of shares to the company's existing shareholders in proportion to their existing shareholding for which they pay nothing. The shares are paid up by capitalizing some of the reserves (retained profits) of the company. The net worth of the company does not change after issue of bonus shares. The 2013 Act includes a new section that provides for issue of fully paid-up bonus shares out of its free reserves or the securities premium account or the capital redemption 'reserve account, subject to the compliance with certain conditions such as authorization by the articles, approval in the general meeting and so on [section 63 of 2013 Act).
- f. Employee Stock Option Plan (ESOP): Shares issued to the employees usually at a price below the market price, a rights issue can also be made to the employees of the company who are under a scheme of employees' stock option, subject to a special resolution and subject to conditions as prescribed. Further, the price of such shares should be determined using the valuation report of a registered valuer, which would be subject to conditions as prescribed [section 62 of 2013 Act).

### Application of premiums received on issue of shares

Certain classes of companies would not be able to apply the securities premium towards the below specified purposes, unless the financial statements are in compliance with the accounting standards issued under section 133 of 2013 Act:

- a. Paying up unissued equity shares of the company as fully paid bonus shares.
- b. Writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.
- c. Purchase of its own shares or other securities.

Securities premium amount can be utilised for purpose of writing off preliminary expenses.

Refusal of registration and appeal against registration.

The provision relating to refusal of registration of transfer or transmission of securities by private and public companies has been separately clarified in the 2013 Act. The private and public companies are required to send notice of refusal within 30 days of the receipt of instrument of transfer, and aggrieved party may appeal to the Tribunal against the refusal within the specified number of days [section 58(2) of 2013 Act].



### **Unlimited company to provide for reserve share capital on conversion into limited company**

This section corresponds to section 32 of the 1956 Act and seeks to provide that an unlimited company having a share capital may be re-registered as a limited company by increasing the nominal amount of each share, subject to the condition that no part of the increased capital shall be capable of being called up, except in the event and for the purposes of the company being wound up. The 2013 Act further provides that a specified portion of its uncalled share capital shall not be capable of being called up except in the event and for the purposes of the company being wound up [section 65 of 2013 Act],

### **Reduction of share capital**

The 2013 Act gives cognizance to one of the amendments made in the listing agreement by SEBI. A new clause 24(1) was inserted to the listing agreement which provided that a scheme of amalgamation or merger or reconstruction, should comply with the requirements of section 211 (3C) of the 1956 Act. A similar requirement has been introduced in section 66 of 2013 Act, which states that no an application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such a reduction is in conformity with the accounting standards specified in section 133 or any other provision of the 2013 Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

Further, the 2013 Act clarifies that no such reduction shall be made if the company is in arrears in repayment of any deposits accepted by it, either before or after the commencement of the 2013 Act, or the interest payable thereon.

### **Power of the company to purchase its own securities**

The existing provision of section 77A of the 1956 Act has been acknowledged by the 2013 Act. The only difference is that the option available to company for a buyback from odd lots is no longer available [section 68).

The 2013 Act provides flexibility in management and administration by recognizing the electronic mode for notices and voting, which is in line with the MCA's efforts to give cognizance to use of electronic media as evident from a number of green initiatives introduced recently, maintenance of registers and returns at a place other than the registered office.

### **Debentures**

The term debenture is derived from Latin term 'deber' meaning 'to owe' So, literally debenture means a document acknowledging a debt.

Debenture is an instrument issued by a company under seal, acknowledging a debt to some person, and containing an undertaking to repay the debt after a specified date or on a particular date or at the option of the company, and in the meantime, to pay interest at a fixed rate and at regular intervals. In short, a debenture is an instilment of credit, a bond of indebtedness, a certificate of loan or an acknowledgement of debts issued by a company.



Every Company can issue secured debentures with the approval of shareholder of the Company. Normally, debentures carry interest at a fixed rate. The debentures can be either partly or fully convertible into equity shares of the Company or Non-Convertible. If the period of redemption of debentures is exceeding eighteen months the Company has to execute a trust deed and create a charge on the immovable property of the Company.

### 3.11 SHAREHOLDER DEMOCRACY

Acknowledging the concept of shareholder democracy, various provisions have been incorporated in the 2013 Act. These provisions can be broadly classified as Shareholder rights or protection and Special consideration to small shareholders

#### Shareholder rights or protection

**Class action suits:** A class action is a legal form of lawsuit where a large group of individuals collectively bring a claim to court or in which a particular class of defendants is being sued. The concept of collective lawsuit finds its roots in the US, where it is still widely prevalent. In several European countries, changes have been made recently in their civil law, to allow consumer organizations to bring claims on behalf of large groups of consumers.

Acknowledging the need to be at par with global standards, for class action lawsuit, the 2013 Act has empowered shareholders associations or group of shareholders to take legal action in case of any fraudulent action on the part of company and to take part in investor protection activities and class action suits (section 245 of the 2013 Act).

Additionally, in response to the Standing Committee's recommendation in its Twenty First Report for ensuring protection of interests of minority shareholders and small investors, the MCA suggested that during adjudication on class action suits, the Tribunal will ensure that the interests of shareholders are protected and wrongdoers, including auditors and audit firms, are required to compensate the victims on suitable orders by Tribunal.

Also, as stated in the 2013 Act, the central government will have power to prescribe class or classes of companies which shall not be permitted to allow use of proxies. The 2013 Act also has provisions to provide that a person shall have proxies for such number of members or such shares as may be prescribed.

#### Special consideration to small shareholders

A listed company may have one director elected by such small shareholders in the manner and with the terms and conditions as may be prescribed. Here the term, 'small shareholders' means a shareholder holding shares of nominal value of not more than 20,000 INR or such other sum as may be prescribed (section 166 of 2013 Act). Also refer to shareholder democracy, chapter on 'Other Areas'.

The board of directors of a company which consists of more than 1,000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a stakeholders relationship committee consisting of a chairperson who shall be a non-executive director and such other members as may be

decided by the board. Further, the section under subsection six recognizes the concept of the stakeholder's relationship committee which is required to consider and resolve the grievances of security holders of the company (section 178 of the 2013 Act).

Specific disclosure under the scheme of mergers or amalgamation regarding the effect of merger on minority shareholders is to be provided. Under various sections in the 2013 Act, for example, variation in terms of contract or object in prospectus, the dissenting shareholders have been provided with an option to exit which act as a protection of the interests of small shareholders.

### 3.12 MANAGEMENT AND ADMINISTRATION

The 2013 Act also intends to improve corporate governance by requiring disclosure of nature of concern or interest of every director, manager, any other key managerial personnel and relatives of such a director, manager or any other key managerial personnel and reduction in threshold of disclosure from 20% to 2%. The term 'key managerial personnel' has now been defined in the 2013 Act and means the chief executive officer, managing director, manager, company secretary,

whole-time director, chief financial officer and any such other officer as may be prescribed.

**Officer:** The definition of officer has been extended to include promoters and key managerial personnel [section 2(59)]

**Promoter:** The term 'promoter' has been defined in the following ways:

- a. A person who has been named as such in a prospectus or is identified by the company in the annual return.
- b. Who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise.
- c. In accordance with whose advice, directions or instructions the board of directors of the company is accustomed to act. [section 2(69)].

**For Board meeting:** In the absence of specific provisions in the articles regarding the quorum.  $\frac{1}{3}^{\text{rd}}$  of the total strength of the directors or at least 2 directors whichever is higher.

#### **Annual return**

The 2013 Act states that requirement of certification by a company secretary in practice of annual return will be extended to listed companies having paid up capital of Rupees five crore or more and turnover of Rupees 25 crore or more. The information that needs to be included in the annual return has been increased. The additional information required, includes particulars of holding, subsidiary and associate companies, remuneration of directors and key managerial personnel, penalty or punishment imposed on the company, its directors or officers [section 92(l) of 2013 Act].



### Place of keeping registers and returns

The 2013 Act allows registers of members, debenture-holders, any other security holders or copies of return, to be kept at any other place in India in which more than one-tenth of members reside [section 94(1) of 2013 Act].

### Loans and investments by a company

The 2013 Act states that companies can make investments only through two layers of investment companies subject to exceptions which includes company incorporated outside India [section 186 of 2013 Act].

### Related party transactions

Provisions in 2013 Act include the following:

- a. Need for central government approval has been done away with.
- b. The 2013 Act has widened the ambit of transactions such as leasing of property of any kind, appointment of any agent for purchase and sale of goods, material, services or property.
- c. Cash at prevailing market price has now been substituted with 'arm's length transaction' which has been defined in the section.
- d. Transactions entered into with related parties now to be included in the board's report along with justification for entering into such contracts and arrangements.
- e. Penalty for contravention of the provisions of section 297 was covered in general provisions in the 1956 Act. However, this is now covered specifically in the section itself which now extends to imprisonment.
- f. Central government may prescribe additional conditions.

### Appointment and remuneration of managerial personnel

The 2013 Act brings significant changes to the existing requirement of the 1956 Act with respect to appointment and remuneration of managerial personnel. One of the major changes that could be identified is in respect of the applicability of these provisions. The provisions for appointment of managing director, whole time director or manager are no longer restricted to the public companies and the private companies which are subsidiaries of public companies and now applicable to all companies. The overall ceiling in respect of payment of managerial remuneration by a public company remains at 11 % of the profit for the financial year computed in the manner laid down in the 2013 Act.

### Appointment of Managing Director, whole time Director or Manager [section 196 of 2013 Act],

The re-appointment of a managerial person cannot be made earlier than one year before the expiry of the term instead of two years as per the existing provision of section 317 of the 1956 Act, however, the term for which managerial personnel can be appointed remains as five years.

The eligibility criteria for the age limit have been revised to 21 years as against the existing requirement of 25 years. Further, the 2013 Act lifts the upper bar for age limit and thus

an individual above the age of 70 years can be appointed as key managerial personnel by passing a special resolution. Provisions in respect of appointment of the managerial personnel have been specified in section 196 and Schedule V to the 2013 Act.

Overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits [section 197 of 2013 Act].

As against the existing requirement of section 198 of the 1956 Act, which specifically provides that the provisions of managerial remuneration would be applicable to both public companies and private companies which are subsidiaries of public companies; the 2013 Act states that such provisions would be applicable only to public limited companies. Listed companies have been mandated to disclose in their board report, the ratio of remuneration of each director to median employee's remuneration and such other details which are quite extensive as proposed in the draft rules.

The provisions of **managerial remuneration** have been incorporated in Schedule V of the 2013. The managerial personnel should not have been convicted of an offence under the Prevention of Money Laundering Act, 2002. The 2013 Act has liberalized the administrative procedures by relaxing the requirement of obtaining the central government approval provided the company complies with certain requirements including seeking approval by way of special resolution for payment of managerial remuneration. Definition of remuneration has undergone few changes in the 2013 Act. The 2013 Act in section 2(78), defines remuneration as any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the income-tax Act, 1961. The remuneration thus defined includes reimbursement of any direct taxes to managerial personnel. The 1956 Act defined remuneration under section 198 by way of an explanation and provided for the certain specific inclusions that would be construed as remuneration. Section 200 of the 1956 Act specifically prohibited tax free payments. The 2013 Act has indirectly incorporated the same requirement by clarifying that the term remuneration includes any reimbursement of direct taxes.

The 2013 Act clarifies that premium paid by a company for any insurance taken by a company on behalf of its managing director, whole time director, manager, chief executive officer, chief financial officer or company secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company would not be treated as part of remuneration except for the cases where person is proved to be guilty. The provisions cited above are similar to that of the existing provisions of section 201 of the 1956 Act.

#### **Calculation of profits [section 198 of 2013 Act]**

The 2013 Act sets out in detail about the allowances and deductions that a company should include while computing the profits for the purpose of determining the managerial remuneration. To illustrate, the 2013 Act states that while computing its profits, credit should not be given for any change in the carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.





### **Recovery of remuneration in certain cases [section 199 of 2013 Act]**

The 2013 Act contains stringent provisions in case the company is required to restate its financial statements pursuant to fraud or non-compliance with any requirement under the 2013 Act and the Rules made there under. As against the existing requirement of section 309 of the 1956 Act which only refers to the fact that excess remuneration paid to managerial personnel cannot be waived except with the previous approval of the central government, the 2013 Act moves a step forward and enables the company to recover the excess remuneration paid (including stock options) from any past or present managing director or whole time director or manager or chief executive officer who, during the period for which the financial statements have been restated, has acted in such capacity.

### **Appointment of key managerial personnel [section 203]**

The 2013 Act provides for mandatory appointment of following whole time key managerial personnel for every listed company and every other company having a paid-up share capital of five crore INR or more:

- a. Managing director, or chief executive officer or manager and in their absence, a whole-time director.
- b. Company secretary.
- c. Chief financial officer.

Further, the 2013 Act also states that an individual cannot be appointed or reappointed as the chairperson of the company, as well as the managing director or chief executive officer of the company at the same time except where the articles of such a company provide otherwise or the company does not carry multiple businesses.

### **Nomination and remuneration committee and stakeholders' relationship committee**

The 2013 Act includes this new section requiring constituting the nomination and remuneration committee by every listed company and the following classes of companies as prescribed in the draft rules:

- a. Every listed company
- b. Every other public company that has a paid-up capital of 100 crore INR or more or which has, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 200 crore INR.

The Nomination and Remuneration Committee is required to formulate and recommend to the Board of Directors, the company's policies, relating to the remuneration for the directors, key managerial personnel and other employees, criteria for determining qualifications, positive attributes and independence of a director [section 178(1) of 2013 Act].

Further, a board of a company that has more than 1000 shareholders, debenture holders, deposit-holders and any other security holders at any time during a financial year is required to constitute a Stakeholders Relationship Committee [section 178(5) of 2013

### Contributions to charitable funds and political parties

As per the 2013 Act the power of making contribution to 'bona fide' charitable and other funds is proposed to be available to the board subject to certain limits [section 181 of 2013 Act]. As per the existing requirement of section 293 of the 1956 Act, such power could only be exercised in the general meeting in case of public companies and subsidiaries of public companies as per the 1956 Act.

Further, the limits of contribution to political parties are proposed to be increased to 7.5% of the average net profits during the three immediately preceding financial years [section 182 of 2013 Act] from the existing limit of 5% under the 1956 Act.

### Other matters

Listed companies will be required to file a return with the ROC with respect to the change in the number of shares held by promoters and top ten shareholders within 15 days of such a change [section 93 of 2013 Act]. This requirement again demonstrates the effort made towards synchronizing the requirements under the 2013 Act and the requirements under SEBI.

The 2013 Act requires every company to observe secretarial standards specified by the Institute of Company Secretaries of India with respect to general and board meetings [section 118 (10) of 2013 Act], which were hitherto not given cognisance under the 1956 Act. Additionally, it is also pertinent to note that these standards do not have a mandatory status for the practicing company secretaries.

### Registered valuers

The 2013 Act has introduced a new concept of registered valuers who are required for providing valuation reports mandated under various sections. These include the following:

- a. Further issue of share-capital (section 62 of the 2013 Act)
- b. Restriction on non-cash transactions involving directors (section 192 of the 2013 Act)
- c. Compromises, arrangements and amalgamations [section 230 of the 2013 Act]
- d. Purchase of minority shareholding (section 236 of the 2013 Act)
- e. Submission of a report by the company liquidator (section 281 of the 2013 Act)
- f. Declaration of solvency in case of proposal to wind up voluntarily (section 305 of the 2013 Act)
- g. Power of the company liquidator to accept shares, etc., as consideration for the sale of property of the company (section 319 of the 2013 Act)
- h. The qualification, experience as well as the process of registration as a valuer has been prescribed in the draft rules\* (section 247 of the 2013 Act).

### Doctrine of indoor management

When a company conducts a Board Meeting, they pass certain resolutions. The certified copies of these resolutions are given to outsiders as a proof of the Board decisions. Outsiders



rely upon these certified copies. They are expected to believe these certified copies. They are not supposed to cross check whether the resolutions are really passed or not. This concept is called as “Doctrine of indoor management”

#### Case Laws:

##### Turquand rule

##### Royal British Bank V/s. Turquand (1856)

**Facts** - The Directors of a company borrowed a sum of money from the plaintiff. The company’s articles provided that the directors might borrow on bonds such sums as may from time to time be authorized by a resolution passed at a general meeting of the company. The shareholders claimed that there had been no such resolution authorizing the loan and, therefore, it was taken without their authority. The company was however held bound by the loan. Once it was found that the directors could borrow subject to a resolution, the plaintiff had a right to infer that the necessary resolution must have been passed.

##### Judgment-

1. Persons dealing with the company are bound to read the registered documents and to see that the proposed dealing is not inconsistent therewith.
2. Outsiders are bound to know the external position of the company, but are not bound to know its indoor management.
3. Company may ratify the ultra vires borrowing by the directors if it is taken bonafide for the benefit of the company.

##### Exception to Turquand rule

##### Ruben V/s. Great Fingall Consolidated (1906)

**Facts** - The plaintiff was the transferee of a share certificate issued under the seal of a defendant company. The certificate was issued by the company’s secretary, who had affixed the seal of the company & forged the signatures of two directors.

##### Judgment-

1. It is quite true that persons dealing with limited liability companies are not bound to enquire into their indoor management and will not be affected by irregularities of which they have no notice. But the doctrine of indoor management, which is well established, applies to irregularities which otherwise might affect a genuine transaction. It can’t apply to a forgery.
2. Plaintiffs suit for damages did not succeed because turquand’s rule did not apply where the document was forged.

##### Anand Biharilal Vs Dinshaw and Co.

**Facts** - The plaintiff accepted a transfer of the company’s property from its accountant.

**Judgment** — The court held that since it is beyond the scope of an accountant’s authority, it was held void.

### 3.13 MEETINGS

A meeting involves the following aspects:

- a. Agenda
- b. Details about Date, Time and Venue
- c. Proper Notice
- d. Type of meeting
- e. Proper person in the chair
- f. Quorum
- g. Resolutions
- h. Voting Method, Rights and counting
- I. Proxy
- j. Minutes

#### Types of Meeting

- a. Annual General Meeting AGM. Also called as General Body Meeting
- b. Statutory Meeting
- c. Board meeting
- d. Extra Ordinary meeting

#### Annual General Meeting

Annual General meeting is a meeting of the shareholders which is held every year. The first annual general meeting should be held within nine months from the date of closing of the first financial year of the company [section 96(1) of 2013 Act] .2013 Act defines business hours as between 9 am and 6 pm. The annual general meeting cannot be held on a national holiday [section 96(2) of 2013 Act], In order to call an annual general meeting at shorter notice, the 2013 Act requires consent of 95% of the members [section 101(1) of 2013 Act],

The nature of concern or interest of every director, manager, any other key managerial personnel and relatives of such director, manager or any other key managerial personnel in each item of special business will also need to be mentioned in the notice of the meeting [section 102 (1) of 2013 Act]. Also, the threshold of disclosure of shareholding interest in the company to which the business relates of every promoter, director, manager and key managerial personnel is 2% [section 102 (2) of 2013 Act],

#### Quorum for the meeting

In case of a public company, the quorum will depend on number of members as on' the date of meeting. The required quorum is as follows:

- a. Five members if number of members is not more than one thousand

## NOTES



- b. Fifteen members if number of members is more than one thousand but up to five thousand
- c. Thirty members if number of members is more than five thousand [section 103(1)]

**Proxy** — It refers to a person who is authorized by a member of a company to attend and vote at a meeting of the company on his behalf. In other words, a proxy is an agent of a shareholder authorized to attend & vote at a meeting of the company.

A limit has been introduced on the number of members which a proxy can represent. The 2013 Act has introduced a dual limit in terms of number of members, which is prescribed as 50 members and also sets a limit in terms of number of shares holding in the aggregate not more than 10 % of the total share capital of the company carrying voting rights [section 105 (1) of 2013 Act],

Further, it is relevant to note that private companies cannot impose restrictions on voting rights of members other than due to unpaid calls or sums or lien [section 106 (1) of 2013 Act]. Listed companies will be required to file with the ROC a report in the manner prescribed in the rules on each annual general meeting including a confirmation that the meeting was convened, held and conducted as per the provisions of the 2013 Act and the relevant rules [section 121 of 2013 Act].

#### Other Provisions

1. Every co public or private, must hold an annual G.M of shareholders every year.
2. Every subsequent A.G.M must be held each year within 6 months after the closing of the financial year. Of the co & within 15 months from the date of the previous A.G.M.
3. The meeting must be held on a working day during the business hours at the Registered office of the company.
4. Notice of meeting should be issued to all the share holders

#### Statutory Meeting

Statutory meeting is the first official general Meeting of the shareholders of public co ltd by shares or a public co ltd by guarantee & having share capital.

#### Provisions

1. Notice.
2. Statutory Report.
3. A certified copy of the Statutory report must be filed with the registrar of companies.
4. At the meeting, a list showing the names, addresses & occupations of the members & the number of shares held by them must be placed by the board of directors.
5. Default.



### Statutory Report

This is a report drafted by directors and certified as correct by at least 2 of them including the managing director. U/S 165 (3) of the Companies Act of 1956, the statutory report must contain the following matters:

1. Total no of shares allotted.
2. An abstract of Receipts and payments.
3. Particulars of directors, managing directors etc.
4. Underwriting contracts.
5. Calls in arrears.
6. Commission or brokerage.

### Objects of Statutory meeting.

1. To know the progress of the company
2. To discuss the finances of the company
3. To help the members to know one another.

**Motion:** A proposition or proposal put before a meeting for consideration & decision.

Method of Voting: a) By show of hands b) by poll

### Resolutions

When motion is passed in a meeting, it becomes a resolution. In other words, it is the recorded decision of a meeting. In short, it is the decision of a meeting on a motion.

**Ordinary Resolution:** As per Sec 189(1) of Co Act an ordinary resolution is one which is passed by a simple majority of votes of members present in person or by proxy at a properly constituted & convened general meeting.

**Special Resolution:** Sec 189 (2) of the Co. Act, a special Resolution is one which is passed by at least 3/ 4th majority of votes of members present in person or proxy at a properly constituted & convened G.M.

### Minutes of Meetings

Literally, minutes refer to a note to preserve the memory of anything.

The minutes of a meeting are the written record of the business transacted and decisions arrived at a meeting. U/S 193 of Co Act provides that every company must keep minutes containing a fair and correct summary of the proceedings.

### Features of Minutes

- 1 Clear, concise and accurate record
- 2 Permanent record of the proceedings and the decisions reached at a meeting.
- 3 Reminder of the subjects previously dealt with and the conclusion reached.
- 4 They are accepted in a court of law as evidence of the proceedings of a meeting.



- 5 Information to the absentee members.

### CHECK YOUR PROGRESS

1. Explain the features of a Company.
2. Explain the different types of Companies.
3. Explain the procedure for formation of a Company.
4. Explain the roles and responsibilities of Directors of a company.
5. Explain the legal provisions regarding Memorandum of Association.

### 3.14 BOARD OF DIRECTORS

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Directors are persons in charge of management of business of company. Only individuals can be Directors

#### No of directors

**Woman Director**-1 in specified cos

**Resident Director**- 1 in specified cos

**Independent Director**-1 /3<sup>rd</sup> in listed Companies

#### Director Identification Number (DIN)

- a. DIN essential for appointment as Directors.
- b. Application to CG for DIN to be filed.
- c. Director to inform DIN to company
- d. Company to inform DIN to ROC
- e. Two DIN not permissible

#### Types of Directors

- a. First Directors or Founder Director
- b. Elected Director or Subsequent Directors
- c. Additional Director
- d. Alternate Director
- e. Nominee Director
- f. Small shareholders' Director
- g. Woman Director
- h. Employee Director
- i. Independent Director
- j. Expert Director
- k. Supplementary Director



### First Directors

They are elected as per procedure in AOA. If not, subscribers to MOA become First Directors. They should be appointed at first AGM. Director to give consent before appointment as Director- to be filed with ROC

### Elected Director or Subsequent Directors

They are elected at Annual General Meeting by the eligible shareholders having voting rights.

14 days 'notice for appointment should be given.

### Additional Director

Can be appointed if so, authorized by AOA. Person should not have failed in appointment at earlier AGM. Holds office till next AGM.

### Appointment of an additional director

It is pertinent to note that, in order to discourage inappropriate practices, the 2013 Act states that any person who fails to get elected as a director in the general meeting can no longer be appointed as an additional director by the board of directors [section 161 of 2013 Act],

### Alternate Director

Alternate director in his place should have same qualifications under the Act as applicable to ID. Alternate Director can be alternate to only one director. For qualifying as ID, absence of any pecuniary relationship is a must.

- a. Appointed by the Board as Director in place of Director away from India for 3 months
- b. Holds office for balance term of original Director
- c. Vacates office if original Director returns
- d. He can be Alternate for Independent Director if so qualified

### Nominee Director

BOD may appoint any nominee of Institution as per law /agreement, Supplementary Directors

Casual Vacancy arises in case of death, resignation of Director. BOD may fill up vacancy, if AOA allows. He holds office till balance term of original Director

### Small shareholders 'Director

Small shareholders —shares of Rs. 20,000 Listed co may provide for it in AOA

### Woman director

The category of companies which need to comply with the requirement of having at least of one-woman director are as follows: [section 149(l) of 2013 Act]



## NOTES



- a. Every listed company, within one year from the commencement of second proviso to sub-section (1) of section 149.
- b. Every other public company that has paid-up share capital of one hundred crores rupees' movie, or a turnover of three hundred crore rupees or more within three years from the commencement of second proviso to sub-section (1) of section 149.

While this new requirement will go a long way in encouraging gender diversity, it has already created quite a stir in the manner in which companies will ensure compliance.

#### **Employee Director.**

A representative of the employees elected by the majority trade union is appointed as Employee Director. There can be more than one employee director representing different classes of employees such as women employees, work men employees\* officer employees etc. Public sector banks in India appoint workmen representative and officer representative nominated by the majority trade union

#### **Independent Director**

A person of integrity with Expertise /experience not related to the company is appointed as Independent Director.

#### **Rotation of Directors**

2/3rd liable for rotation (excel Independent Directors). 1 /3rd retire at second AGM, Retiring Directors eligible for reappointment

#### **Disqualifications**

- a. Convicted for 6 months' imprisonment and 5 years after.
- b. Unsound mind, insolvent.
- c. Disqualified by court to be Director.
- d. Not paid calls for 6 months.
- c. Convicted for related party transactions.
- f. Director in a company that not filed financial statements for 3yrs or defaulted in payments.

#### **Board Committees**

- a. Audit Committee
- b. Nomination and Remuneration Committee
- c. Stakeholders Relations Committee

#### **Powers of Board**

Board authorized to do all acts that company can do except powers vested with shareholders at.

#### **General Meeting**

Following Powers **only at meeting**

call for unpaid shares, Buyback, issue securities, borrow, invest, grant loans, diversify business, approve fin statements, M&As

NOTES



### **Powers by special resolution at GM**

- a. Sell, dispose of undertaking.
- b. Investment of amount read from M&As.
- c. Borrow in excess of paid-up capital +free reserves.
- d. Remit any loan to Director.

### **Number of directorships**

The 2013 Act increases the limit for number of directorships that can be held by an individual from 12 to 15 [section 149(1) of 2013 Act],3. One director to be resident in India

A new requirement with respect to directors is that at least one director to have stayed in India for at least 182 days in the previous calendar year [section 149(3) of 2013 Act]. This requirement appears to be a departure from the focus given in the 2013 Act towards use of electronic mode such as use of video conferences for meetings and electronic voting. With the increasing use of electronic media, the need, for a director to be resident in India for a minimum amount of time, becomes redundant.

A person can be a director in maximum 20 companies. There is a further restriction that maximum 10 Public companies (including private companies which are holding or subsidiary co of public company). This number can be further reduced by special resolution

### **Additional compliance requirements for private companies**

There are certain increased compliance requirements mandated for private companies which, till now, were mandated only for public companies and private companies which are subsidiaries of public companies. These include the following:

- a. Appointment of director to be voted individually
- b. Option to adopt principle of proportional representation for appointment of directors
- c. Ineligibility on account of non-compliance with section 274(1)) (g) now extended for appointment or reappointment as a director in a private limited company also.

### **Meetings of the board and its powers**

There have been significant inroads made by the MCA in the recent past with respect to giving cognizance to use of electronic media in day-to-day operations of corporates. The 2013 Act takes this further by allowing use of electronic mode for sending notice of meetings [section 173(3) of 2013 Act], passing of resolution by circulation [section 175 of 2013 Act] and other areas. Some of the other significant changes in relation to the board and its functioning include:



### Board Meetings

- a. 4 meetings in a year
- b. Not more than 4 months' time in between two meetings
- c. Directors can participate in person or by video conferencing / audio visual means
- d. 7 days' notice for meeting to be given
- e. Quorum: Means minimum no required for a valid meeting. One third Directors (non interested) forms quorum. If Interested Directors more than 2/3rd non-IDs makes quorum, if not less than 2

### Board Decisions

- a. At regular meeting or by circulation
- b. Circulation — draft to be circulated
- c. Needs approval by majority for decision
- d. To be noted at next meeting
- e. 1/3rd Directors may require circulation item to be considered at meeting

### Disclosure of interest by director

Where a contract or arrangement entered into by the company without disclosure of interest by director or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company [section 184 of 2013 Act],

The 2013 Act also intends to improve corporate governance by requiring disclosure of nature of concern or interest of every director, manager, any other key managerial personnel and relatives of such a director, manager or any other key managerial personnel and reduction in threshold of disclosure from 20% to 2%.

### Case Laws regarding Directors.

If the power of appointing additional directors is delegated to the Board by the articles, the Board can appoint additional directors without taking this item on the agenda of its meeting. *Needle Industries Ltd. V/s. Needle Industries Newly (India) Holding Ltd.* (1981)

*Gramophone Ltd. V/s. Tanlcy* (1908) "Even a resolution of a numerical majority, at a general meeting cannot impose its will upon the directors, when the articles have confided to them the control of the company's affairs."

Just as in case of agency, a notice to agent will amount to a notice to the principal, in the same way a notice to director will be deemed as a notice to the company. *R. PRATT Ltd. V/s. Sasson & Co. Ltd T.* (1936) for contravention of provisions relating to charges, minimum fine Rs. 1 lakh extendable up to Rs. 10 lakh and OI punishable with imprisonment up to six months or fine or both.

For failure to file Annual return, minimum fine Rs. 50,000 extendable up to Rs. 5 lakh and OI punishable with imprisonment up to six months or fine or both.

Public company minimum 3, Private minimum 2, OPC 1

Maximum 15, can be more with Special resolution

Listed companies minimum one third - independent directors (However, listing agreement provisions will apply).

Listed Companies and public Companies having PUC of 100 Cr. or more or turnover of 300 Cr. or more should appoint one woman director maximum 20 out of which no. of public Companies should not be more than 10.

Private Companies which are holding/sub of public co will be included in counting of public cos. loans to Directors banned with limited exemptions.

### Exemptions

- a. Loan to MD/WTD as a part of conditions of service to all employees or
- b. Pursuant to any scheme approved by members by a special resolution Loan, guarantee or security for repayment of loan in the ORDINARY course of business and charging interest at prevailing bank rate.

### Duties of a director

- a. A director shall act in good faith in order to promote the objects of the company.
- b. He shall exercise his duties with due and reasonable care, skill and diligence, exercise independent judgment.
- c. Shall not involve in a situation of conflict of interest.
- d. Shall not achieve or attempt to achieve undue gain or advantage. If found, liable to pay equal amount to company.

### Responsibilities

- a. Not to participate in the meeting, if interested.
- b. A few additional disclosures in Director's 'report'.
- c. Directors' report to include extract of annual return.
- d. To include explanation or comment on every qualification, reservation or adverse remark or disclaimer made by auditor.
- e. Particulars of loans, investments, guarantees.
- f. Particulars of related party transactions.
- g. Risk management policy statement.
- h. Directors' Responsibility statement shall include the following additional clause.
- i. The Directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating efficiently.
- j. Further for listed co: the Directors have laid down internal financial controls and they are adequate and operating effectively.



- k. If a director absents himself from attending all meetings in 12 months, he will vacate his office. He should attend at least one Board meeting in a financial year.
- l. A director of a private company has to file his consent.
- m. At least one director should have stayed in India for at least 182 days in previous calendar year.

**Consent of a company by a special resolution is necessary for following matters:**

- a. To sell, lease or otherwise dispose of the whole undertaking. Undertaking means an undertaking in which investment exceeds 20% of net worth of the co or which generates 20% of total income during previous fin year. Substantially the whole means 20% or more of the value of the undertaking as per balance sheet of preceding fin year
- b. To invest otherwise in trust securities the amount of compensation recd on merger or amalgamation
- c. To borrow money (where all borrowings exceed aggregate of paid up capital and free reserves)
- d. To remit or give time for repayment of any debt due from a director

**Managerial Remuneration**

Overall limit retained at 11 %

In case no profit or inadequacy of profit Schedule V will apply, wo types of criteria under schedule V: effective capital or percentage of current relevant profit.

Effective capital	Annual Limit
Negative or less than 5 Crores	30 lakhs
5 Cr to less than 100 Cr	42 lakhs
100 Cr to less than 250 Crores	60 lakhs
250 Grand above	60 lakhs + 0.01% of edify capital above 250 Double if special resolution is passed.

If a managerial person was not a security holder holding securities of nominal value of 5 lakh or more or employee or director or not related to director or promoter during two years prior to his appointment: 2.5% of current relevant profit. If special resolution is passed then double.

### **3.15 INDEPENDENT DIRECTORS**

One of the significant aspects of the 2013 Act is the effort made towards incorporating some of the salient requirements mandated by the SEBI in clause 49 of the listing agreement in the 2013 Act itself. To this effect, the 2013 Act requires every listed public company to have at least one-third of the total number of directors as independent directors.



Further, the central government in the draft rules has prescribed the minimum number of independent directors in case of the **following classes of public companies\*** [section 149(4) of 2013 Act].

- a. Public companies having paid up share capital of 100 crore INR or more; or
- b. Public companies having turnover of 300 crore INR or more
- c. Public companies which have, in aggregate, outstanding loans or borrowings or debentures or deposits, exceeding 200 crore INR

The 2013 Act also states that companies will have a period of one year to ensure compliance with the 2013 Act and the Rules that are framed.

Independent Director to be appointed by general meeting. Elaborate definition with restrictions on pecuniary relationship.

Non promoter, non-relative, person of integrity and having relevant experience and expertise. He should not have held or holding position of KMP or as an employee, proprietor or partner of auditor, PCS or Cost accountant or legal consulting firm, should not be holding voting power of 2% or more along with relatives, should not be CEO or Director of non-profit organization which receives 25% or more of its receipts from the co. etc.

Listed Company - 1 /3<sup>rd</sup> of total number directors. Other companies minimum 2.

Public Companies having PUC of 10 Cr or more or Public Companies having turnover of 100 Cr or more.

Public Companies - aggregate outstanding loans, debentures deposits exceeding 50 Cr No of IDs can be more if required due to audit committee composition.

Complete code for IDs in the form of Schedule IV guidelines for professional conduct include that he should uphold ethical standards of integrity and probity, he should act objectively and constructively, exercise his responsibilities in the interest of the company, devote sufficient time and attention to his professional.

#### **Duties of independent directors are:**

- a. Undertake appropriate induction and regularly update and refresh their skills, knowledge, and familiarity with the company.
- b. Attempt to attend company's general meetings.
- c. Attempt to attend BOD's meetings and board committees meeting being a member.
- d. Have adequate knowledge about the company and the external environment in which it operates.
- e. Report matters concerning unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.
- f. Acting within his or her authority, assist in protecting the legitimate interests of the company, shareholders and its employees.



- g. Not to unfairly obstruct the functioning of the company or committee of the Board.
- h. Participate in the Board's committee being chairpersons or members of that committee.
- i. Not to disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.
- j. Ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use.

### **Role of an Independent Director**

Independent Director acts as a guide, coach, and mentor to the Company. The role includes improving corporate credibility and governance standards by working as a watchdog and help in managing risk. Independent directors are responsible for ensuring better governance by actively involving in various committees set up by the company.

**The independent directors are required because they perform the following important roles:**

- a. Facilitate withstanding and countering pressures from owners.
- b. Fulfil a useful role in succession planning.
- c. On issues such as strategy, performance, risk management, resources, key appointments and standards of conduct he or she must support in gaining independent judgment to bear the board's deliberations.
- d. While evaluating the performance of the board and management of the company, he or she needs to bring an objective view.
- e. Scrutinizing, monitoring and reporting management's performance regarding goals and objectives agreed in the board meetings.
- f. Safeguard the interests of all stakeholders, particularly the minority shareholders.
- g. Balance the conflicting interest of the stakeholders.
- h. Check on the integrity of financial information and ensure financial controls and systems of risk management are in operation.
- i. In situations of conflict between management and shareholder's interest, aim towards the solutions which are in the best interest of the company.
- j. Establishing suitable levels of remuneration of executive directors, key managerial personnel, and senior management.

### **Features about independent directors**

- a. He is in addition to Managing Director, Whole Time Director, Nominee Director.
- b. Board considers him person of integrity with Expertise/experience.
- c. Not related to promoters / Directors.

- d. No pecuniary relations with company /promoters/ Directors/ holding co/ subsidiary in current and last two years.
- e. No relative with 2% of turnover.
- f. Not held key management position, employee in last 3 years.
- g. Not been partner in audit firm, consultancy firm that had dealings with company.
- h. Not holds 2% voting power, with relatives.
- i. Any change in status to be informed to company.
- j. Term-5 years, eligible for second term with special resolution Third term after 3 years provided no association with to company in the interval.



### Conflicting requirements

While there have been attempts to harmonize the requirements of SEBI and the 2013 Act was made, there are several aspects relating to independent directors where the requirements of the 2013 Act differ from that of clause 49 of the equity listing agreement. The requirements of the 2013 Act and the manner in which they differ from those under the clause 49 of the equity listing agreement include the definition itself. The other main differences are as follows:

- Clause 49 does not require the board to exercise its judgment and opine on whether the independent director is a person of integrity or has relevant expertise or experience. This requirement poses difficulty in terms of the manner in which integrity of an individual can be assessed by the board.
- Clause 49 does not require examination of the independence of the relatives of independent directors. Extending the disqualification of the independent directors to consider the pecuniary relationship of the relatives would pose unnecessary hardship for the independent directors.
- The 2013 Act brings the constitution of the board in India at par with other international capital markets i.e., by mandating at least one-third of the board to be independent directors in case of listed companies. Whereas, the SEBI requirements are where the chairman of the board is a non-executive director, at least one-third of the board should comprise of independent directors and where the non-executive chairman is a promoter of the company or is related to any promoter or person occupying management positions at the board level or at one level below the board, at least one-half of the board of the company shall consist of independent directors.
- The 2013 Act limits the tenure of office of an independent director to a maximum of two tenures of five consecutive years, with a cooling-off period of three years between the two tenures. During the cooling-off period of three years, should not be appointed in or be associated with the company in any other capacity, either directly or indirectly [proviso to section 149(11) of 2013 Act].
- It is also relevant to note that the MCA had released the corporate governance voluntary guidelines in 2009, which permitted three tenures (with other conditions





similar to those discussed above) for an independent director while as per the clause 49 of the equity listing agreement, an independent director cannot serve for more than nine consecutive years.

- Stock options: As per the 2013 Act, an independent director will not be eligible to get stock options but may get payment of fees and profit linked commission subject to limits specified or to be specified in the rules [section 149 (9) of 2013 Act], This again, is in contradiction with SEBI's requirements, whereby for the purpose of granting stock options, the term employee includes independent directors also.

#### **Databank of independent directors**

The 2013 Act makes the appointment process of the independent directors, independent of the company's management by constituting a panel or a data bank to be maintained by the MCA, out of which companies may choose their independent directors. The proposal has its origins in the report of the 21<sup>st</sup> Standing Committee on finance, wherein it was acknowledged that preparation of a databank of independent directors would vest with a regulatory body that may comprise of representatives of MCA, SEBI, Reserve Bank of India, professional institutions, Chambers of Commerce and Industry etc [section 150 of 2013 Act].

A drawback of constituting a panel of independent directors is that it may discourage people from registering with the panel and in that sense limit the options available to a company for appointment of independent directors.

#### **Code for independent director**

The 2013 Act includes Schedule IV 'Code for Independent Directors'(Code) which broadly prescribes the following for independent directors:

- a. Professional conduct
- b. Role and functions
- c. Duties
- d. Manner of appointment
- e. Reappointment
- f. Resignation or removal
- g. Holding separate meetings
- h. Evaluation mechanism

**The code appears to be mandatory which would lead to some of the following concerns:**

- a. The code states that an independent director shall uphold ethical standards of integrity and probity, however what would constitute ethical behaviour is not defined and is open to interpretation.
- b. The code does not give any cognizance to the need for training for the independent directors.
- c. The code refers to appointment of independent directors by the board after evaluating certain attributes. The concern that remains unaddressed is the manner

in which companies need to carry out an assessment of the attributes of an independent director as specified under 'manner of appointment' in the code from the databank maintained by the MCA.



### Liability of independent directors

The 2013 Act makes an attempt to distinguish between the liability of an independent director and non-executive director from the rest of the board and has 'accordingly inserted a provision to provide immunity from any civil or criminal action against the independent directors. The intention and effort to limit liability of independent directors is demonstrated from the section 149(12) of the 2013 Act which inter-alia provides that liability for independent directors would be as under:

“Only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, with his consent or connivance or where he had not acted diligently.”

The section seeks to provide immunity from civil or criminal action against independent directors in certain cases. Further, in accordance with the requirement of section 166 (2) of 2013 Act, whole of the board is required to act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interest of the company, its employees, the shareholders, the community and for the protection of the environment. By virtue of this section the duty of independent directors actually goes beyond its normal definition and is not restricted to executive directors only.

It is amply clear that independent directors have little or no defence and their obligations continue to remain a debatable topic since they would still be treated equivalent to the other directors by holding them responsible for decisions made through board process

## 3.16 FINANCIAL REPORTS

### Financial year

It has been defined as the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1<sup>st</sup> day of January, the period ending on the 31<sup>st</sup> day of March of the following year. [Section 2(41)].

There are several reasons for a company to use a year-end which is different from April to March. These include companies which are subsidiaries of foreign companies which follow a different year-end or entities which have significant subsidiaries outside India which need to follow a different year-end, etc. Accordingly, it would not be appropriate to mandate a single year-end for all companies. Since the 2013 Act does not mandate any specific rules or requirements on the basis of a specific year, as in the case of tax laws, the reason for requiring a uniform year-end under the 2013 Act, seems to be unclear.

Further, recent notifications or circulars of the Ministry seem to indicate relaxation in the norms for requiring approvals from the Tribunal or the central government, etc for matters which are administrative or procedural in nature. Accordingly, the option available with

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companies to seek an exemption from the Tribunal will create additional administrative and procedural roadblocks, with no benefits to the companies. Rather, they will need to expend additional costs as well as time either by way of seeking an exemption or preparing multiple sets of financial statements.

Schedule II of the 2013 Act, relating to depreciation defines the useful life of assets as against the depreciation rates specified in the 1956 Act.

The 2013 Act has introduced certain significant amendments in this chapter. It has also introduced several additional requirements such as preparation of consolidated financial statements, additional reporting requirements for the directors in their report such as the development and implementation of the risk management policy, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates, etc.

### **Books of accounts**

Every company is required to maintain books of accounts at its registered office. [Section 128(1) of the 2013 Act], 'Books of accounts' are required to show

- a. All money received and spent and details thereof,
- b. Sales and purchases of goods,
- c. Assets and liabilities and
- d. Items of cost as may be prescribed. The books of accounts of a company essentially provide the complete financial information of a company.

Further, with respect to branches, while the existing 1956 Act provides that where company has a branch office(s) proper summarized return, made up to date at interval of not more than three months was supposed to be sent by branch to the company at its registered office or another place etc., such a requirement has now been done away with and only returns are to be periodically sent by the branch to the registered office [section 128(2) of 2013 Act].

Also, in keeping with the times, books of accounts and relevant papers can now be maintained in electronic mode [section 128(1) of 2013 Act],

### **Cognizance of accounting standards**

In several instances across the 2013 Act, there are provisions which are also covered within the accounting standards currently notified under section 211 (3C) of the 1956 Act and the Companies (accounting standards) Rules, 2006 there under.

### **Publication of Annual reports**

All the companies are expected to prepare and publish Operating Statement (Income and Expenditure Statement), Balance Sheet. The detailed guidelines are given for classification of various assets and liabilities and the formats of statements are also given in the act. There are also rules regarding rounding off of accounts.



### **New Schedule VI (Section 221)**

The Schedule VI has been revised by MCA and is applicable for all Balance Sheet made after 31<sup>st</sup> March, 2011. The Format has done away with earlier two options of format of Balance Sheet, now only Vertical format has been permitted

### **General Instructions for preparation of Balance Sheet**

The disclosure requirements specified in Part I and Part II of this Schedule are in addition to the disclosure requirements specified in the Accounting Standards.

Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts.

### **Rounding off**

Depending upon the turnover of the Company, the figures appearing in the Financial Statements may be rounded as below:

### **Turnover Rounding off**

- a. Less than one hundred crore rupees: To the nearest hundreds, thousands, lakhs or millions, or decimals thereof
- b. one hundred crore rupees or more: To the nearest lakhs or millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

The corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements

## **PART I — FORM OF BALANCE SHEET**

**Name of the company**.....

**Balance Sheet as at**.....

**(Rupees in..... )**

### **Associate company**

Significant influence is defined to mean 'control of business decisions under an agreement'

It differs from the definition of an associate as per the Accounting Standard 23: Accounting for Investments in Associates in Consolidated Financial Statements.

The status of an associate and a joint venture cannot be equated since, the degree of control that a company can exercise in such entities, varies significantly. While 'joint control' is the driving factor in case of joint ventures, a company can at the most only 'participate' in the operating or financing decisions in case of an associate company.

With regard to the explanation to the section in the 2013 Act, which defines the term 'significant influence, it is to be noted that if a company has 'control' [control has been defined in section 2(27) of the 2013 Act] with respect to business decisions of another



company, such other company will in fact be tantamount to a subsidiary and not an associate company. Hence, the use of the term 'control' within the definition of significant influence leads to a conflict between the two definitions (associate company and subsidiary company).

### **Subsidiaries**

The term 'control', which is relevant with respect to identifying subsidiaries, has been defined in section 2(27) of the 2013 Act. While this definition mandates consideration of 'shareholding' as one of the factors, the corresponding definition in AS 21: Consolidated Financial Statements (AS 21), refers to 'voting power'. This issue is an existing one since a similar difference exists between the definition of 'subsidiary', where the term 'control' is relevant under the existing 1956 Act [section 4(1) of the 1956 Act]. Accordingly, while for consideration of an entity as a subsidiary for the purpose of consolidated financial statements (CFS), reference is made to AS 21, for the purpose of any compliance with the 1956 Act, reference is made to section 4(1) of 1956 Act.

Now that the requirement of preparing consolidated financial statements has been included within the 2013 Act itself, a conflict arises as to whether the definition as per the 2013 Act should be considered for identifying a subsidiary or the definition as per the AS 21. In any case, the company will be non-compliant with the requirement of either the 2013 Act or the AS.

With regard to related party, while there is a substantial difference between the definition under the 2013 Act and AS 18, the difference does not impact the financial statements, since the disclosures in the financial statements will be continued to be made as per AS 18.

### **Consolidated financial statements**

The 2013 Act now mandates CFS for any company having a subsidiary, associate or a joint venture [section 129(3)]. The manner of consolidation is required to be in line with the requirements of AS 21 as per the draft rules. \* Further, the 2013 Act requires adoption and audit of CFS in the same manner as standalone financial statements of the holding company [section 129(4)].

Apart from CFS, the 2013 Act also requires a separate statement, containing the salient features of financial statements of its subsidiary (ies) in a form as prescribed in the draft rules\* [First proviso to section 129 (3)]. Further, section 137(1), also requires an entity to file accounts of subsidiaries outside of India, along with the financial statements (including CFS).

While section 129 of the 2013 Act, requires all companies to file a statement containing salient features of the subsidiary's financial statements, in addition to the CFS, section 137 of the 2013 Act further requires entities with foreign subsidiaries to submit individual financial statements of such foreign subsidiaries along with its own standalone and consolidated financial statements. There seems to be significant amount of overlap and additional burden on companies with respect to these compliances.



To illustrate this point, in order to comply with these requirements, a company which has a global presence, **with subsidiaries both within as well as outside India will need to comply to the following:**

- a. Prepare its standalone financial statements [section 129(1) of the 2013 Act].
- b. Prepare a CFS, including all subsidiaries, associates and joint ventures (whether in India or outside) [section 129(3) of the 2013 Act].
- c. Prepare a summary statement for all its subsidiaries, associates and joint ventures of the salient features of their respective financial statements [Proviso to section 129(3) of the 2013 Act].
- d. Submit the standalone financial statements of subsidiary(ies) outside India to the Registrar of Companies (RoC) [section 137(l) of the 2013 Act].

This situation clearly indicates the extent of duplication and additional costs which will be incurred by entities in order to provide the same information in multiple forms or formats.

Re-opening of accounts and voluntary revision of financial statements or the board's report. A company would be able to re-open its books of accounts and recast its financial statements after making an application in this regard to the central government, the income tax authorities, the SEBI, or any other statutory regulatory body or authority or any other person concerned, and an order is made by a court of competent jurisdiction or the Tribunal under the following circumstances (**section 130 of the 2013 Act**):

- a. Relevant earlier accounts were prepared in a fraudulent manner
- b. The affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of the financial statements

Further, a company would be able to undertake voluntary revision of financial statements or Board's report if it appears to the director of a company that the financial statement of the company or the board report does not comply with the provisions of section 129(financial statement) and section 134 of the 2013 Act (financial statements and board reports) in respect of any of three preceding financial years, after obtaining approval from the Tribunal. The Tribunal shall give notice to the central government and the income tax authorities and shall take into consideration the representations, if any, made by the government or the authorities before passing any such order.

To prevent misuse of these specific provisions, the section contains a proviso which states that such a revised financial statement or report shall not be prepared or filed more than once within a financial year and the detailed reasons for revision of such financial statement or report shall also be disclosed in the board's report in the relevant financial year in which such a revision is being made (section 131 of 2013 Act).

### **Dealing with fraud**

The 2013 Act deals extensively on the issue of fraud (section 447 of the 2013 Act) and has for the first-time defined fraud specifically as:

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“Fraud in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss”

The term, ‘wrongful gain’ means gain by unlawful means of property to which the person gaining is not legally entitled and ‘wrongful loss’ means the loss by unlawful means of property to which the person losing is legally entitled [Explanation to section 447 of the 2013 Act].

**Further, the penalties as prescribed under this section are as follows:**

- a. Imprisonment for a term of not less than six months, but which may extend to 10 years.
- b. Fine not less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.
- c. Also, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

The provisions of this section have a significant impact and there are various areas across the 2013 Act, which will lead a person to be liable under this section. Some of these areas are as follows: Where a person furnishes any false or incorrect particulars of any information or suppresses any material information in relation to incorporation of a company filed with the ROC [section 7(5) and (6) of the 2013 Act].

In case of the formation of the company with charitable purpose, where it is proved that the affairs of the company were conducted fraudulently - every officer in default [section 8(11) of the 2013 Act].

### 3.17 AUDIT

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#### Appointment of auditors

The auditor will now be appointed for a period of five years, with a requirement to ratify such an appointment at each annual general meeting [section 139(1) of 2013 Act].

Further, the 2013 Act provides that in respect of appointment of a firm as the auditor of a company, the firm shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008 [Explanation to section 139(4) of 2013 Act].

Also, the 2013 Act specifies that where a firm, including a limited liability partnership is appointed as an auditor of a company, only those partners who are chartered accountants shall be authorized to act and sign on behalf of the firm [section 141 of 2013Act],

Section 141 of the 2013 Act further prescribes an additional list of disqualifications, and extends the disqualification to also include relatives. The Section of the 2013 Act states that a person who, or his relative or partner is holding any security of or inter cast in



the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company of face value exceeding one thousand rupees or such sum as may be prescribed; is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs. 1,00,000\*; or has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for Rs. 1,00,000\*, will not be eligible to be appointed as an auditor.

Additionally, a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, will be disqualified from being appointed as an auditor.

It would be relevant to note that the draft rules include 15 relationships in the list of relatives including step son/daughter and step brother/sister.

The ineligibility also extends to person or a partner of a firm who holds appointment as an auditor in more than twenty companies as well as a person who is in full time employment elsewhere, [section 141 (3)(g) of the 2013 Act].

The definition of a relative does not give cognizance to the Code of Ethics prescribed by the Institute of Chartered Accountants of India (ICAI) and thus, there are likely to be interpretational issues. Also, the 2013 Act does not specify as to what would constitute as indirect interest and thus in absence of guidance it would be difficult to assess the extent of implication on the audit profession.

### **Mandatory firm rotation**

The 2013 Act has introduced the concept of rotation of auditors as well as audit firms. It states that in case of listed companies (and other class(es) of companies as may be prescribed) it would be mandatory to rotate auditors every five years in case of the appointment of an individual as an auditor and every 10 years in case of the appointment of an audit firm with a uniform cooling off period of five years in both the cases. Further, firms with common partners in the outgoing audit firm will also be ineligible for appointment as auditor during the cooling off period. The 2013 Act has allowed a transition period of three years for complying with the requirements of the rotation of auditors [section 139(2) of the 2013 Act], Further, the 2013 Act also grants an option to shareholders to further require rotation of the audit partner and staff at such intervals as they may choose [section 139(3) of the 2013 Act].

### **Son-audit services to audit clients**

The 2013 Act states that any service to be rendered by the auditor needs to be approved by the board of directors or the audit committee.

**Additionally, the auditor is restricted from providing specific services, which include the following:**





- a. Accounting and book keeping services.
- b. Internal audit.
- c. Design and implementation of any financial information system.
- d. Actuarial services.
- e. Investment advisory services.
- f. Investment banking services.
- g. Rendering of outsourced financial services.
- h. Management services, and any other service which may be prescribed (no other service has been prescribed).

Further, the 2013 Act provides that such services cannot be rendered by the audit firm either directly or indirectly through itself or any of its partners, its parent or subsidiary or through any other entity whatsoever, in which the firm or any other partner from the firm has significant influence or control or whose name or trademark or brand is being used by the firm or any of its partners [section 144 of the 2013 Act]. The 1956 Act currently does not specify any requirements relating to non-audit services.

These restrictions are aimed at achieving auditor independence. Auditor independence is fundamental to public confidence on the reliability of the auditors' reports. This concept adds credibility to the published financial information and value to investors, creditors, companies, employees as well as other stakeholders. Independence is the audit profession's primary means of demonstrating to the public as well as the regulators that auditors and audit firms are performing in line with established principles of integrity and objectivity. To comply with these independence norms, the 2013 Act provides for a transitional period of one year, that is, an auditor or an audit firm who or which has been performing any non-audit services on or before the commencement of the 1956 Act shall comply with these provisions before closure of the first financial year after the date of commencement.

### **Joint audits**

The 2013 Act provides that members of the company may require the audit process to be conducted by more than one auditor [section 139(3) of the 2013 Act].

### **Auditor's liability**

The scope and extent of the auditor's liability, has been substantially enhanced under the 2013 Act. Now, the auditor is not only exposed to various new forms of liabilities, however, these liabilities prescribed in the existing 1956 Act have been made more stringent. The auditor is now subject to oversight by multiple regulators apart from the ICAI such as The National Financial Reporting Authority (NFRA and the body replacing the NACAS) is now authorized to investigate matters involving professional or other misconduct of the auditors. The penalty provisions and other repercussions that an auditor may now be subject to as per the 2013 Act includes monetary penalties, imprisonment, debarment of the auditor and the firm, and in case of frauds, can even be subject to class action suits.



### Additional responsibilities of the auditor

The 2013 Act requires certain new aspects which need to be covered in an auditors' report. These include the following:

- a. The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company [section 143(3)(f) of the 2013 Act].
- b. Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith [section 143 (3)(h) of the 2013 Act].
- c. Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls [section 143(3)(I) of the 2013 Act].

There are other reporting requirements specified in the draft rules which include reporting on pending litigations, etc which are already covered either by the accounting standards or guidance from the ICAI, and thus result in duplication.

The 2013 Act requires an auditor to report to the central government within 30 days in a format prescribed within the draft rules, if he or she has any reasons to believe that any offence involving fraud is being committed or has been committed against the company by its officers or employees [section 143(12) of the 2013 Act]. Further, where any auditor does not comply with the above requirements, he or she shall be punishable with a fine which shall not be less than 1 lakh INR, but which may extend to 25 lakh INR [section 143(15) of the 2013 Act].

Where a prospectus, issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus [section 34 of the 2013 Act]

- Fraudulently inducing persons to invest money (section 36 of 2013 Act)
- Personating for acquisition, etc. of securities (section 38 of the 2013 Act)
- Where any depository or depository participant, has transferred shares with an intention to defraud a person (section 46(6) of the 2013 Act)

Failure to repay the deposit or a part thereof or any interest thereon, within the time limits as applicable, and where it is proved that such deposits were accepted with intent to defraud the depositors or for any fraudulent purpose (section 75 of the 2013 Act).

Where the Tribunal is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers [section 140(5) of the 2013 Act].

Where it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers [section 147(4) of the 2013 Act]. Penalty for furnishing false statement, mutilation, destruction of documents (section 229 of the 2013 Act)



### Audit committee

Audit committees are a measure of ensuring self-discipline, constituted with the object to strengthen and oversee management in public companies and to ensure that the board of directors discharge their functions effectively. The 2013 Act acknowledges the importance of an audit committee and entrusts it with additional roles and responsibilities [section 177 of 2013 Act],

However, the fact that the 2013 Act is not entirely in harmony with the requirements of clause 49 of the equity listing agreement, cannot be ignored. While most of the requirements including establishment of a 'vigil mechanism' for directors and employees to report genuine concerns, that are similar to the requirements of clause 49 of the equity listing agreement have been incorporated in the 2013 Act.

## 3.18 DIVIDEND

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### Declaration of dividend

The existing requirement of the 1956 Act with regard to the transfer of a specified percentage of profits not exceeding 10% to reserve [that is, Companies (Transfer of Profits to Reserve) Rules, 1975] has not been acknowledged in the 2013 Act and thus companies are free to transfer any or no number of profits to reserves [section 123 (1) of the 2013 Act].

Similar to the existing provisions of the 1956 Act, the 2013 Act also provides that no dividend shall be declared or paid in case of inadequate profits by a company subject to the Rules yet to be notified. The company also cannot declare or pay dividend from its reserves other than free reserves [section 123(1) of the 2013 Act]. This could mean that the requirements provided in Companies (Declaration of Dividend out of Reserves) Rules, 1975 have been retained.

As per the existing provisions of the 1956 Act, dividend includes interim dividend and all provisions of the 1956 Act which applies to the final dividend equally apply to interim dividend. The 2013 Act, however, imposes a further restriction on the declaration of interim dividend. The 2013 Act specifically provides that in case a company has incurred loss during the current financial year, up to the end of the quarter immediately preceding the date of declaration of the interim dividend, then the interim dividend cannot be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years [section 123(3) of the 2013 Act].

The 2013 Act states that if a company fails to comply with the provisions of acceptance of deposits and repayment of deposits accepted prior to the commencement of this 1956 Act, it will not be able to declare any dividend on equity shares, as against the non-compliance of section 80A of the 1956 Act regarding redemption of irredeemable preference shares, etc [section 123(6) of the 2013 Act].

The provisions of the existing Schedule XIV of the 1956 Act have been acknowledged under Schedule II of the 2013 Act. Important highlights from the Schedule II are as follows:

The useful life or residual value of an asset have been specified in Part (1) of the Schedule. Companies will be required to give disclosure for cases where the useful life or residual value is different from the useful life or residual value as specified in Part C of the Schedule.

#### **Transfer of shares to the investor education and protection fund (IEPF)**

As against the existing requirement of section 205C of the 1956 Act, the 2013 Act proposes that all shares in respect of which unpaid or unclaimed dividend has been transferred to the IEPF shall also be transferred by the company in name of the fund along with a statement with certain specified details [section 124 of the 2013 Act].

In addition to above, following amounts also need to be transferred by the company to the IEPF [section 125 (2) of the 2013 Act]:

- a. Gain through the seizure and disposal of securities in possession of a person who fictitiously acquires or subscribes for a company's securities
- b. Sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years
- c. Redemption amount of preference shares remaining unpaid or unclaimed for seven or more years.

**Additionally, the 2013 Act specifies the following modes of utilisation of amounts available in the IEPF:**

The refund of unclaimed dividends, matured deposits, matured debentures, apply Ration money due for refund and interest thereon. Distribution of any disgorged amount among investors who have suffered losses due to wrong actions by any person in accordance with the order of the Court that had decided for such disgorgement.

**In order to prevent misuse of underlying securities, investors can claim them back from the IEPF through the provisions in the rules.**

- a. Reimbursement of legal expenses incurred in pursuing class action suits under sections 37 (misleading prospectus) and 245 of the 2013 Act (management or conduct of affairs of the company being overseen in a manner prejudicial to the interests of the company or its members or depositors) by members, debenture holders or depositors as sanctioned by the Tribunal.
- b. Any other purpose incidental thereto, in accordance with such rules as prescribed.

### **3.19 COMPROMISES, ARRANGEMENTS AND AMALGAMATIONS**

#### **Streamlining requirements**

The section dealing with compromises and arrangements, deals comprehensively with all forms of compromises as well as arrangements, and extends to the reduction of share capital, buy-back, takeovers and corporate debt restructuring as well. Another positive inclusion within this section is that objection to any compromise or arrangement can now be made only by persons holding not less than 10% of shareholding or having an outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statements, [section 230 of the 2013 Act] Further, currently, under

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the 1956 Act, an order does not have any effect until the same is filed with the ROC. However, such requirement has been done away with under the 2013 Act. The 2013 Act merely requires filing of the order with the ROC.

### **Mergers or division of companies**

There are certain additional documents mandated to be circulated for the meeting to be held of creditors or a class of members (section 232 of the 2013 Act). These include the following:

- a. Draft of the proposed terms of the scheme drawn-up and adopted by the directors of the merging company.
- b. Confirmation that a copy of the draft scheme has been filed with the ROC.
- c. Report adopted by the directors of the merging companies explaining the effect of the compromise.
- d. Report of the expert with regard to valuation.
- e. Supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purpose of approving the scheme.

### **Certifying the accounting treatment**

The 2013 Act requires all companies undertaking any compromise or arrangement to obtain an auditor's certificate (section 230 and 232 of the 2013 Act). This requirement will help in streamlining the varied practices as well as ensuring appropriate accounting treatment. However, another aspect that is yet to be addressed is that the applicable notified accounting standards in India, currently, address only amalgamations and not any other form of restructuring arrangements.

### **Simplifying procedures**

The current procedural requirements in case of a merger and acquisition in any form are quite cumbersome and complex. There are no exemptions even in the case of mergers between a company and its wholly owned subsidiaries. The 2013 Act now introduces simplification of procedures in two areas, firstly, for holding wholly owned subsidiaries and secondly, for arrangements between small companies (section 233 of the 2013 Act). Small companies are a new category of companies, introduced within the 2013 Act, with defined capital and turnover thresholds, which has been given certain benefits, including simplified procedures.

One of the significant restrictions proposed in case of these situations is the restriction on the transferee company to hold any shares either in its own name or in the name of a trust, subsidiary or associate, since all shares will need to be cancelled or extinguished on merger or amalgamation. This requirement will stem the practice followed by several companies which have in the past followed this route. Further, in certain cases, it has also rationalised the requirements, for example in the case of the reduction of the share capital, which is

part of compromise or arrangement, the company will need to comply with the provisions of this section only.

### **Cross-border mergers**

The 2013 Act allows this flexibility, with a rider that any such mergers can be affected only with respect to companies incorporated within specific countries, the names of which will be notified by the central government. With prior approval of the central government, companies are now allowed to pay the consideration for such mergers either in cash or in depository receipts or partly in cash and partly in depository receipts as agreed upon in the scheme of arrangement, (section 234 of the 2013 Act). These new provisions can be greatly beneficial to Indian companies which have a global presence by providing them structuring options which do not exist currently.

### **Squeeze out provisions**

The 2013 Act has introduced new provisions for enabling the acquirer of a company (holding 90% or more shares) by way of amalgamation, share exchange, etc to acquire shares from the minority holders subject to compliance with certain conditions. This has also introduced the requirement for 'registered valuers', since the price to be offered by majority shareholder needs to be determined on the basis of valuation by a registered valuer (section 236 of the 2013 Act).

## **3.20 REVIVAL AND REHABILITATION OF SICK COMPANIES**

The coverage of Sick Industrial Companies Act, 1985 (SICA) is limited to only industrial companies, while the 2013 Act covers the revival and rehabilitation of all companies, irrespective of their sector.

The determination of whether a company is sick, would no longer be based on a situation where accumulated losses exceed the net worth. Rather it would be determined on the basis whether the company is able to pay its debts. In other words, the determining factor of a sick company has now been shifted to the seemed creditors or banks and financial institutions with regard to the assessment of a company as a sick company.

The 2013 Act does not recognise the role of all stakeholders in the revival and rehabilitation of a sick company, and provisions predominantly revolve around secured creditors. The fact that the 2013 Act recognises the presence of unsecured creditors, is felt only at the time of the approval of the scheme of revival and rehabilitation. In accordance with the requirement of section 253 of the 2013 Act, a company is assessed to be sick on a demand by the secured creditors of a company representing 50% or more of its outstanding amount of debt under the following circumstances:

- a. The company has failed to pay the debt within a period of 30 days of the service of the notice of demand
- b. The company has failed to secure or compound the debt to the reasonable satisfaction of the creditors





To speed up the revival and rehabilitation process, the 2013 Act provides a one-year time period for the finalization of the rehabilitation plan.

### Overview of the process

In response to the application made by either the secured creditor or by the company itself, if the Tribunal is satisfied that a company has become a sick company, it shall give time to the company to settle its outstanding debts if Tribunal believes that it is practical for the company to make the repayment of its debts within a reasonable period of time.

Once a company is assessed to be a sick company, an application could be made to the Tribunal under section 254 of the 2013 Act for the determination of the measures that may be adopted with respect to the revival and rehabilitation of the identified sick company either by a secured creditor of that company or by the company itself. The application thus made must be accompanied by audited financial statements of the company relating to the immediately preceding financial year, a draft scheme of revival and rehabilitation of the company, and with

such other document as may be prescribed.

Subsequent to the receipt of the application, for the purpose of revival and rehabilitation, the Tribunal, not later than seven would be required to fix a date for hearing and would be appointing an interim administrator under Section 256 of 2013 Act to convene a meeting of creditors of the company in accordance with the provisions of section 257 of the 2013 Act.

**In certain circumstances, the Tribunal may appoint an interim administrator as the company administrator to perform such functions as the Tribunal may direct.**

- a. The administrator thus appointed would be required to prepare a report specifying the measures for revival and rehabilitation of the identified sick industry. The measures that have been identified under the section 261 of the 2013 Act for the purpose of revival and rehabilitation of a sick company provides for the following options: Financial reconstruction
- b. Change in or takeover of the management
- c. Amalgamation of the sick company with any other company, or another company's amalgamation with the sick company

The scheme thus prepared, will need to be approved by the secured and unsecured creditors representing three-fourth and one-fourth of the total representation in amounts outstanding respectively, before submission to the Tribunal for sanctioning the scheme pursuant to the requirement of section 262 of the 2013 Act. The Tribunal, after examining the scheme will give its approval with or without any modification. The scheme, thus approved will be communicated to the sick company and the company administrator, and in the case of amalgamation, also to any other company concerned.

The sanction accorded by the Tribunal will be construed as conclusive evidence that all the requirements of the scheme relating to the reconstruction or amalgamation or any other

measure specified therein have been complied with. A copy of the sanctioned scheme will be filed with the ROC by the sick company within a period of 30 days from the date of its receipt.

However, if the scheme is not approved by the creditors, the company administrator shall submit a report to the Tribunal within 15 days, and the Tribunal shall order for the winding up of the sick company. On passing of an order, the Tribunal shall conduct the proceedings for winding up of the sick company in accordance with the provisions of Chapter XX,

### 3.21 CORPORATE SOCIAL RESPONSIBILITY

The Ministry of Corporate Affairs (MCA) had introduced the Corporate Social Responsibility Voluntary Guidelines in 2009. These guidelines have now been incorporated within the 2013 Act and have obtained legal sanctity. Section 135 of the 2013 Act, seeks to provide that every company having a net worth of 500 crore INR, or more or a turnover of 1000 crore INR or more, or a net profit of five crore INR or more, during any financial year shall constitute the corporate social responsibility committee of the board.

This committee needs to comprise of three or more directors, out of which, at least one director should be an independent director. The composition of the committee shall be included in the board's report. The committee shall formulate the policy, including activities specified in Schedule VII, **which are as follows:**

- a. Eradicating extreme hunger and poverty.
- b. Promotion of education.
- c. Promoting gender equality and empowering women.
- d. Reducing child mortality and improving maternal health.
- e. Combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases.
- f. Ensuring environmental sustainability.
- g. Employment enhancing vocational skills.
- h. Social business projects.
- i. Contribution to the Prime Minister's National Relief Fund or any other fund set-up by the central government or the state governments for socio-economic development and relief, and funds for the welfare of the scheduled castes and Tribes, other backward classes, minorities and women.
- j. Such other matters as may be prescribed.

The committee will also need to recommend the amount of expenditure to be incurred and monitor the policy from a time-to-time. The board shall disclose the contents of the policy in its report, and place it on the website, if any, of the company. The 2013 Act mandates that these companies would be required to spend at least 2% of the average net-profits of the immediately preceding three years on CSR activities, and if not spent,





explanation for the reasons thereof would need to be given in the director's report (section 135 of the 2013 Act).

### 3.22 ACCEPTANCE OF DEPOSITS

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The companies which meet such net worth or turnover criteria as may be prescribed will be eligible to accept deposits from individuals other than its members. Such companies will also be required to obtain the rating (including its net worth, liquidity and ability to pay its deposits on due date) from a recognized credit rating agency which ensures adequate safety [section 76(1) of the 2013 Act].

Companies which do not meet the net worth or turnover criteria will only be able to accept deposits from its members [section 73(2) of the 2013 Act].

All companies will be required to comply with the prescribed conditions which includes issuance of a circular to its members, obtaining credit rating, providing deposit insurance, maintaining deposit repayment reserve account, etc. [section 73(2) of the 2013 Act],

#### Outstanding deposits

The 2013 Act states that deposits accepted before the 2013 Act comes into force will need to be repaid within one year from the commencement of the 2013 Act or when such payments are due, whichever is earlier [section 74(1) of the 2013 Act]. This is likely to create significant financial impact on companies which have currently accepted deposits and will not meet the eligibility criteria under the 2013 Act.

#### Protection of depositors

An amount equivalent to a minimum 15% of deposits maturing during the financial year as well as the following financial year will need to be kept in a separate bank account with a scheduled bank. The Companies (Acceptance of Deposits) Rules, 1975 currently requires that 15% of deposits maturing during the financial year needs to be kept in bank or invested in specified securities [section 73(2) of the 2013 Act], Additionally, the 2013 Act also states that the deposit insurance as prescribed will also be required to be provided [section 73(2) of the 2013 Act].

### 3.23 WINDING UP OF A COMPANY

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Chapter XX of the 2013 Act consisting of sections 270 to 365, deals with the provisions of winding-up of companies. **The 2013 Act prescribes the following two modes:**

- a. By the Tribunal
- b. Voluntary

The 2013 Act does not acknowledge the distinction between members voluntarily winding-up and creditors voluntarily winding-up. Additionally, the new grounds for winding-up by Tribunal are as follows:

- a. In a situation when the company has acted against the interests of sovereignty and integrity of India, the security of the state, friendly relations with foreign states, public order, decency or morality.
- b. Order has been made under Chapter XIX (Revival and Rehabilitation of Sick Companies).
- c. An application has been made by the ROC or any other person authorised by the central government by a notification under the 2013 Act.
- d. The tribunal is of the opinion that the affairs of the company have been: conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purposes or the persons concerned in the formation or management of its affairs have been found guilty of fraud, misfeasance or misconduct in connection therewith, and that it is proper that the company be wound up.
- c. The company has made a default in filing with the ROC, its financial statements or annual returns for immediately preceding five consecutive financial years.

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### Petition for Winding Up

- a. The company.
- b. Any creditor or creditors including any contingent or prospective creditor or creditors.
- c. Any contributor or contributories.
- d. The Registrar.
- e. Any person authorized by the central government.

### Case Laws on Winding Up

#### Peveril Gold Mines Ltd. Re (1898)

**Facts** - The articles provided that no winding up petition could be presented without the consent of two directors or unless a resolution to wind up was passed at a general meeting or the petitioner held one-fifth of the share capital. None of these conditions was fulfilled.

#### Judgment-

1. Restriction was invalid & the petition could be presented.
2. Companies Act, confers the right on a shareholder to petition for winding up of the company in certain circumstances. This right can't be excluded or limited by the articles.
3. Each member is entitled to say that there shall be no breach of the Articles and he is entitled to an injunction to prevent breach.

## 3.24 CHAPTER SUMMARY

The Companies Act 2013 got assent from the President of India on 29th August, 2013. The Act comprises of 29 Chapters, 470 Sections with 7 Schedules. Company is “an incorporated association which is an artificial person created by law, having separate legal entity with a perpetual succession and common seal”



### Features of a Company

- a. Registration/Incorporated association.
- b. Separate legal entity.
- c. Common Seal.
- d. Perpetuity.
- e. Limited Liability.
- f. Separation of ownership and management.
- g. Transferability of shares.
- h. Separate property.
- i. Capacity to sue and to be sued.

“Private company” means a company having a minimum paid up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles:

- a. Restricts the right to transfer its shares;
- b. limits the number of its members to two hundred
- c. Prohibits any invitation to the public to subscribe for any securities of the company.

Government is also called as Public Sector Company. If the shares held by Government is less than 50% it is called a Private Sector Company.

### Documents to be filed with the Registrar

- a. Memorandum of Association
- b. Articles of Association
- c. Agreement if any for appointment of M.D
- d. Statement of nominal capital
- c. Address of the Registered Office
- f. Just of directors and sign
- g. Undertaking in writing to take and pay for his qualification shares
- h. Declaration

### Various Clauses in MOA are: -

- a. Name clause
- b. Registered office clause
- c. Objects clause
- d. Liability clause
- e. Capital clause

Articles of Association (AOA) refers to the rules and regulations of a company

### Ingredients to be called prospectus -

- a. There must be an invitation offering to the public

- b. The invitation must be made by or on behalf of the company
- c. The invitation must be to subscribe or purchase
- d. The invitation must relate to shares or debentures

New shares capital should be issued only in the form of two kinds of shares, viz. Preference Shares and Equity Shares.

“Equity share capital” means, all share capital which is not preference share capital.

The 2013 Act states that companies can make investments only through two layers of investment companies.

Outsiders dealing with a company are not supposed to cross check whether the resolutions are really passed or not. This concept is called as “Doctrine of indoor management”

### Types of Meeting

- a. Annual General Meeting AGM. Also called as General Body Meeting
- b. Statutory Meeting
- c. Board meeting
- d. Extra Ordinary meeting

Annual General meeting is a meeting of the shareholders which is held every year. The quorum will depend on number of members as on the date of meeting.

Proxy refers to a person who is authorized by a member of a company to attend and vote at a meeting. Directors are persons in charge of management of business of company.

### Types of Directors

- a. First Directors or Founder Director
- b. Additional Director
- c. Alternate Director
- d. Nominee Director
- e. Small shareholders' Director
- f. Woman Director
- g. Independent Director

Board Meetings should be held 4 meetings in a year and not more than 4 months' time in between two meetings.

### Features about independent directors

- a. Board considers him person of integrity with Expertise /experience
- b. Not related to promoters / Directors
- c. No relative with 2% of turnover
- d. Not held key management position, employee in last 3 years





- e. Not been partner in audit firm, consultancy firm that had dealings with company
- f. Term - 5 years,

**Financial year** has been defined as the period ending on the 31st day of March every year.

The Schedule VI has been revised by MCA and is applicable for all Balance Sheet made after 31st March, 2011. The Format has done away with earlier two options of format of Balance Sheet, now only Vertical format has been permitted

The auditor will now be appointed for a period of five years, with a requirement to ratify such an appointment at each annual general meeting.

Audit committees are a measure of ensuring self-discipline, constituted with the object to strengthen and oversee management in public companies. Companies are free to transfer any or no number of profits to reserves.

The section dealing with compromises and arrangements, deals comprehensively with all forms of compromises as well as arrangements. 2013 Act covers the revival and rehabilitation of all companies, irrespective of their sector.

Section 135 of the 2013 Act, seeks to provide that every company having a net worth of 500 crore INR, or more or a turnover of 1000 crore INR or more, or a net profit of five crore INR or more, during any financial year shall constitute the corporate social responsibility committee of the board.

The companies which meet such net worth or turnover criteria as may be prescribed will be eligible to accept deposits from individuals other than its members but they have to obtain rating from the rating agencies. The 2013 Act prescribes the two modes By the Tribunal and Voluntary.

### 3.25 KEY WORDS

<b>Abridged prospectus</b>	Abridged prospectus: means a memorandum containing such salient features of a prospectus as may be prescribed.
<b>Articles of Association</b>	Articles of association of a company as originally framed or as altered from time to time. Rules for internal functioning of a company.
<b>Body Corporate</b>	Any incorporated company.
<b>Company</b>	A company formed and registered under the Indian Companies Act or an existing company.
<b>Debenture</b>	Debenture: long term borrowings of a company carrying a fixed rate of interest.
<b>Employee Stock Option</b>	The option given to employees of a company, which gives the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price which is usually less than market price.

Existing Company	Company formed and registered under any of the previous companies' laws.
Limited company	A company where liability of members is limited by shares.
Listed Public Companies	A public company which has any of its securities listed in any recognised stock exchange.
Material Alteration	Alteration in date, amount, payee etc which makes a material difference and require drawer's full signature.
Memorandum	The memorandum of association of a company as originally framed or as altered from time to time. It contains basic information like, name, address, objectives, authorised capital and promoters.
Paid-up Capital	Paid-up capital: The capital actually received from shareholders and credited as paid-up in books of accounts.
Private Company	A company which has a minimum paid-up capital of one lakh rupees and (a) restricts the right to transfer its shares (b) limits the number of its members to 200 (c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company and (d) prohibits any invitation or acceptance of deposits from public.
Prospectus	Any document described or issued as a prospectus inviting offers from the public for the subscription or purchase of any shares in, or debentures/deposits of a body corporate.
Public Company	A company which (a) is not a private company; (b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, as may be prescribed (c) is a private company which is a subsidiary of a company which is not a private company.
Registrar	A Registrar, or an Additional, a Joint, a Deputy or an Assistant Registrar, having the duty of registering companies under this Act.
Share	Share in the share capital of a company expressed with a face value.

### 3.26 REVIEW QUESTIONS

#### SHORT ANSWER TYPE QUESTIONS

1. Explain the legal provisions regarding Articles of Association.
2. Explain the legal provisions regarding Prospectus.
3. Explain the legal provisions regarding Audit.
4. Explain the legal provisions regarding Meetings.
5. Explain the different types of Share Capital.



## LONG ANSWER TYPE QUESTIONS

1. Explain the legal provisions regarding winding up of a company.
2. Explain the legal provisions regarding Lifting the Corporate Veil.
3. What is employee stock option?
4. Explain the legal provisions regarding corporate social responsibility.
5. Explain the legal provisions regarding acceptance of deposits.

### 3.27 MULTIPLE CHOICE QUESTIONS

1. Financial year has been defined as the period ending on the 31st day of \_\_\_\_\_ every year.
  - a. January
  - b. February
  - c. March
  - d. April
2. Annual \_\_\_\_\_ meeting is a meeting of the shareholders which is held every year.
  - a. General
  - b. Basic
  - c. Both A and B
  - d. None of the above
3. \_\_\_\_\_ refers to a person who is authorized by a member of a company to attend and vote at a meeting.
  - a. Proxy
  - b. Dealer
  - c. Advocate
  - d. None of the above
4. The Companies Act 2013 got assent from the President of \_\_\_\_\_.
  - a. America
  - b. Pakistan
  - c. India
  - d. Russia
5. The Companies Act 2013 got assent on \_\_\_\_ August, 2013.
  - a. 29<sup>th</sup>
  - b. 28<sup>th</sup>
  - c. 27<sup>th</sup>
  - d. 26<sup>th</sup>

6. \_\_\_\_\_ means, all share capital which is not preference share capital.
- “Equity Share Audit”
  - “Equity Share Money”
  - “Equity Share Capital”
  - None of the above
7. The Schedule VI has been revised by MCA and is applicable for all Balance Sheet made after 31st March, \_\_\_\_\_.
- 2011
  - 2012
  - 2013
  - 2014
8. The 2013 Act prescribes the \_\_\_\_\_ modes.
- 1
  - 2
  - 3
  - 4
9. The 2013 Act \_\_\_\_\_ recognise the role of all stakeholders in the revival and rehabilitation of a sick company, and provisions predominantly revolve around secured creditors.
- Does not
  - Does
  - Both a and b
  - None of the above
10. \_\_\_\_\_ are persons in charge of management of business of company.
- Producers
  - Directors
  - Stakeholders
  - None of the above

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# THE CONSUMER PROTECTION ACT-1986 AND INFORMATION TECHNOLOGY ACT 2000

## STRUCTURE

- 4.1 Learning objective
- 4.2 Introduction
- 4.3 Rights of a consumer
- 4.4 Important Definitions
- 4.5 Consumer Protection Councils
- 4.6 Consumer Disputes Redressal Agencies
- 4.7 Penalties
- 4.8 Concept of information technology act 2000
- 4.9 Important Definitions
- 4.10 Electronic Commerce
- 4.11 Digital Signatures
- 4.12 The licensing processes
- 4.13 Civil Wrongs under IT Act
- 4.14 Cyber Crimes
- 4.15 Overview of other relevant provisions
- 4.16 Chapter Summary
- 4.17 Key Words
- 4.18 Review Questions
- 4.19 Multiple choice questions

## 4.1 LEARNING OBJECTIVE

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After completing this Unit, student will be able to:

- Understand the Rights of a consumer.
- Explain the role of Consumer Disputes Redressal Agencies.
- Explain the Procedure for filing a complaint.
- Describe the usage of Digital Signatures.
- Explain The licensing process.
- State Civil Wrongs under IT Act.
- Explain Cyber Crimes.

## 4.2 INTRODUCTION

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It extends to the whole of India except the State of Jammu and Kashmir. The objectives of Consumer Protection Act are as under

1. To promote and protect the rights of consumers
2. To establish Consumer Protection Council at the Central and State level
3. To provide speedy and simple redressal to consumer disputes by establishing consumer courts

## 4.3 RIGHT OF CONSUMERS

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- a. The right to be protected against marketing of goods which are hazardous to life and property;
- b. The right to be informed about the quality, quantity, potency, purity, standard and price of goods to protect the consumer against unfair trade practices;
- c. The right to be assured, wherever possible, access to an authority of goods at competitive prices;
- d. The right to be heard and to be assured that consumers interests will receive due consideration at appropriate forums;
- e. The right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers; and
- f. The right to consumer education.

## 4.4 IMPORTANT DEFINITIONS

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**Definition of complainant**

“complainant” means-

- a. A consumer
- b. Any voluntary consumer association registered under the Companies Act, 1956 or under any other law for the time being in force.

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## NOTES



- c. The Central Government or any State Government.
- d. One or more consumers, where there are numerous consumers having the same interest.
- e. In case of death of a consumer, his legal heir or representative who or which makes a complaint.

**Definition of complaint**

“complaint” means any allegation in writing made by a complainant that-

- a. An unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider.
- b. The goods bought by him or agreed to be bought by him suffer from one or more defects.
- c. The services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect.
- d. A trader or the service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price fixed or displayed.

**Definition of consumer**

“Consumer” means any person who- buys any goods or services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose;

**Definition of consumer dispute**

“Consumer dispute” means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint

**Definition of Defect**

“Defect” means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied or as is claimed by the trader in any manner whatsoever in relation to any goods;

**Definition of Deficiency**

“Deficiency” means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service. “Goods” means goods as defined in the Sale of Goods Act, 1930

**Definition of unfair trade practice**

“Unfair trade practice” means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices, namely; -

1. The practice of making any statement, whether orally or in writing or by visible representation which, -
  - a. Falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style or model.
  - b. Falsely represents that the services are of a particular standard, quality or grade.
  - c. Falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods.
  - d. Represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have.
  - e. Represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;
  - f. Makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services.
  - g. Gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof.
2. Permits the publication of any advertisement whether in any newspaper or otherwise, for the sale or supply at a bargain price, of goods or services that are not intended to be offered for sale or supply at the bargain price.
3. Permits- the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged, in the transaction as a whole.
4. Permits the sale or supply of goods intended to be used, or are of a kind likely to be used, by consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, constructions, finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods.
5. Permits the hoarding or destruction of goods, or refuses to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those or other similar goods or services.
6. Manufacture of spurious goods or offering such goods for sale or adopting deceptive practices in the provision of services.





## 4.5 CONSUMER PROTECTION COUNCILS

The Central Consumer Protection Council consist of the following members:

- a. Minister in charge of the consumer affairs shall be the chairman.
- b. Such number of other official or non-official members.

Central Council shall conduct meeting at least once in a year. The objects of the Central Council shall be to promote and protect the rights of the consumers

### State Consumer Protection Councils

The State Consumer Protection Councils consist of the following members

- a. Minister in charge of consumer affairs in the state government who shall be its chairman
- b. Such number of other official or non-official members prescribed by the state government
- c. Such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government

The State Council shall meet as and when necessary but not less than two meetings shall be held every year.

### District Consumer Protection Council

The District Consumer Protection Council consist of the following members:

- a. Collector of the district (by whatever name called), who shall be its Chairman
- b. Such number of other official and non-official members representing such interests as may be prescribed by the State Government.

District Council shall meet as and when necessary but not less than two meetings shall be held every year

## 4.6 CONSUMER DISPUTES REDRESSAL AGENCIES

The following agencies have been established by government for consumer dispute redressal process.

- a. District Forum
- b. State Commission
- c. National Consumer Disputes Redressal Commission

### District Forum

#### Composition of the District Forum

1. A person who is, or has been, or is qualified to be a District Judge, who shall be its President

2. Two other members, one of whom shall be a woman, who shall have the following qualifications, namely
  - i. Be not less than thirty-five years of age.
  - ii. Possess a bachelor's degree from a recognized university,
  - iii. Be persons of ability, integrity and standing, and have adequate problems relating to economics, law, commerce, accountancy, industry public affairs or administration.

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### District Forum

Every member of the District Forum shall hold office for a term of five years or up to the age of 65 years, whichever is earlier. District Forum shall be deemed to be a civil court and shall have all the powers of the civil court.

### Jurisdiction of the District Forum

Section 11: Pecuniary jurisdiction (On the basis of claim amount) District Forum shall have jurisdiction to entertain complaints where the value of the goods or services and the compensation, if any, claimed does not exceed rupees twenty lakhs.

### Geographical jurisdiction within the local limits of whose jurisdiction-

- a. The opposite party actually and voluntarily resides or carries on business, or has a branch office or
- b. The cause of action, wholly or in part, arises.

### Who can file a complaint?

A complaint may be filed by (S-24)

- a. The consumer;
- b. Any recognized consumers association whether the consumer is a member of such association or not.
- c. One or more consumers, where there are numerous consumers having the same interest, on behalf of, or for the benefit of, all consumers so interested.
- d. The central or the state government.

A complaint should be lodged within 2 years from the date of cause of action. (S- 24 A).

### Procedure of complaint

- a. The complaint should be given in writing duly signed with required amount of fee.
- b. The complaint should be given within 2 years from the date of cause of action.
- c. It can be in regional language or Hindi or English. Language of the complaint can be plain but not ambiguous.
- d. Complaint should be specific.
- e. Number of copies depends upon the number of respondents + three copies.

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- f. Complainant can take the help of an advocate even though it is not compulsory.
- g. Once the complaint is received District forum should proceed with it within 21 days.

### Procedure of District forum Section 13

#### Procedure on receipt of complaint

The District Forum shall, if it relates to any goods-

- a. Refer a copy of the complaint to the opposite party directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days
- b. Where the opposite party denies the allegations or fails to take any action to represent his case the district forum shall proceed to settle the consumer dispute in the manner specified in clauses (c) to (g);
- c. The district forum shall obtain a sample of the goods, refer it to the appropriate laboratory to report its findings within a period of forty-five days.
- d. The district forum shall forward a copy of the report along with such remarks as the district forum may feel appropriate to the opposite party;
- e. If opposition denies the complaint forum will fix a date to hear the parties and will take decision after hearing both parties.
- f. If the complaint involves technical knowledge, the complaint will be referred to experts for their opinion.

#### Findings of the District Forum. Section 14.

If, the District Forum is satisfied that the goods suffer from any of the defects it shall issue an order to the opposite party directing him to do one or more of the following things, namely, -

- a. To remove the defect pointed out by the appropriate laboratory from the goods in question.
- b. To replace the goods with new goods of similar description which shall be free from any defect.
- c. To return to the complainant the price, or, as the case may be, the charges paid by the complainant.
- d. To pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party.
- e. To remove the defects in goods or deficiencies in the services.
- f. To discontinue the unfair trade practice.
- g. To withdraw the hazardous goods from being offered for sale.
- h. To cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature.
- i. To provide for adequate costs to parties.

**Appeal Section 15**

Any person aggrieved by an order made by the District Forum may prefer an appeal against such order to the State Commission within a period of thirty days from the date of the order, in such form and manner as may be prescribed. Court can condone delay if satisfied.

**Composition of the State Commission Section 16**

State Commission shall consist of-

- a. A person who is or has been a Judge of a High Court, appointed by the State Government, who shall be its President.
- b. Not less than two, and not more than such number of members, as may be prescribed, and one of who shall be a woman.

**Jurisdiction of the State Commission Section 17:**

- a. Complaints where the value of the goods or services and compensation, if any, claimed exceeds rupees twenty lakhs but does not exceed rupees one crore
- b. Appeals against the orders of any District Forum within the State.

**Appeals**

Any person aggrieved by an order made by the State Commission in exercise of its powers conferred by sub-clause (i) of clause (a) of section 17 may prefer an appeal against such order to the National Commission within a period of thirty days from the date of the order in such form and manner as may be prescribed.

**National Commission Section 20**

- a. A person who is or has been a Judge of the Supreme Court, to be appointed by the Central Government, who shall be its President.
- b. Not less than four, and not more than such number of members, as may be prescribed, and one of whom shall be a woman.

**Jurisdiction of the National Commission**

- a. Complaints where the value of the goods or services and compensation if any exceed one crore.
- b. Appeals against the orders of any State Commission.

**Appeal**

Any person, aggrieved by an order made by the National Commission in exercise of its powers may prefer an appeal against such order of the Supreme Court within a period of thirty days from the date of the order.

**Limitation period**

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





## CHECK YOUR PROGRESS

1. Write short note on composition of district forum.
2. File a demo complaint by following the procedure of filing complaint.
3. Describe state consumer protection councils.
4. Describe district consumer protection council.
5. Define unfair trade practice.

### 4.7 PENALTIES

#### Section 26. Frivolous or vexatious complaints

The Court may order that the complainant shall pay to the opposite party such cost, not exceeding ten thousand rupees.

#### Section 27. Penalties

If a party fails to comply with any order made by the consumer court such person shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to three years, or with fine which shall not be less than two thousand rupees but which may extend to ten thousand rupees, or with both:

### 3.8 CONCEPT OF INFORMATION TECHNOLOGY ACT 2000

Information Technology Act 2000 was enacted on 17th May 2000. India is 12th nation in the world to adopt cyber laws. IT Act is based on Model law on e-commerce adopted by UNCITRAL

#### Objectives of the IT Act

- To provide legal recognition for transactions carried out by means of electronic data interchange, and other means of electronic communication, commonly referred to as “electronic commerce”
- To facilitate electronic filing of documents with Government agencies and E-Payments
- To amend the Indian Penal Code, Indian Evidence Act, 1872, the Banker’s Books Evidence Act 1891, Reserve Bank of India Act, 1934

IT Act extends to whole of India and also applies to any offence or contravention there under committed outside India by any person {section 1 (2)} read with Section 75. Act applies to offence or contravention committed outside India by any person irrespective of his nationality, if such act involves a computer, computer system or network located in India.

#### Act is inapplicable to

- a. a negotiable instrument (Other than a cheque) as defined in section 13 of the Negotiable Instruments Act, 1881;
- b. a power-of-attorney as defined in section 1A of the Powers-of-Attorney Act, 1882;

- c. a trust as defined in section 3 of the Indian Trusts Act, 1882;
- d. a will as defined in clause (h) of section 2 of the Indian Succession Act, 1925 including any other testamentary disposition
- e. any contract for the sale or conveyance of immovable property or any interest in such property;
- f. any such class of documents or transactions as may be notified by the Central Government



#### 4.9 IMPORTANT DEFINITIONS

Section 2 (1) (a) - "Access" means gaining entry into instructing or communicating with the logical, arithmetic or memory function resources of a computer, computer resource or network

"Computer" means electronic, magnetic, optical or other high-speed data processing device or system which performs logical, arithmetic and memory functions by manipulations of electronic, magnetic or optical impulses, and includes all input, output, processing, storage, computer software or communication facilities which are connected or relates to the computer in a computer system or computer network;

"Computer network" means the inter-connection of one or more computers through-

- a. the use of satellite, microwave, terrestrial lime or other communication media; and
- b. terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained;

"Computer system" means a device or collection of devices, including input and output support devices and excluding calculators which are not programmable and capable being used in conjunction with external files which contain computer programmes, electronic instructions, input data and output data that performs logic, arithmetic, data storage and retrieval, communication control and other functions;

"Data" means a representation of information, knowledge, facts, concepts or instruction which are being prepared or have been prepared in a formalised manner, and is intended to be processed, is being processed or has been processed in a computer system or computer network, and may be in any form (including computer printouts magnetic or optical storage media, punched cards, punched tapes) or stored internally in the memory of the computer.

"Electronic record" means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer-generated micro fiche;

"Secure system" means computer hardware, software, and procedure that-

- a. are reasonably secure from unauthorized access and misuse;
- b. provide a reasonable level of reliability and correct operation;



- c. are reasonably suited to performing the intended function; and
- d. adhere to generally accepted security procedures

“Security procedure” means the security procedure prescribed by the Central Government under the IT Act, 2000.

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

#### **4.10 ELECTRONIC COMMERCE**

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EC transactions over the Internet include Formation of Contracts, Delivery of Information and Services and Delivery of Content. Future of Electronic Commerce depends on “the trust that the transacting parties place in the security of the transmission and content of their communications”

Electronic World is an electronic document produced by a computer. Stored in digital form, and cannot be perceived without using a computer. It can be deleted, modified and rewritten without leaving a mark. Integrity of an electronic document is “genetically” impossible to verify. A copy is indistinguishable from the original. It can't be sealed in the traditional way, where the author affixes his signature.

#### **4.11 DIGITAL SIGNATURES**

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The functions of identification, declaration, proof of electronic documents are carried out by using a digital signature based on cryptography. Digital signature is created and verified using cryptography. Public key System based on Asymmetric keys is used for this purpose. An algorithm generates two different and related keys: Public key and Private Key. Private key is used to digitally sign. Public key is used to verify.

The digital equivalent of a handwritten signature or stamped seal, but offering far more inherent security, a digital signature is intended to solve the problem of tampering and impersonation in digital communications. Digital signatures can provide the added assurances of evidence to origin, identity and status of an electronic document, transaction or message, as well as acknowledging informed consent by the signer.

##### **Public Key Infrastructure**

Allow parties to have free access to the signer's public key. This assures that the public key corresponds to the signer's private key. Trust between parties as if they know one another. Parties with no trading partner agreements, operating on open networks, need to have highest level of trust in one another.

Government has to provide the definition of the structure of PKI, the number of levels of authority and their juridical form (public or private certification) which authorities are allowed to issue key pairs, the extent to which the use of cryptography should be authorized for confidentiality purposes, whether the Central Authority should have access

to the encrypted information; when and how the key length, its security standard and its time validity.

### Section 3 Defines Digital Signatures

A digital signature is a mathematical technique used to validate the authenticity and integrity of a message, software or digital document.

The authentication is to be affected by use of asymmetric crypto system and hash function. The private key and the public key are unique to the subscriber and constitute functioning key pair through which verification of electronic record possible.

A digital signature scheme typically consists of three algorithms:

1. HASHING algorithm.
2. Signature Generation Algorithm
3. A signature verifying algorithm that, given a message, public key and a signature, either accepts or rejects the message's claim to authenticity.

### Secure digital signature-S.15

If by application of a security procedure agreed to by the parties concerned, it can be verified that a digital signature, at the time it was affixed, was:

- a. Unique to the subscriber affixing it;
- b. Capable of identifying such subscriber;
- c. Created in a manner or using a means under the exclusive control of the subscriber and is linked to the electronic record to which it relates in such a manner that if the electronic record was altered the digital signature would be invalidated, then such digital signature shall be deemed to be a secure digital signature

### Certificate based Key Management

It is operated by trusted-third party. CA provides trading partners Certificates and Notarises the relationship between a public key and its owner.

### Private key encryption

Private key means that each computer has a secret key (code) that it can use to encrypt a packet of information before it is sent over the network to the other computer.

### Public Key encryption

Public key encryption uses a combination of a private key and a public key. The key is based on a hash value. This is a value that is computed from a base input number using a hashing algorithm.

### Essential steps of the digital signature process

#### STEP 1

The signatory is the authorized holder a unique cryptographic key pair;



## NOTES

**STEP 2**

The signatory prepares a data message (for example, in the form of an electronic mail message) on a computer;

**STEP 3**

The signatory prepares a “message digest”, using a secure hash algorithm. Digital signature creation uses a hash result derived from and unique to the signed message;

**STEP 4**

The signatory encrypts the message digest with the private key. The private key is applied to the message digest text using a mathematical algorithm. The digital signature consists of the encrypted message digest,

**STEP 5**

The signatory typically attaches or appends its digital signature to the message;

**STEP 6**

The signatory sends the digital signature and the (unencrypted or encrypted) message to the relying party electronically;

**STEP 7**

The relying party uses the signatory’s public key to verify the signatory’s digital signature. Verification using the signatory’s public key provides a level of technical assurance that the message came exclusively from the signatory;

**STEP 8**

The relying party also creates a “message digest” of the message, using the same secure hash algorithm;

**STEP 9**

The relying party compares the two message digests. If they are the same, then the relying party knows that the message has not been altered after it was signed. Even if one bit in the message has been altered after the message has been digitally signed, the message digest created by the relying party will be different from the message digest created by the signatory;

**STEP 10**

Where the certification process is resorted to, the relying party obtains a certificate from the certification service provider (including through the signatory or otherwise), which confirms the digital signature on the signatory’s message. The certificate contains the public key and name of the signatory (and possibly additional information), digitally signed by the certification service provider.



### Digital Signature Certificate

Any person may make an application to the Certifying Authority for issue of Digital Signature Certificate. The Certifying Authority while issuing such certificate shall certify that it has complied with the provisions of the Act.

The Certifying Authority has to ensure that the subscriber (i.e., a person in whose name the Digital Signature Certificate is issued) holds the private key corresponding to the public key listed in the Digital Signature Certificate and such public and private keys constitute a functioning key pair. The Certifying Authority has the power to suspend or revoke Digital Signature Certificate.

### Section 4- Legal recognition of Electronic Records

If any information is required in printed or written form under any law the Information provided in electronic form, which is accessible so as to be usable for subsequent use, shall be deemed to satisfy the requirement of presenting the document in writing or printed form.

### Sections 5,6 & 7 cover the following aspects

- a. Legal recognition of Digital Signatures.
- b. Use of Electronic Records in Government & Its Agencies.
- c. Publications of rules and regulations in the Electronic Gazette.
- d. Retention of Electronic Records.
- e. Accessibility of information, same format, particulars of dispatch, origin, destination, time stamp, etc

## 4.12 THE LICENSING PROCESS

### CCA has to regulate the functioning of CAs in the country by-

- a. Licensing Certifying Authorities (CAs) under section 21 of the IT Act and exercising supervision over their activities.
- b. Certifying the public keys of the CAs, i.e., their Digital Signature Certificates more commonly known as Public Key Certificates (PKCs).
- c. Laying down the standards to be maintained by the CAs,
- d. Addressing the issues related to the licensing process

### The licensing processes

- a. Examining the application and accompanying documents as provided in sections 21 to 24 of the IT Act, and all the Rules and Regulations there- under;
- b. Approving the Certification Practice Statement (CPS);
- c. Auditing the physical and technical infrastructure of the applicants through a panel of auditors maintained by the CCA.

## NOTES



**Licensed Certifying Authorities** provide services to its subscribers and relying parties as per its certification practice statement (CPS) which is approved by the CCA as part of the licensing procedure.

1. Identification and authentication
2. Certificate issuance
3. Certificate suspension and revocation
4. Certificate renewal
5. Notification of certificate-related information
6. Display of all these on its website
7. Time-stamping

### **Regulation of Certifying Authorities**

The Central Government may appoint a Controller of Certifying Authority who shall exercise supervision over the activities of Certifying Authorities.

Certifying Authority means a person who has been granted a licence to issue a Digital Signature Certificate. The Controller of Certifying Authority shall have powers to lay down rules, regulations, duties, responsibilities and functions of the Certifying Authority issuing Digital Signature Certificates. The Certifying Authority empowered to issue a Digital Signature Certificate shall have to procure a license from the Controller of Certifying Authority to issue Digital Signature Certificates. The Controller of Certifying Authority has prescribed detailed rules and regulations in the Act, as to the application for license, suspension of license and procedure for grant or rejection of license.

## **4.13 CIVIL WRONGS UNDER IT ACT**

Chapter IX of IT Act, Section 43

Whoever without permission of owner of the computer commits the following wrongs is liable to pay damages not exceeding Rs. One crore to the affected party

- a. Secures access (mere U/A access) Not necessarily through a network
- b. Downloads, copies, extracts any data.
- c. Introduces or causes to be introduced any viruses or contaminant.
- d. Damages or causes to be damaged any computer resource.
- e. Destroy, alter, delete, add, modify or rearrange.
- f. Change the format of a file.
- g. Disrupts or causes disruption of any computer resource.
- h. Preventing normal continuance of computer.
- i. Denies or causes denial of access by any means.
- j. Denial of service attacks.

- k. Assists any person to do anything above.
- l. Rogue Websites, Search Engines, Insiders providing vulnerabilities.
- m. Charges the services availed by a person to the account of another person by tampering or manipulating any computer resource.
- n. Credit card frauds.
- o. Internet time thefts.

NOTES



#### 4.14 CYBER CRIMES

The following are the types of Cyber Crimes

1. Cyber terrorism
2. Cyber pornography
3. Defamation
4. Cyber stalking (section 509IPC)
5. Sale of illegal articles-narcotics, weapons, wildlife
6. Online gambling
7. Intellectual Property crimes- software piracy, copyright infringement, trademarks violations, theft of computer source code
8. Email spoofing
9. Forgery
10. Phishing
11. Credit card frauds

The following are the important offences under IT Act

Tampering with Computer source documents	Sec.65
Hacking with Computer systems, Data alteration	Sec.66
Publishing obscene information	Sec.67
Un-authorized access to protected system	Sec.70
Breach of Confidentiality and Privacy	Sec.72
Publishing false digital signature certificates	Sec.73

#### Sec 65: Source Code

It is the most important asset of software companies. "Computer Source Code" means the listing of programmes, computer commands, design and layout Ingredients

1. Knowledge or intention
2. Concealment, destruction, alteration
3. Computer source code required to be kept or maintained by law

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**Punishment:** imprisonment up to three years and/or fine up to Rs. 2 lakhs

### **Sec 67: Pornography**

Publishing or transmitting or causing to be published in the electronic form, obscene material.

**Punishment:** On first conviction: imprisonment of either description up to five years and fine up to Rs. 1 lakh. On subsequent conviction: imprisonment of either description up to ten years and fine up to Rs. 2 lakhs.

Section covers Internet Service Providers, Search engines. Pornographic websites. This offence is cognizable and non-Bailable,

### **Sec 69: Decryption of information**

Controller issues order to Government agency to intercept any information transmitted through any computer resource. Order is issued in the interest of the sovereignty or integrity of India, the security of the State, friendly relations with foreign States, public order or preventing incitement for commission of a cognizable offence.

If a person in charge of the computer resource fails to extend all facilities and technical assistance to decrypt the information, he will be liable for punishment of imprisonment up to 7 years.

### **Sec 70 Protected Systems**

**Description** - Securing unauthorised access or attempting to secure unauthorised access to 'protected system'

Acts covered by this section:

1. Switching computer on / off
2. Using installed software / hardware
3. Installing software/hardware
4. Port scanning

**Punishment:** Imprisonment up to 10 years and fine. This offence is cognizable and non-Bailable,

**Sec 71: Offence Name** - Misrepresentation to the Controller or the Certifying Authority

**Description** - Making any misrepresentation to, or suppression of any material fact from, the Controller or the Certifying Authority for obtaining any licence or Digital Signature Certificate, as the case may be.

**Penalty** - Imprisonment for a term which may extend to 2 years, or with fine up to 1 lakh Rupees, or with both

**Sec 72: Offence Name** - Penalty for breach of confidentiality and privacy



**Description** - Any person who, in pursuance of any of the powers conferred under IT Act, has secured access to any electronic record, book, register, correspondence, information or document without the consent of the person concerned discloses such electronic record, book., register, correspondence, information, document to any other person.

**Penalty** - Imprisonment for a term which may extend to 2 years, or with fine up to 1 lakh Rupees, or with both.

**Sec 73: Offence Name** - Publishing Digital Signature Certificate false in certain particulars

**Description** - Publishing a Digital Signature Certificate or otherwise making it available to any other person with the knowledge that the Certifying Authority listed in the certificate has not issued it or the subscriber listed in the certificate has not accepted it or the certificate has been revoked or suspended, unless such publication is for the purpose of verifying a digital signature created prior to such suspension or revocation.

**Penalty** - Imprisonment for a term which may extend to 2 years, or with fine which may extend to 1 lakh Rupees.

**Sec 74: Offence Name** - Publication for fraudulent purpose

**Description** - Creation, publication or otherwise making available a Digital Signature Certificate for any fraudulent or unlawful purpose

**Penalty** - Imprisonment for a term which may extend to 2 years, or with fine up to 1 lakh Rupees, or with both.

#### 4.15 OVERVIEW OF OTHER RELEVANT PROVISIONS

**Section 16-** Central Government to prescribe security procedures

**Sec 17 to 34-** Appointment and Regulation of Controller and certifying authority

**Sec 35 to 39-** Obtaining Digital Signature Certificate

**Sec 40 to 42-** Duties of Subscriber of DSC- exercise due care to retain the private key

**Section 12-** Acknowledgement of Receipt

If Originator has not specified particular method- Any communication automated or otherwise or conduct to indicate the receipt.

If specified that the receipt is necessary- Then unless acknowledgement has been received Electronic Record shall be deemed to have been never sent.

Where ack. not received within time specified or within reasonable time the originator may give notice to treat the electronic record as though never sent.

**Section 13-** Dispatch of Electronic record

## NOTES



Unless otherwise agreed dispatch occurs when ER enters resource outside the control of originator.

If addressee has a designated computer resource, receipt occurs at time ER enters the designated computer, if electronic record is sent to a computer resource of addressee that is not designated, receipt occurs when ER is retrieved by addressee.

If no Computer Resource designated- when ER enters Computer Resource of Addressee.

Shall be deemed to be dispatched and received where originator has their principal place of business otherwise at his usual place of residence.

**Sec 48 to 64-** prescribes for establishment of Appellate tribunals etc and compounding of contraventions, Appeal to High court within 60 days from decision of Cyber appellate tribunal.

Network service provider -Section 79- provides for non-liability of network service provider in certain cases if he proves that the offence or contravention was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence or contravention.

**Explanation. For the purposes of this section,**

1. "Network service provider" means an intermediary;
2. "Third party information" means any information dealt with by a network service provider in his capacity as an intermediary

**Section 85-** corporate responsibility-offences by companies -directors' managers liable unless he proves that the offence or contravention was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence or contravention

Amendments- Indian Evidence Act 1872

Section 3 of the Evidence Act amended to take care of admissibility of electronic record as evidence along with the paper-based records as part of the documents which can be produced before the court for inspection.

**Presumptions in law**

In any proceedings involving a secure electronic record, the court shall presume, unless contrary is proved, that the secure electronic record has not been altered since the specific point of time, to which the secure status relates.

The law also presumes that in any proceedings, involving secure digital signature, the court shall presume, unless the contrary is proved, that the secure digital signature is affixed by the subscriber with the intention of signing or approving the electronic record.

**Power of Police to investigate**

Section 78 of IT Act, 2000: Power to investigate offences-not below rank of DSP.

Section 80 of IT Act, 2000: Power of police officer to enter any public place and search & arrest.

NOTES



### Investigation by adjudicating officer

Adjudicating officer has all the Powers of a civil court Section 46 of the IT Act states that an adjudicating officer shall be adjudging whether a person has committed a contravention of any of the provisions of the said Act, by holding an inquiry. Principles of Audi alterum partum and natural justice are enshrined in the said section which stipulates that a reasonable opportunity of making a representation shall be granted to the concerned person who is alleged to have violated the provisions of the IT Act. The said Act stipulates that the inquiry will be carried out in the manner as prescribed by the Central Government

All proceedings before him are deemed to be judicial proceedings, every Adjudicating Officer has all powers conferred on civil courts. Appeal to cyber–Appellate Tribunal- from decision of Controller, Adjudicating Officer {section 57 IT Act}

Section 47 of the Act lays down that while adjudging the quantum of compensation under this Act, the adjudicating officer shall have due regard to the following factors, namely-

1. The amount of gain of unfair advantage, wherever quantifiable, made as a result of the default;
2. The amount of loss caused to any person as a result of the default;
3. The repetitive nature of the default

## 4.16 CHAPTER SUMMARY

1. The objectives of Consumer Protection Act are to promote and protect the rights of consumers and to provide speedy and simple Redressal to consumer disputes by establishing consumer courts
2. The right to be protected against marketing of goods which are hazardous to life and right to be informed about the quality, quantity, potency, purity, standard and price of goods are the important rights of a consumer.
3. Consumer” means any person who buys any goods or services for a consideration.
4. Defect” means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard of a goods.
5. Unfair trade practice means a trade practice which for the purpose of promoting the sale, adopts any unfair method or unfair or deceptive practice
6. The following agencies have been established by government for consumer dispute redressal process:

<b>District Forum</b>	<b>Pecuniary jurisdiction: Claims up to Rs.20 Lakhs</b>
<b>State Commission</b>	Pecuniary jurisdiction: Claims above Rs.20 Lakhs and up to 1 crore Appeals against the decision of District Forum
<b>National Consumer</b>	Pecuniary jurisdiction: Claims above 1 crore
<b>Disputes Redressal</b>	Appeals against the decision of State Commission

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NOTES 

Information Technology Act 2000 was enacted on 17th May 2000. Objectives of the IT Act are to provide legal recognition to e commerce and facilitate electronic filing of documents with Government agencies and E-Payments.

“Electronic record” means data, record or data generated, image or sound stored, received or sent in an electronic form.

The functions of identification, declaration, and proof of electronic documents are carried out by using a digital signature based on cryptography.

Private Key is used to digitally sign. Public key is used to verify digital signature. Digital Signature is unique to the subscriber affixing it and capable of identifying such subscriber;

The Certifying Authority has to ensure that the holds the private key corresponding to the public key listed in the Digital Signature Certificate.

Licensed Certifying Authorities provide services to its subscribers and relying parties as per its certification practice statement (CPS) which is approved by the CCA as part of the licensing procedure.

Publishing or transmitting or causing to be published in the electronic form, obscene material is called as pornography.

**4.17 KEY WORDS**

<b>Complainant</b>	A consumer who makes a complaint;
<b>Complaint</b>	Any allegation in writing made by a complainant against unfair trade practice or defective goods or deficiency of service.
<b>Consumer</b>	A person who buys goods or services for a price.
<b>Defect in goods</b>	Any fault or imperfection or short coming in goods
<b>Deficiency of service</b>	Any shortcoming in the manner/method of service.
<b>Fault</b>	Wrongful act or default;
<b>Quality</b>	The state or condition of goods
<b>Digital signature</b>	A mathematical technique used to validate the authenticity! and integrity of a message, software or digital document.
<b>Electronic record</b>	Data, record or data generated, image or sound stored, received or sent in an electronic form.
<b>Pornography</b>	Publishing or transmitting or causing to be published in the electronic form, obscene material.
<b>Private key</b>	System to affix digital signature
<b>Public key</b>	System to verify digital signature

## 4.18 REVIEW QUESTIONS

NOTES



### SHORT ANSWER TYPE QUESTIONS

1. Explain the constitution of Consumer Redressal Agencies.
2. Explain the procedure for Redressal of Consumer Grievances.
3. Explain the various restrictive trade practices.
4. Explain the functions of Private Key and Public Key.
5. Define E-commerce and E- record.

### LONG ANSWER TYPE QUESTIONS

1. State the penalties for various violations under Consumer Protection Act.
2. Write brief note on penalties.
3. Write a note on cybercrimes.
4. What are the various civil wrongs under IT act?
5. State the powers of various authorities in investigating the cybercrimes.

## 4.19 MULTIPLE CHOICE QUESTIONS

1. Section \_\_. Frivolous or vexatious complaints.
  - a. 25
  - b. 26
  - c. 27
  - d. 28
2. Any voluntary consumer association registered under the Companies Act, \_\_\_\_ or under any other law for the time being in force.
  - a. 1953
  - b. 1954
  - c. 1955
  - d. 1956
3. \_\_\_\_\_ means any person who- buys any goods or services for a consideration which has been paid or promised or partly paid and partly promised.
  - a. "Consumer"
  - b. "buyer"
  - c. "sailor"
  - d. None of the above
4. "Goods" means goods as defined in the Sale of Goods Act, \_\_\_\_\_.
  - a. 2928
  - b. 1929
  - c. 1930

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- d. 1931
5. \_\_\_\_\_ means a trade practice which, for the purpose of promoting the sale.
- “Unfair trade practice”
  - “Unfair trade movement”
  - “Unfair trade money”
  - None of the above
6. \_\_\_\_\_ means a representation of information, knowledge, facts, concepts or instruction which are being prepared or have been prepared in a formalised manner.
- Hardware
  - Software
  - Inter-connection
  - Data
7. \_\_\_\_\_ means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer-generated micro fiche.
- Electronic record
  - Data
  - Hardware
  - Computer system
8. \_\_\_\_\_ means the security procedure prescribed by the Central Government under the IT Act, 2000.
- Security procedure
  - Security act
  - Security service
  - None of the above
9. Integrity of an electronic document is “genetically” \_\_\_\_\_ to verify.
- Impossible
  - Possible
  - Integrated
  - None of the above
10. An algorithm generates \_\_\_\_\_ different and related keys.
- 1
  - 2
  - 3
  - 4

# LAWS RELATED TO INTELLECTUAL PROPERTY RIGHTS, INDIAN PATENTS ACT, 1970 AND PARTNERSHIP LAWS

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## 5.1 LEARNING OBJECTIVE

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After completing this unit, you will be able to:

- The Trade Marks Act, 1999.
- Infringement of trade marks.
- Registration of Copyrights.
- Infringement of Copyrights.
- Exclusive Marketing rights.
- Working of patented inventions.
- Working of Patent office.
- To know the procedure for Conversion and Reconstruction under LLP Act.
- To know the procedure for Winding up and dissolution of a Limited Liability Partnership.
- To explain Penalties under Limited liability partnership Act.

## 5.2 INTRODUCTION

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Intellectual Property is a property that arises from the human intellect. It is a product of human creation. Intellectual Property comprises two distinct forms: Literary & Artistic Works and Industrial Property. “Literary & Artistic Works” They are books, paintings, musical compositions, plays, movies, radio/tv programs, performances, & other artistic works. Industrial Property describes physical matter that is the product of an idea or concept for commercial purposes.

Intellectual property (IP) refers to creations of the mind, such as inventions; literary and artistic works; designs; and symbols, names and images used in commerce. IP is protected in law by, for example, Patents, Trademarks, Copyrights, which enable people to earn recognition from what they invent or create.

WIPO (World Intellectual Property Organization) was established by the WIPO Convention in 1967. The WIPO is a specialized agency of the United Nations. It promotes the protection of IP throughout the world. Its headquarters are in Geneva, Switzerland.

The Trade Marks Act, 1999, Copyright Act 1957 and Indian Patents Act, 1970 deal with the Intellectual property rights in India.

## 5.3 THE TRADE MARKS ACT, 1999 AND INFRINGEMENT OF TRADE MARKS

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The Trade and Merchandise Marks Act, 1940 (“TM Act, 1940”) was the first law in this regard in India, which was replaced later by the TM Act, 1958. The Trade Marks Act, 1999 (“TM Act”) - which has replaced the TM Act, 1958 - came into effect on September 15, 2003 and is in compliance with the Trade Related Intellectual Property Rights (TRIPS)

obligations. The TM Act allows for the registration of service marks and three-dimensional marks as well. India follows the NICE Classification of goods and services, which is incorporated in the Schedule to the Rules under the TM Act. 1 A

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### Meaning of Trade Mark

A trade mark is a visual symbol in the form of a word, a device, or a label applied to articles of commerce with a view to indicate to the purchasing public that they are the goods manufactured or otherwise dealt in by a particular person as distinguished from similar goods manufactured or dealt in by other persons.

Mark used by a manufacturer or dealer to identify the origin or ownership of goods and to distinguish them from others.

A trademark is literally a “mark” that one business uses to distinguish its products or services from another.

### Definition of Trade Mark

Statutory definition of trade mark—section 2(1) of the 1999 act Trade mark must be a mark which includes a device, brand, shape of goods, packaging or combination of colours or any combination thereof— s. 2(1) (m).

- a. The mark must be capable of being represented graphically.
- b. It must be capable of distinguishing the goods or services of one person from those of others.
- c. It may include shape of goods, their packaging and combination of colours.
- d. It must be used or proposed to be used in relation to goods or services.
- e. The right to proprietorship
- f. The use must be for the purpose of indicating a connection in the course of trade between the goods or services and some persons having the right as proprietor to use the mark.
- g. The right to proprietorship of a trade mark may be acquired by registration under the Act or by use in relation to particular goods or services.
- h. The right of proprietorship acquired by registration is a statutory right which requires no actual user but only an intention to use the mark.

### Functions of a trade mark

Under modern business conditions a trade mark performs four functions:

- a. It identifies the product and its origin,
- b. It guarantees its unchanged quality,
- c. It advertises the product, and
- d. It creates an image for the product.

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### Functions of a trade mark

**Origin Function** - Helps to identify the source and those responsible for the products and services sold in the market.

**Choice Function** - Enables consumers to choose goods and services with ease while shopping.

**Quality Function** - Consumers choose a particular trade mark for its known quality.

**Marketing Function** - Plays an important role in advertising.

**Economic Function** - Established trade mark is a valuable asset. Trade marks may be licensed or franchised.

### The object of trade mark law

The object of trade mark law is to deal with

- The precise nature of the rights which a person can acquire in respect of trade marks,
- The mode of acquisition of such rights,
- The method of transfer of those rights to others,
- The precise nature of infringement of such rights, and
- The remedies available in respect thereof.

### Attributes of a good trade mark

Apart from distinctiveness or capable of distinguishing a good trade mark should possess the following attributes:

1. It should be easy to pronounce and remember, if the mark is a word.
2. In the case of device mark the device should be capable of being described by a single word.
3. It must be easy to spell correctly and write legible.
4. It should not be descriptive but may be suggestive of the quality of the goods.
5. It should be short.
6. It should appeal to the eye as well as to the ear.
7. It should satisfy the requirements of registration.
8. It should not belong to the class of marks prohibited for registration. In general, a manufacturer of goods is free to adopt any mark to distinguish his goods.

### Trademarks registry

#### Sections 5 and 6

An office called the Trade Marks Registry has been established for the purpose of registration of trademarks, maintenance of the register and matters incidental thereto. The Head Office of The Registry is at Mumbai. It has branch office at Kolkata, Delhi, Chennai

and Ahmedabad. The Trade Mark Registry has a seal. The Trade Mark Registry is under the charge of the Registrar of Trade Marks who is also the Controller - General of Patents, and Designs. He is assisted by a joint Register, Deputy Registers, Assistant Registrars, Examiners of Trade Marks and a Complement of Clerical staff.

### **Procedure for Registration of Trade Marks**

The procedure for registration of trademarks is contained in sec. 18-24 of the Trade Mark Act 1999.

#### **Step 1: Preliminary advice and search**

Before or after applying for registration he may also request for the Registrar's opinion as to the distinctive-character of the mark. The Registrar's search report or opinion is not, however, binding on him.

#### **Step 2: Examination and objections**

The Registrar will cause the application to be examined and communicate to the applicant any objection to the mark which mainly relates to distinctive character and similarity with already registered marks. The applicant can put forward his case either in writing or at a hearing. If the application is accepted, it will be advertised in the Trade Marks Journal. If refused, the applicant may go on appeal to the Appellate Board.

If the application is refused on the ground of lack of distinctive character, the applicant may, after some years of use, make a fresh application.

#### **Step 3: Opposition to registration - section 21**

Every application accepted will be advertised in the Trade Marks Journal (an official publication.) any person may object to the registration by following the procedure for the prescribed purpose. The Registrar may either accept-the application; with or without condition or limitations or refuse the application. Conditions are in the form of disclaimer of certain parts of the mark or as to mode of use. Limitations may be in the form of amendment of the goods or as to area of the use of the mark or as to mode of use.

#### **Step 4: Onus**

The onus of establishing a case for registration is on the applicant.

#### **Step 5: Duration and renewal of registration- sections 25 and 26**

If the application for registration after its advertisement is unopposed; or if opposed decided in favour of registration the mark will be registered as of the date of the application for registration. The first registration is for a period of ten years which can be renewed from time to time by paying the renewal fee. Although registration is antedated to the date of application, no infringement action can be instituted before the mark is actually entered on the register. If the mark is not renewed, it will be removed from the register but can be restored if a request is made to that effect within one year from the date of expiry of registration or last renewal.





### Step 6: Certification trade mark- sections 69-78

Trademarks indicate trade sources or trade connection. There is a class of marks the purpose of which is to indicate that the goods on which it is impressed have been certified by some competent person in respect of some characteristic of the goods like origin, composition, mode of manufacture or quality.

### Infringement of trade marks

#### Section 27 and 29(1)

A registered trademark will be infringed if the person in course of the trade, in relation to the same goods for which the mark is registered, uses without authority the same mark or deceptively similar mark. If the whole of the registered mark is taken the addition of the other matter will not affect the issue. Fraudulent intention is not necessary to prove infringement. The mark must be used in the course of trade as a trade mark and use must be of a printed or other visual representation of the mark. Use on advertisement, invoices or bills would be infringement.

Use of the mark as part of the trading style of the defendant is also an infringement. Use on reconditioned or second-hand articles will infringe the registered mark even if it is made clear that the goods are not original but only reconditioned. Where the mark registered consists of a descriptive word, surname or geographical name, any bonafide use of that word or name by others for descriptive purposes is protected and will not be an infringement.

Under s. 29(2) & (3) the following uses of the registered trade mark which are likely to cause confusion or likely to have an association with the registered mark also constitute infringement of the registered trade mark:

- a. Marks identical and goods or services similar;
- b. Marks similar and goods or services identical or similar;
- c. Marks identical and goods or services identical.

#### Section 29(4)

Marks identical or similar, and goods or services not similar; and the registered trade mark has a reputation in India; and the use of the mark without due cause takes unfair advantage of or is detrimental to the distinctive character or repute of the registered trade mark.

#### Section 29(5)

Mark used as a trade name or part of trade name or name of business concern dealing in the goods or services in respect of which the trademark is registered.

#### Section 29(6)

For the purpose of this section (i.e.s.29) a person uses a registered trade mark if, in particular he-

- a. Affixes it to goods or to the packaging thereof;

- b. Offers or exposes goods for sale, puts them on the market, or stocks them for these purposes under the registered trade mark;
- c. Imports or exports goods under the mark; or
- d. Uses the registered trade mark on business papers or in advertising.
- e. It would appear that this sub-section will apply to all kinds of infringement where the marks are similar and/or the goods are similar.

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### Section 29(7)

Unauthorized application of the registered trade mark to a material intended to be used for labelling packaging goods as a business paper, or for advertising goods or services, provided that such person when he applied the trade mark knew or had reason to believe that the application of the mark was not duly authorized by the proprietor or a licensee.

### Section 29(8)

Any unauthorized advertisement of the registered trade mark if such advertisement

- a. takes unfair advantage of and is contrary to honest practices in industrial or commercial matters, or
- b. is detrimental to its distinctive character; or
- c. Is against the reputation of the trade mark. This refers to comparative advertisement.

### Section 29(9)

Unauthorized spoken (oral) use of words, which constitute distinctive elements of a registered trade mark.

The various types of infringement listed under s.29(2) to (9) involves expressions like similar mark, similar goods or services, use of the mark without de cause, taking unfair advantage, detrimental to distinctive character or repute, contrary to honest practices in industrial or commercial matters, against the reputation of a trade mark, and distinctive elements of a registered trade mark.

## 5.4 PASSING OFF OF THE INTELLECTUAL PROPERTY AND COPYRIGHT ACT, 1957

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### Classical formulation of passing off

‘No man is entitled to represent his goods as being the goods of another man, and no man is permitted to use any mark, sign or symbol, devise, or other means, whereby, without making a direct false representation himself to a purchaser who purchases from him, he enables such purchaser to tell a lie or to make a false representation to somebody else who is the ultimate customer. This principle also applies to business where no goods are involved. It is an actionable wrong for any person to pass off his goods or business as and for the goods or business of another person by whatever means that result may be achieved.

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### **Passing off is a form of tort**

The law of passing off, based on common law, has remained substantially the same over more than a century though its formulation has changed over the time. The

object of this law is to protect the goodwill and reputation of a business from encroachment by dishonest competitors.

### **Passing off by misrepresenting connection**

In certain circumstances passing off action will lie when there is a representation to the effect that the defendants' goods or business is connected or associated with the goods or business of the plaintiff.

### **Modern formulation of the law of passing off**

The essential characteristics which must be present in order to create a valid cause of action for passing off has been stated as follows:

misrepresentation, made by a person in the course of trade, to prospective customers of his or ultimate customers of goods or services supplied by him, which is calculated to injure the business or the goodwill of another trader (in the sense that is reasonably foreseeable consequence).

### **Copyright act, 1957**

**The Indian Copyright Act, 1957** governs the system of copyrights in India. [Amended in 1982, 1984, 1992, 1994 & 1999].

### **Meaning of Copyright**

Copyright is a form of protection given to authors/creators of original works. This property right can be sold or transferred to others. It is a right which Grants protection to the unique expression of Ideas. According to Oxford English Dictionary Copyright is "The exclusive right given by law for a certain term of years to an author, composer etc. (or his assignee) to print, publish and sell copies of his original work" "It is the product of the labour, skill and capital of one man which must not be appropriated by another."

### **Copyright V/s. Patent and Trademark**

Copyright protects original works of authorship, while a patent protects inventions or discoveries. A trademark protects words, phrases, symbols, or designs identifying the source of the goods or services of one party and distinguishing them from those of others.

### **Copyright Office and Copyright Board**

The Central Government shall appoint a Registrar of Copyrights and may appoint one or more Deputy Registrars of Copyrights. Registrar of Copyrights shall act under the superintendence and direction of the Central Government Ministry of Law. Copyright Board which shall consist of a Chairman and not less than two nor more than eight other members. All proceedings before the Board shall deemed to be judicial proceedings.

## Coverage of Copy Right

Copyright shall subsist throughout India in the following classes of works,

- a. Original literary, dramatic, musical and artistic works;
- b. Cinematograph films; and
- c. Sound recordings.

### Examples

Novels, poems, short stories, Books on any subject, Computer programmes, tables, computer, databases, Song lyrics, Programme Manuals, Punched Cards, Magnetic Tapes/ Discs, Computer printouts. Computer programmes Modification of genes of plants, animals Rights under Copyright.

### Section 14, Meaning of copyright

“Copyright” means the exclusive right, by virtue of and subject to the provisions of, this Act,

1. **In the case of a literary, dramatic or musical work, to do and authorize the doing of any of the following acts, namely:**
  - a. To reproduce the work in any material form;
  - b. To publish the work;
  - c. To perform the work in public;
  - d. To produce, reproduce, perform or publish any translation of the work;
  - e. To communicate the work by radio-diffusion or to communicate to the public by a loud-speaker or any other similar instrument the radio-diffusion of the work;
  - f. To make any adaptation of the work;
  - g. To do in relation to a translation or an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (vi);
2. **In the case of an artistic work, to do or authorise the doing of any of the following acts, namely:**
  - a. To reproduce the work in any material form;
  - b. To publish the work;
  - c. To include the work in any cinematograph film;
  - d. To make any adaptation of the work;
  - e. To do in relation to an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (iii).
3. **In the case of a cinematograph film, to do or authorize the doing of any of the following acts, namely:**
  - a. To make a copy of the film;





- b. To cause the film, in so far as it consists of visual images, to be seen in public and, in so far as it consists of sounds, to be heard in public;
  - c. To make any record embodying the recording in any part of the sound track associated with the film by utilizing such sound track;
  - d. To communicate the film by radio-diffusion;
4. **In the case of a record, to do or authorize the doing of any of the following acts by utilizing the record, namely: -**
- a. To make any other record embodying the same recording;
  - b. To cause the recording embodied in the record to be heard in public;
  - c. To communicate the recording embodied in the record by radio-diffusion.

(2) Any reference in sub-section (1) to the doing of any act in relation to a work or a translation or an adaptation thereof shall include a reference to the doing of that act in relation to a substantial part thereof.

#### **Sec. 17 First owner of copyright**

The author of a work shall be the first owner of the copyright therein:

Provided that—

- a. In the case of a literary, dramatic or artistic work made by the author in the course of his employment by the proprietor of a newspaper, magazine or similar periodical under a contract of service or apprenticeship, for the purpose of publication in a newspaper, magazine or similar periodical, the said proprietor shall, in the absence of any agreement to the contrary, be the first owner of the copyright
- b. In case of a photograph taken, or a painting or portrait drawn, or an engraving or a cinematograph film made, for valuable consideration at the instance of any person, such person shall, be the first owner of the copyright therein;
- c. In the case of a work made in the course of the author's employment under a contract of service or apprenticeship, the employer shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein;
- d. In the case of the government work, government shall be the first owner of the copyright therein;

#### **Sec. 18. Assignment of copyright**

The owner of the copyright in an existing work or the prospective owner of the copyright in a future work may assign to any person the copyright either wholly or partially and either generally or subject to limitations and either for the whole term of the copyright or any part thereof.

#### **Sec. 19. Mode of assignment**

No assignment of the copyright in any work shall be valid unless it is in writing signed by the assignor or by his duly authorised agent.



### Sec. 21. Right of author to relinquish copyright

The author of a work may relinquish all or any of the rights comprised in the copyright in the work by giving notice in the prescribed form to the Registrar of Copyrights.

## 5.5 TERM, REGISTRATION AND INFRINGEMENT OF COPYRIGHTS

**Term of copyright in published literary, dramatic, musical and artistic works:** - copyright shall subsist in any literary, dramatic, musical or artistic work (other than a photograph) published within the lifetime of the author until fifty years from the beginning of the calendar year next following the year in which the author dies.

**Term of copyright in photographs:** - In the case of a photograph, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the photograph is published.

**Term of copyright in cinematograph films:** - In the case of a cinematograph film, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the film is published.

**Term of copyright in records:** - In the case of a record, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the record is published.

**Term of copyright Government works:** - In the case of Government work, where Government is the first owner of the copyright therein, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the work is first published.

### Licenses by owners of copyright

The owner of the copyright in any existing work or the prospective owner of the copyright in any future work may grant any interest in the right by license in writing signed by him or by his duly authorized agent.

**License to produce and publish translations.** Any person may apply to the Copyright Board for a license to produce and publish a translation of a literary or dramatic work in any language.

### Registration of copyrights

**Register of Copyrights:** - There shall be kept at the Copyright Office a register in the prescribed form to be called the Register of Copyrights in which may be entered the names or title of works and the names and addresses of authors, publishers and owners of copyright and such other particulars as may be prescribed

**Entries in Register of Copyrights:** - (1) The author or publisher of, or the owner of or other person interested in the copyright in, any work may make an application in the

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prescribed form accompanied by the prescribed fee to the Register of Copyrights for entering particulars of the work in the Register of Copyrights.

**Form and inspection of register:** -The Register of Copyrights and indexes thereof kept under this Act shall at all reasonable times be open to inspection, and any person shall be entitled to take copies of, or make extracts from, such register or indexes on payment of such fee and subject to such conditions as may be prescribed.

**When copyright infringed:** Copyright in a work shall be deemed to be infringed -

- a. when any person, without a license granted by the owner of the Copyright or the Registrar of Copyrights under this Act or in contravention of the conditions of a license so granted or of any condition imposed by a competent authority under this Act —
  1. Does anything, the exclusive right to do which is by this Act conferred upon the owner of the copyright, or
  2. Permits for profit any place to be used for the performance of the work in public where such performance constitutes an infringement of the copyright in the work unless he was not aware and had no reasonable ground for believing that such performance would be an infringement of copyright, or
- b. when any person-
  1. make for sale or hire, or sells or lets for hire, or by way of trade displays or offers for sale or hire, or
  2. distributes either for the purpose of trade or to such an extent as to affect
  3. prejudicially the owner of the copyright, or
  4. by way of trade exhibits in public, or
  5. imports (except for the private and domestic use of the importer) into India, any infringing copies of the work.

### Infringement of copyrights

#### Non-Infringement

#### Certain acts not to infringement of:

1. The following acts shall not constitute an infringement of copyright, namely:
  - a. A fair dealing with a literary, dramatic, musical or artistic work for the purposes of
    - Research or private study;
    - Criticism or review, whether of that work or of any other work;
  - b. A fair dealing with a literary, dramatic, musical or artistic work for the purpose of reporting current events
    - In a newspaper, magazine or similar periodical, or
    - By radio-diffusion or in a cinematograph film or by means of photographs;

- d. The reproduction of a literary, dramatic, musical or artistic work for the purpose of a judicial proceeding or for the purpose of a report of a judicial proceeding;
- e. The reproduction or publication of a literary, dramatic, musical or artistic work in any work prepared by the Secretariat of a Legislature or, where the Legislature consists of two Houses, by the Secretariat of either House of the Legislature, exclusively for the use of the members of that Legislature;
- f. The reproduction of any literary, dramatic or musical work in a certified copy made or supplied in accordance with any law for the time being in force;
- g. The reading or recitation in public of any reasonable extract from a published literary or dramatic work;
- h. The publication in a collection, mainly composed of non-copyright matter, bona fide intended for the use of educational institutions, and so described in the title and in any advertisement issued by or on behalf of the publisher, of short passages from published literary or dramatic works, not themselves published for the use of educational institutions, in which copyright subsists
- i. The reproduction of a literary, dramatic, musical or artistic work—
  - By a teacher or a pupil in the course of instruction; or
  - As part of the questions to be answered in an examination; or
  - In answers to such questions;
- j. The performance in the course of the activities of an educational institution, of a literary, dramatic or musical work by the staff and students of the institution, or of a cinematograph film or a record, if the audience is limited to such staff and students, the parents and guardians of the students and persons directly connected with the activities of the institution;
- k. The making of records in respect of any literary dramatic or musical work, if—
  - Records recording that work have previously been made by, or with the license or consent of, the owner of the copyright in the work; and
  - The person making the records has given the prescribed notice of his intention to make the records, and has paid in the prescribed manner to the owner of the copyright in the work royalties in respect of all such records to be made by him, at the rate fixed by the copyright board in this behalf.

### Civil remedies for infringement

#### Civil remedies for infringement of copyright: -

- a. Where copyright in any work has been infringed, the owner of the copyright shall, except as otherwise provided by this Act, be entitled to all such remedies by way of injunction, damages, accounts and otherwise as are or may be conferred by law for the infringement of a right;
- b. Where, in the case of a literary, dramatic, musical or artistic work, a name purporting to be that of the author or the publisher, as the case may be, appears on copies of the work as published or in the case of an artistic work, appeared





on the work when it was made, the person whose name so appears or appeared shall, in any proceeding in respect of infringement of copyright in such work, be presumed, unless the contrary is proved, to be the author or the publisher of the work, as the case may be.

## 5.6 CONCEPT OF INDIAN PATENTS ACT, 1970 AND IMPORTANT DEFINITIONS

Patent law is a specific area of law that encompasses the legal regulation, jurisprudence, and enforcement of specific intellectual property rights known as patent rights. A patent law is a government issued right granted to individuals or groups that protects their original inventions from being made, used, or sold by others without their permission for a set period of time

The word patent originates from the Latin *patere*, which means “to lay open” (i.e., to make available for public inspection). Patents in the modern sense originated in 1474, when the Republic of Venice enacted a decree that new and inventive devices, once put into practice, had to be communicated to the Republic to obtain the right. United States adopted a Patent Act, in 1790. The Act VI of 1856 on Protection of Inventions in India was enacted on 28 February 1856. Patents Act, 1970 extends to the whole of India.

### Important definitions

“Convention application” means an application for a patent made by virtue of section 135;

“Exclusive license” means a license from a patentee which confers on the licensee, or on the licensee and persons authorized by him, to the exclusion of all other persons (including the patentee), any right in respect of the patented invention, and “exclusive licensee” shall be construed accordingly;

“Patent” means a patent granted under this Act and includes for the purposes of sections 44,49,50,51,52,54,55,56,57,58,63,65,66,68,69,70,78,134,140,153, 154 and 156 and Chapters XVI, XVII and XVIII, a patent granted under the Indian Patents and Designs Act, 1911 (2 of 1911);

“Patent agent” means a person for the time being registered under this Act as a patent agent;

“Patented article” and “patented process” mean respectively an article or process in respect of which a patent is in force;

“Patentee” means the person for the time being entered on the register as the grantee or proprietor of the patent;

### Meaning of Patent:

A patent is a set of exclusive rights granted by a state (national government) to an inventor or their assignee for a limited period of time in exchange for a public disclosure of an invention. The term patent usually refers to a right granted to anyone who invents or

discovers any new and useful process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereof.

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## 5.7 WHAT ARE NOT INVENTIONS?

### According to section 3.

The following are not inventions within the meaning of this Act, -

- a. An invention which is frivolous or which claims anything obviously contrary to well established natural laws;
- b. An invention the primary or intended use of which would be contrary to law or morality or injurious to public health;
- c. The mere discovery of a scientific principle or the formulation of an abstract theory;
- d. The mere discovery of any new property or new use for a known substance or of the mere use of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant;
- e. A substance obtained by a mere admixture resulting only in the aggregation of the properties of the components thereof or a process for producing such substance;
- f. The mere arrangement or re-arrangement or duplication of known devices each functioning independently of one another in a known way;
- g. A method or process of testing applicable during the process of manufacture for rendering the machine, apparatus or other equipment more efficient or for the improvement or restoration of the existing machine, apparatus or other equipment or for the improvement or control of manufacture;
- h. A method of agriculture or horticulture;
- i. Any process for the medicinal, surgical, curative, prophylactic or other treatment of human beings or any process for a similar treatment of animals or plants to render them free of disease or to increase their economic value or that of their products.

### Inventions relating to atomic energy not patentable

No patent shall be granted in respect of an invention relating to atomic energy falling within sub-section (1) of section 20 of the Atomic Energy Act, 1962 (33 of 1962).

### Inventions were only methods or processes of manufacture patentable.

In the case of inventions-

- a. Claiming substances intended for use, or capable of being used, as food or as medicine or drug, or
- b. Relating to substances prepared or produced by chemical processes (including alloys, optical glass, semi-conductors and inter-metallic compounds), no patent shall be granted in respect of claims for the substances themselves, but claims for the methods or processes of manufacture shall be patentable.

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## 5.8 APPLICATION FOR PATENT AND EXCLUSIVE MARKETING RIGHTS

### Why one should go for a getting a patent?

- a. To enjoy the exclusive rights over the invention.
- b. The patent is to ensure commercial returns to the inventor for the time and money spend in
- c. Generating a new product.

### What can be patented?

In order to be patentable, an invention must pass four tests;

1. The invention must fall into one of the five “statutory classes’: Processes, Machines Manufactures Compositions of matter, and New uses of any of the above
2. The invention must be “useful”
3. The invention must be “novel”
4. The invention must be “no obvious’

### What cannot be patented?

- a. An invention which claims anything obvious contrary to well established natural laws.
- b. An invention the intended use of which can be injurious to public health.
- c. The mere discovery of a scientific principle or the formulation of an abstract theory.
- d. The mere discovery of any new property of new use for a known substance or of the mere use
- e. Of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant.
- f. A substance obtained by a mere admixture resulting only in the aggregation of the properties of the components thereof or a process for producing such substance;

### Who can apply for a patent?

- a. A patent can be made by any person whether a citizen of India or not, claiming to be the true or first inventor of the invention or by his “assignee” or legal representative.
- b. Application may be made alone or jointly with any other person.
- c. A company or firm cannot be named as the true inventor. The term person includes the Government.

### Patent application

A patent application is a request pending at a patent office for the grant of a patent for the invention described and claimed by that application.

**Type of Patent applications**

- a. Standard application
- b. Provisional applications
- c. Continuation applications
- d. Divisional applications

**Persons entitled to apply for patents**

Subject to the provisions contained in section 134, an application for a patent for an invention may be made by any of the following persons, that is to say. -

- a. By any person claiming to be the true and first inventor of the invention;
- b. By any person being the assignee of the person claiming to be the true and first inventor in respect of the right to make such an application;
- c. By the legal representative of any deceased person who immediately before his death was entitled to make such an application.

**Form of application**

1. Every application for a patent shall be for one invention only and shall be made in the prescribed form and filed in the patent office.
2. Where the application is made by virtue of an assignment of the right to apply for a patent for the invention, there shall be furnished with the application, or within such period as may be prescribed after the filing of the application, proof of the right to make the application.
3. Every application under this section shall state that the applicant is in possession of the invention and shall name the owner claiming to be the true and first inventor; and where the person so claiming is not the applicant or one of the applicants, the application shall contain a declaration that the applicant believes the person so named to be the true and first inventor.
4. Every such application (not being a convention application) shall be accompanied by a provisional or a complete specification.

**Provisional and complete specifications**

Where an application for a patent (not being a convention application) is accompanied by a provisional specification, a complete specification shall be filed within twelve months from the date of filing of the application, and if the complete specification is not so filed the application shall be deemed to be abandoned:

**Contents of specifications**

1. Every specification, whether provisional or complete, shall describe the invention and shall begin with a title sufficiently indicating the subject-matter to which the invention relates.
2. Subject to any rules that may be made in this behalf under this Act, drawings may, and shall, if the Controller so requires, be supplied for the purposes of any specification, whether complete or provisional; and any drawings so supplied shall,





- unless the Controller otherwise directs, be deemed to form part of the specification, and references in this Act to a specification shall be construed accordingly.
3. If, in any particular case, the Controller considers that an application should be further supplemented by a model or sample of anything illustrating the invention or alleged to constitute an invention, such model or sample as he may require shall be furnished before the acceptance of the application, but such model or sample shall not be deemed to form part of the specification.
  4. Every complete specification shall-
    - a. Fully and particularly describe the invention and its operation or use and the method by which it is to be performed;
    - b. Disclose the best method of performing the invention which is known to the applicant and for which he is entitled to claim protection; and
    - c. End with a claim or claims defining the scope of the invention for which protection is claimed.
  5. The claim or claims of a complete specification shall relate to a single invention, shall be clear and succinct and shall be fairly based on the matter disclosed in the specification and shall, in the case of an invention such as is referred to in section 5, relate to a single method or process of manufacture.
  6. A declaration as to the inventorship of the invention shall, in such cases as may be prescribed be furnished in the prescribed form with the complete specification or within such period as may be prescribed after the filing of that specification.
  7. Subject to the foregoing provisions of this section, a complete specification filed after a provisional specification may include claims in respect of developments of, or additions to the invention which was described in the provisional specification, being developments or additions in respect of which the applicant would be entitled under the provisions of section 6 to make a separate application for a patent.

#### **Examination of application**

1. When the complete specification has been filed in respect of an application for a patent, the application and the specification relating thereto shall be referred by the controller to an examiner for making a report to him in respect of the following matters, namely, -
  - a. Whether the application and the specification relating thereto are in accordance with the requirements of this Act and of any rules made thereunder;
  - b. Whether there is any lawful ground of objection to the grant of the patent under this Act in pursuance of the application;
  - c. The result of investigations made under section 13; and
  - d. Any other matter which maybe prescribed.
2. The examiner to whom the application and the specification relating thereto are referred under sub-section (1) shall ordinarily make the report to the Controller within a period of eighteen months from the date of such reference.



### Consideration of report of examiner by Controller

Where, in respect of an application for a patent, the report of the examiner received by the Controller is adverse to the applicant or requires any amendment of the application or of the specification to ensure compliance with the provisions of this Act or of the rules made there under, the Controller, before proceeding to dispose of the application in accordance with the provisions hereinafter appearing, shall communicate the gist of the objections to the applicant and shall, if so required by the applicant within the prescribed time, give him an opportunity of being heard.

### Power of Controller to refuse or require amended applications in certain cases

1. Where the Controller is satisfied that the application or any specification filed in pursuance thereof does not comply with the requirements of this Act or of any rules made thereunder, the controller may either-
  - a. Refuses to proceed with the application; or
  - b. Requires the application, specification or drawings to be amended to his satisfaction before he proceeds with the application.
2. If it appears to the Controller that the invention claimed in the specification is not an invention within the meaning of, or is not patentable under, this Act, he shall refuse the application.
3. If it appears to the Controller that any invention, in respect of which an application for a patent is made, might be used in any manner contrary to law, he may refuse the application, unless the specification is amended by the insertion of such disclaimer in respect of that use of the invention, or such other reference to the illegality thereof, as the controller thinks fit.

### Power of Controller to make orders respecting division of application

1. A person who has made an application for a patent under this Act may, at any time before the acceptance of the complete specification, if he so desires, or with a view to remedy the objection raised by the Controller on the ground that the claims of the complete specification relate to more than one invention, file a further application in respect of an invention disclosed in the provisional or complete specification already filed in respect of the first-mentioned application.
2. The further application under sub-section (1) shall be accompanied by a complete specification but such complete specification shall not include any matter not in substance disclosed in the complete specification filed in pursuance of the first-mentioned application.
3. The Controller may require such amendment of the complete specification filed in pursuance of either the original or the further application as may be necessary to ensure that neither of the said complete specification includes a claim for any matter claimed in the other.

### Power of Controller to make orders respecting dating of application.

1. Subject to the provisions of section 9, at any time after the filing of an application and before acceptance of the complete specification under this Act, the Controller

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may, at the request of the applicant made in the prescribed manner, direct that the, application shall be post-dated to such date as may be specified in the request, and proceed with the application accordingly:

2. PROVIDED that no application shall be post-dated under this sub-section to a date later than six months from the date on which it was actually made or would, but for the provisions of this sub-section, be deemed to have been made.
3. Where an application or specification (including drawings) is required to be amended under clause (b) of sub-section (1) of section 15, the application or specification shall, if the Controller so directs, be deemed to have been made on the date on which the requirement is complied with or where the application or specification is returned to the applicant, on the date on which it is re-filed after complying with the requirement.

#### **Powers of Controller in case of potential infringement**

1. If, in consequence of the investigation required by the foregoing provisions of this Act or of proceedings under section 25, it appears to the Controller that an invention in respect of which an application for a patent has been made cannot be performed without substantial risk of infringement of a claim of any other patent, he may direct that a reference to that other patent shall be inserted in the applicant's complete specification by way of notice to the public, unless within such time as may be prescribed-
  - a. The applicant shows to the satisfaction of the controller that there are reasonable grounds for contesting the validity of the said claim of the other patent; or
  - b. The complete specification is amended to the satisfaction of the Controller.
2. Where, after a reference to another patent has been inserted in a complete specification in pursuance of a direction under sub-section (1)-
  - a. That other patent is revoked or otherwise ceases to be in force; or
  - b. The specification of that other patent is amended by the deletion of the relevant claim; or
  - c. It is found, in proceedings before the court of the Controller, that the relevant claim of that other patent is invalid or is not infringed by any working of the applicant's invention.

The Controller may, on the application of the applicant, delete the reference to that other patent.

#### **Powers of Controller to Make orders regarding substitution of applicants, etc.**

1. If the Controller is satisfied on a claim made in the prescribed manner at any time before a patent has been granted, that by virtue of any assignment or agreement in writing made by the applicant or one of the applicants for the patent or by operation of law, the claimant would, if the patent were then granted, be entitled thereto or to the interest of the applicant therein, or to an undivided share of the patent or of that interest, the Controller may, subject to the provisions of this

section, direct that the application shall proceed in the name of the claimant or in the names of the claimants and the applicant or the other joint applicant or applicants, accordingly as the case may require.

2. No such direction as aforesaid shall be given by virtue of any assignment or agreement made by one of two or more joint applicants for a patent except with the consent of the other joint applicant or applicants.
3. No such direction as aforesaid shall be given by virtue of any assignment or agreement for the assignment of the benefit of an invention unless-
  - a. the invention is identified therein by reference to the number of the application for the patent; or
  - b. there is produced to the Controller an acknowledgment by the person by whom the assignment or agreement was made that the assignment or agreement relates to the invention in respect of which that application is made; or
  - c. the rights of the claimant in respect of the invention have been finally established by the decision of a court; or
  - d. the Controller gives directions for enabling the application to proceed or for regulating the manner in which it should be proceeded with under sub-section (5).
4. Where one of two or more joint applicants for a patent dies at any time before the patent has been granted, the Controller may, upon a request in that behalf made by the survivor or survivors and with the consent of the legal representative of the deceased, direct that the application shall proceed in the name of the survivor or survivors alone.
5. If any dispute arises between joint applicants for a patent whether or in what manner the application should be proceeded with, the Controller may, upon application made to him in the prescribed manner by any of the parties, and after giving to all parties concerned an opportunity to be heard, give such directions as he thinks fit for enabling the application to proceed in the name of one or more of the parties alone or for regulating the manner in which it should be proceeded with, or for both those purposes, as the case may require.

#### **Time for putting application in order for acceptance**

1. An application for a patent shall be deemed to have been abandoned unless within fifteen months from the date on which the first statement of objections to the application or complete specification is forwarded by the Controller to the applicant or within such longer period as may be allowed under the following provisions of this section the applicant has complied with all the requirements imposed on him by or under this Act, whether in connection with the complete specification or otherwise in relation to the application.

**Explanation:** Where the application or any specification or, in the case of a convention application, any document filed as part of the application has been returned to the applicant by the Controller in the course of the proceedings, the applicant shall not be deemed to have complied with such requirements unless and until he has re-filed it.



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2. The period of fifteen months specified in sub-section (1) shall, on request made by the applicant in the prescribed manner and before the expiration of the period so specified, be extended for a further period, so requested (hereafter in this section referred to as the extended period), so, however, that the total period for complying with the requirements of the Controller does not exceed eighteen months from the date on which the objections referred to in sub-section (1) are forwarded to the applicant.
3. If at the expiration of the period of fifteen months specified in sub-section (1) or the extended period-
  - a. An appeal to the High Court is pending in respect of the application for the patent for the main invention; or
  - b. In the case of an application for a patent of addition, an appeal to the High Court is pending in respect of either that application or the application for the main invention, the time within which the requirements of the Controller shall be complied with shall, on an application made by the applicant before the expiration of the said period of fifteen months or the extended period, as the case may be, be extended until such date as the High Court may determine.
4. If the time within which the appeal mentioned in sub-section (3) may be instituted has not expired, the Controller may extend the period of fifteen months, or as the case may be, the extended period, until the expiration of such further period as he may determine:

PROVIDED that if an appeal has been filed during the said further period, and the High Court has granted any extension of time for complying with the requirements of the Controller, then, the requirements may be complied with within the time granted by the court.

#### Acceptance of complete specification

Subject to the provisions of section 21, the complete specification filed in pursuance of an application for a patent may be accepted by the Controller at any time after the applicant has complied with the requirements mentioned in sub-section (1) of that section, and, if not so accepted within the period allowed under that section for compliance with those requirements, shall be accepted as soon as may be thereafter.,

PROVIDED that the applicant may make an application to the Controller in the prescribed manner requesting him to postpone acceptance until such date not being later than eighteen months from the date on which the objections referred to in subsection (1) of section 21 are forwarded to the applicant as may be specified in the application, and, if such application is made, the Controller may postpone acceptance accordingly.

#### Advertisement of acceptance of complete specification

On the acceptance of a complete specification, the Controller shall give notice thereof to the applicant and shall advertise in the Official Gazette the fact that the specification has

been accepted, and thereupon the application and the specification with the drawings (if any) filed in pursuance thereof shall be open to public inspection.

### Effect of acceptance of complete specification

On and from the date of advertisement of the acceptance of a complete specification and until the date of sealing of a patent in respect thereof, the applicant shall have the like privileges and rights as if a patent for the invention had been sealed on the date of advertisement of acceptance of the complete specification:

PROVIDED that the applicant shall not be entitled to institute any proceedings for infringement until the patent has been sealed.

### Exclusive marketing rights

#### Application for grant of exclusive rights (24 A)

1. Notwithstanding anything contained in sub-section (1) of section 12, the Controller shall not, under that sub-section, refer an application in respect of a claim for a patent covered under sub-section (2) of section 5 to an examiner for making a report till the 31st day of December, 2004 and shall, where an application for grant of exclusive right to sell or distribute the article or substance in India has been made in the prescribed form and manner and on payment of prescribed fee, refer the application for patent, to an examiner for making a report to him as to whether the invention is not an invention within the meaning of this Act in terms of section 3 or the invention is an invention for which no patent can be granted in terms of section 4.
2. Where the Controller, on receipt of a report under sub-section (1) and after such other investigation as he may deem necessary, is satisfied that the invention is not an invention within the meaning of this Act in terms of section 3 or the invention is an invention for which no patent can be granted in terms of section 4, he shall reject the application for exclusive right to sell or distribute the article or substance.
3. In a case where an application for exclusive right to sell or distribute an article or a substance is not rejected by the Controller on receipt of a report under sub-section (1) and after such other investigation, if any, made by him, he may proceed to grant exclusive right to sell or distribute the article or substance in the manner provided in section 248.

**Explanation:** It is hereby clarified that for the purposes of this section, the exclusive right to sell or distribute any article or substance under this section shall not include any, article or substance based on the system of Indian medicine as defined in clause (e) of sub-section (1) of section 2 of the Indian Medicine Central Council Act, 1970 (48 of 1970) and where such article or substance is already in the public domain.

#### Grant of exclusive rights (248)

1. Where a claim for patent covered under sub-section (2) of section 5 has been made and the applicant has, -
  - a. Where an invention has been made whether in India or in a country other





than India and before filing such a claim, filed an application for the same invention claiming identical article or substance in a convention country on or after the 1st day of January, 1995 and the patent and the approval to sell or distribute the article or substance on the basis of appropriate tests conducted on or after the 1st day of January, 1995, in that country has been granted on or after the date of making a claim for patent covered under sub-section (2) of section 5; or

- b. Where an invention has been made in India and before filing such a claim, made a claim for patent on or after the 1st day of January, 1995 for method or process of manufacture for that invention relating to identical article or substance and has been granted in India the patent therefor on or after the date of making a claim for patent covered under sub-section (2) of section 5, and has received the approval to sell or distribute the article or substance from the authority specified in this behalf by the Central Government, then, he shall have the exclusive right by himself, his agents or licensees to sell or distribute in India the article or the substance on and from the date of approval granted by the Controller in this behalf till a period of five years or till the date of grant of patent or the date of rejection of application for the grant of patent, whichever is earlier.
2. Where, the specifications of an invention relatable to an article or a substance covered under sub-section (2) of section 5 have been recorded in a document or the invention has been tried or used, or, the article or the substance has been sold, by a person, before a claim for a patent of that invention is made in India or in a convention country, then, the sale or distribution of the article or substance by such person, after the claim referred to above is made, shall not be deemed to be an infringement of exclusive right to sell or distribute under sub-section (1):

PROVIDED that nothing in this sub-section shall apply in a case where a person makes or uses an article or a substance with a view to sell or distribute the same, the details of invention relatable thereto were given by a person who was holding an exclusive right to sell or distribute the article or substance.

#### **Compulsory licenses (24C)**

The provisions in relation to compulsory licences in Chapter XVI shall, subject to the necessary modifications, apply in relation to an exclusive right to sell or distribute under section 24B as they apply to. and in relation to, a right under a patent to sell or distribute and for that purpose the following modifications shall be deemed to have been made to the provisions of that Chapter and all their grammatical variations and cognate expressions shall be construed accordingly, namely, -

- a. Throughout Chapter XVI,
  - i. Working of the invention shall be deemed to be selling or distributing of the article or substance.
  - ii. References to “patents” shall be deemed to be references to “right to sell or distribute”;

- iii. References to “patented article” shall be deemed to be references to “an article for which exclusive right to sell or distribute has been granted”;
- b. Three years from the date of sealing of a patent in section 84 shall be deemed to be two years from the date of approval by the Controller for exclusive right to sell or distribute under section 24B;
- c. The time which has elapsed since the sealing of a patent under section 85 shall be deemed to be the time which has elapsed since the approval by the controller for exclusive right to sell or distribute under section 24B; clauses (d) and (e) of section 90 shall be omitted.

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#### **Special provision for selling or distribution (24V)**

1. Without prejudice to the provisions of any other law for the time being in force, where, at any time after an exclusive right to sell or distribute any article or substance has been granted under sub-section (1) of section 24B, the Central Government is satisfied that it is necessary or expedient in public interest to sell or distribute the article or substance by a person other than a person to whom exclusive right has been granted under sub-section (1) of section 24B, it may, by itself or through any person authorised in writing by it in this behalf, sell or distribute the article or substance.
2. The Central Government may, by notification in the Official Gazette and at any time after an exclusive right to sell or distribute an article or a substance has been granted, direct, in the public interest and for reasons to be stated, that the said article or substance shall be sold at a price determined by an authority specified by it in this behalf.

#### **Suits relating to infringements (24E)**

All suits relating to infringement of a right under section 24B shall be dealt with in the same Manner as if they were suits concerning infringement of patents under Chapter XVIII

#### **Central Government and its officers not to be liable (24F)**

The examination and investigation required under this Chapter shall not be deemed in any way to warrant the validity of any grant of exclusive right to sell or distribute, and no liability shall be incurred by the Central Government or any officer thereof by reason of, or in connection with, any such examination or investigation or any report or other proceedings consequent thereon.]

#### **Opposition to grant of patent (25)**

1. At any time within four months from the date of advertisement of the acceptance of a complete specification under this Act (or within such further period not exceeding one month in the aggregate as the Controller may allow on application made to him in the prescribed manner before the expiry of the four months aforesaid) any person interested may give notice to the Controller of opposition to the grant of the patent on any of the following grounds, namely, -

*LAWS RELATED  
TO INTELLECTUAL  
PROPERTY RIGHTS,  
INDIAN PATENTS  
ACT, 1970 AND  
PARTNERSHIP LAWS*



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- a. That the applicant for the patent or the person under or through whom he claims, wrongfully obtained the invention or any part thereof from him or from a person under or through whom he claims;
- b. That the invention so far as claimed in any claim of the complete specification has been published before the priority date of the claim-
  - a. In any specification filed in pursuance of an application for a patent made in India on or after the 1st day of January, 1912; or
  - b. In India or elsewhere, in any other document:
 

PROVIDED that the ground specified in sub-clause (ii) shall not be available where such publication does not constitute an anticipation of the invention by virtue of sub-section (2) or sub-section (3) of section 29;
- c. That the invention so far as claimed in any claim of the complete specification is claimed in a claim of a complete specification published on or after the priority date of the applicant's claim and filed in pursuance of an application for a patent in India, being a claim of which the priority date is earlier than that of the applicant's claim;
- d. That the invention so far as claimed in any claim of the complete specification was publicly known or publicly used in India before the priority date of that claim.

**Explanation:** For the purposes of this clause, an invention relating to a process for which a patent is claimed shall be deemed to have been publicly known or publicly used in India before the priority date of the claim if a product made by that process had already been imported into India before that date except where such importation has been for the purpose of reasonable trial or experiment only;

- e. that the invention so far as claimed in any claim of the complete specification is obvious and clearly does not involve any inventive step, having regard to the matter published as mentioned in clause (b) or having regard to what was used in India before the priority date of the applicant's claim;
- f. that the subject of any claim of the complete specification is not an invention within the meaning of this Act, or is not patentable under this Act;
- g. that the complete specification does not sufficiently and clearly describe the invention or the method by which it is to be performed;
- h. that the applicant has failed to disclose to the Controller the information required by section 8 or has furnished the information which in any material particular was false to his knowledge;
- i. that in the case of a convention application, the application was not made within twelve months from the date of the first application for protection for the invention made in a convention country by the applicant or a person from whom he derives title, but on no other ground.

2. Where any such notice of opposition is duly given, the Controller shall notify the applicant and shall give to the applicant and the opponent an opportunity to be heard before deciding the case.
3. The grant of a patent shall not be refused on the ground stated in clause (c) of subsection (1) if no patent has been granted in pursuance of the application mentioned in that clause; and for the purpose of any inquiry under clause (d) or clause (e) of that sub-section, no account shall be taken of any secret use.

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### **Refusal of patent without opposition (27)**

If at any time after the acceptance of the complete specification filed in pursuance of an application for a patent and before the grant of a patent thereon it comes to the notice of the Controller otherwise than in consequence of proceedings in opposition to the grant under section 25, that the invention, so far as claimed in any claim of the complete specification, has been published before the priority date of the claim-

- a. In any specification filed in pursuance of an application for a patent made in India and dated on or after the 1st day of January, 1912;
- b. In any other document in India or elsewhere,

The Controller may refuse to grant the patent unless, within such time as may be prescribed, the complete specification is amended to his satisfaction:

PROVIDED that the Controller shall not refuse to grant the patent on the ground specified in clause (b) if such publication does not constitute an anticipation of the invention by virtue of sub-section (2) or sub-section (3) of section 29.

### **Mention of inventor as such in patent (28)**

1. If the controller is satisfied, upon a request or claim made in accordance with the provisions of this section-
  - a. That the person in respect of or by whom the request or claim is made is the inventor of an invention in respect of which application for a patent has been made, or of a substantial part of that invention; and
  - b. That the application for the patent is a direct consequence of his being the inventor, the controller shall, subject to the provisions of this section, cause him to be mentioned as inventor in any patent granted in pursuance of the application in the complete specification and in the register of patents:

### **No anticipation if circumstances are only as described in sections 29,30,31 and 32 (34)**

Notwithstanding anything contained in this Act, the Controller shall not refuse to accept a complete specification for a patent or to grant a patent, and a patent shall not be revoked or invalidated by reason only of any circumstances which, by virtue of section 29 or section 30 or section 31 or section 32 do not constitute an anticipation of the invention claimed in the specification.

*LAWS RELATED  
TO INTELLECTUAL  
PROPERTY RIGHTS,  
INDIAN PATENTS  
ACT, 1970 AND  
PARTNERSHIP LAWS*



## Provisions for secrecy of certain intentions

### Secrecy directions relating to inventions relevant for defence purposes (35)

1. Where, in respect of an application made before or after the commencement of this Act for a patent, it appears to the Controller that the invention is one of a class notified to him by the Central Government as relevant for defence purposes, or, where otherwise the invention appears to him to be so relevant, he may give directions for prohibiting or restricting the publication of information with respect to the invention or the communication of such information to any person or class of persons specified in the directions.
2. Where the Controller gives any such directions as are referred to in sub-section (1), he shall give notice of the application and of the directions to the Central Government, and the Central Government shall, upon receipt of such notice, consider whether the publication of the invention would be prejudicial to the defence of India, and if upon such consideration, it appears to it that the publication of the invention would not so prejudice, give notice to the Controller to that effect, who shall thereupon revoke the directions and notify the applicant accordingly.
3. Without prejudice to the provisions contained in sub-section (1), where the Central Government is of opinion that an invention in respect of which the Controller has not given any directions under sub-section (1), is relevant for defence purposes, it may at any time before acceptance of the complete specification notify the Controller to that effect, and thereupon the provisions of that sub-section shall apply as if the invention were one of the class notified by the Central Government of the directions issued by him.

### Secrecy directions to be periodically reviewed (36)

1. The question whether an invention in respect of which directions have been given under section 35 continues to be relevant for defence purposes shall be re- considered by the Central Government within nine months from the date of issue of such directions and thereafter at intervals not exceeding twelve months, and if, on such re-consideration it appears to the Central Government that the publication of the invention would no longer be prejudicial to the defence of India it shall forthwith give notice to the Controller accordingly and the Controller shall thereupon revoke the directions previously given by him.
2. The result of every re-consideration under sub-section (1) shall be communicated to the applicant within such time and in such manner as may be prescribed.

### Consequences of secrecy directions (37)

So long as any directions under section 35 are in force in respect of an application-

- a. The Controller shall not pass an order refusing to accept the same; and
- b. Notwithstanding anything contained in this Act, no appeal shall lie from any order of the Controller passed in respect thereof:

## CHECK YOUR PROGRESS

1. Explain intellectual property.
2. What is trade mark?
3. Explain Right of exclusive licensee to take proceedings against infringement.
4. Describe Jurisdiction in brief.
5. Write a short note on Restoration of Lapsed Patents.

### 5.9 GRANT AND SEALING OF PATENT

#### Grant and sealing of patent (43)

1. Where, a complete specification in pursuance of an application for a patent has been accepted and either-
  - a. The application has not been opposed under section 25 and the time for the filing of the opposition has expired; or
  - b. The application has been opposed and the opposition has been finally decided in favour of the applicant; or
  - c. The application has not been refused by the controller by virtue of any power vested in him by this act, the patent shall, on request made by the applicant in the prescribed form, be granted to the applicant or, in the case of a joint application, to the applicants jointly, and the Controller shall cause the patent to be sealed with the seal of the patent office and the date on which the patent is sealed shall be entered in the register.
2. Subject to the provisions of sub-section (1) and of the provisions of this Act with respect to patents of addition, a request under this section for the sealing of a patent shall be made not later than the expiration of a period of six months from the date of advertisement of the acceptance of the complete specification:  
 PROVIDED that-
  - a. Where at the expiration of the said six months any proceeding in relation to the application for the patent is pending before the Controller or the High Court, the request may be made within the prescribed period after the final determination of that proceeding;
  - b. Where the applicant or one of the applicants has died before the expiration of the time within which under the provisions of this sub-section the request could otherwise be made, the said request may be made at any time within twelve months after the date of the death or at such later time as the Controller may allow.
3. The period within which under sub-section (2) a request for the sealing of a patent may be made may, from time to time, be extended by the Controller to such longer period as may be specified in an application made to him in that behalf, if the application is made and the prescribed fee paid within that longer period:

NOTES **Amendment of patent granted to deceased applicant (44)**

Where, at any time after a patent has been sealed in pursuance of an application under this Act, the Controller is satisfied that the person to whom the patent was granted had died, or, in the case of a body corporate, had ceased to exist, before the patent was sealed, the Controller may amend the patent by substituting for the name of that person the name of the person to whom the patent ought to have been granted, and the patent shall be deemed always to have had effect, | accordingly.

**Date of patent (45)**

1. Subject to the other provisions contained in this Act, every patent shall be dated as of the date on which the complete specification was filed:

PROVIDED that a patent which is granted in pursuance of an application to which any directions issued under section 78C of the Indian Patents and Designs Act, 1911 (2 of 1911), applied immediately before the commencement of this Act, shall be dated as of the date of the filing of the complete specification or the date of such commencement whichever is later.

2. The date of every patent be entered in the register.
3. Notwithstanding anything contained in this section, no suit or other proceeding shall be commenced or prosecuted in respect of an infringement committed before the date of advertisement of the acceptance of the complete; specification.

**Form, extent and effect of patent (46)**

1. Every patent shall be in the prescribed form and shall have effect throughout India.
2. A patent shall be granted for one invention only:

PROVIDED that it shall not be competent for any person in a suit or other proceeding to take any objection to a patent on the ground that it has been granted for more than one invention.

**Rights of Patentees (48)**

1. Subject to the other provisions contained in this Act, a patent granted before the commencement of this Act, shall confer on the patentee the exclusive right by himself, his agents or licensees to make, use, exercise, sell or distribute the invention in India.
2. Subject to the other provisions contained in this Act and the conditions specified in section 47, a patent granted after the commencement of this Act shall confer upon the patentee-
  - a. Where the patent is for an article or substance, the exclusive right by himself, his agents or licensees to make, use, exercise, sell or distribute such article or substance in India;
  - b. Where a patent is for a method or process of manufacturing an article or substance, the exclusive right by himself, his agents or licensees to use or exercise the method or process in India.

**Term of Patent (53)**

1. Subject to the provisions of this Act, the term of every patent granted under this Act shall-
  - a. In respect of an invention claiming the method or process of manufacture of a substance, where the substance is intended for use, or is capable of being used, as food or as medicine or drug, be five years from the date of sealing of the patent, or seven years from the date of the patent whichever period is shorter; and
  - b. In respect, of any other invention, be fourteen years from the date of the patent.
2. A patent shall cease to have effect notwithstanding anything therein or in this Act on the expiration of the period prescribed for the payment of any renewal fee, if that fee is not paid within the prescribed period or within that period as extended under this section.
3. The period prescribed for the payment of any renewal fee shall be extended to such period, not being more than six months longer than the prescribed period, as may be specified in a request made to the Controller if the request is made and the renewal fee and the prescribed additional fee paid before the expiration of the period so specified.

**Patents of addition (54)**

1. Subject to the provisions contained in this section, where an application is made for a patent in respect of any improvement in or modification of an invention described or disclosed in the complete specification filed therefor (in this Act referred to as the “main invention”) and the applicant also applies or has applied for a patent for that invention or is the patentee in respect thereof, the Controller may, if the applicant so requests, grant the patent for the improvement or modification as a patent of addition.
2. Subject to the provisions contained in this section, when an invention, being an improvement in or modification of another invention, is the subject of an independent patent and the patentee in respect of that patent is also the patentee in respect of the patent for the main invention, the Controller may, if the patentee so requests, by order, revoke the patent for the improvement or modification and grant to the patentee a patent of addition in respect thereof, bearing the same date as the date of the patent so revoked.
3. A patent shall not be granted as a patent of addition unless the date of filing of the complete specification was the same as or later than the date of filing of the complete specification in respect of the main invention.
4. A patent of addition shall not be sealed before the sealing of the patent for the main invention, and if the period within which, but for the provisions of this subsection, a request for the sealing of a patent of addition could be made under section 43 expires before the period within which a request for the sealing of the patent for the main invention may be so made, the request for the sealing of the patent of addition may be made at any time within the last-mentioned period.

**Restoration of Lapsed Patents****Applications for restoration of lapsed patents (60)**

1. Where a patent has ceased to have effect by reason of failure to pay any renewal fee within the prescribed period or within that period as extended under subsection (3) of section 53, the patentee or his legal representative, and where the patent was held by two or more persons jointly, then, with the leave of the Controller, one or more of them without joining the others, may, within one year from the date on which the patent ceased to have effect, make an application for the restoration of the patent.
2. The provisions of sub-section (1) shall also apply to patents granted before the commencement of this Act, subject to the modification that for the reference to the prescribed period or to sub-section (3) of section 53, there shall be substituted a reference to the period prescribed therefor under the Indian Patents and Designs Act, 1911 (2 of 1911) or to sub-section (2) of section 14 of that Act.
3. An application under this section shall contain a statement, verified in the prescribed manner, fully setting out the circumstances which led to the failure to pay the prescribed fee, and the Controller may require from the applicant such further evidence as he may think necessary.

**Surrender and Revocation of Patents****Surrender of patents (63)**

1. A patentee may, at any time by giving notice in the prescribed manner to the Controller, offer to surrender his patent.
2. Where such an offer is made, the Controller shall advertise the offer in the prescribed manner, and also notify every person other than the patentee whose name appears in the register as having an interest in the patent.
3. Any person interested may, within the prescribed period after such advertisement, give notice to the Controller of opposition to the surrender, and where any such notice is given the Controller shall notify the patentee.
4. If the Controller is satisfied after hearing the patentee and any opponent, if desirous of being heard, that the patent may properly be surrendered, he may accept the offer and, by order, revoke the patent.

**Revocation of patents (64)**

Subject to the provisions contained in this Act, a patent, whether granted before or after the commencement of this Act, may, on the petition of any person interested or of the Central Government or on a counter-claim in a suit for infringement of the patent, be revoked by the High Court on any of the following grounds, that is to say-

- a. That the invention, so far as claimed in any claim of the complete specification, was claimed in a valid claim of earlier priority date contained in the complete specification of another patent granted in India;
- b. That the patent was granted on the application of a person not entitled under the provisions of this Act to apply therefor.

**Assignments, etc. not to be valid unless in writing and registered (68)**

An assignment of a patent or of a share in a patent, a mortgage, license or the creation of any other interest or of a share in a patent, a mortgage, license or the creation of any other interest in a patent shall not be valid unless the same were in writing and the agreement between the parties concerned is reduced to the form of a document embodying all the terms and conditions governing their rights and obligations and the application for registration of such document is filed in the prescribed manner with the Controller within six months from the commencement of this Act or the execution of the document, whichever is later or within such further period not exceeding six months in the aggregate as the Controller on application made in the prescribed manner allows:

PROVIDED that the document shall, when registered, have effect from the date of its execution.

**Registration of assignments, transmissions, etc. (69)**

1. Where any person becomes entitled by assignment, transmission or operation of law to a patent or to a share in a patent or becomes entitled as a mortgagee, licensee or otherwise to any other interest in a patent, he shall apply in writing in the prescribed manner to the Controller for the registration of his title or, as the case may be of notice of his interest in the register.
2. Without prejudice to the provisions of sub-section (1), an application for the registration of the title of any person becoming entitled by assignment to a patent or a share in a patent or becoming entitled by virtue of a mortgage, licence or other instrument to any other interest in a patent may be made in the prescribed manner by the assignor, mortgagor, licensor or other party to that instrument, as the case may be.
3. Where an application is made under this section for the registration of the title of any person, the Controller shall, upon proof of title to his satisfaction, -
  - a. Where that person is entitled to a patent or a share in a patent, register him in the register as proprietor or co-proprietor of the patent, and enter in the register particulars of the instrument or event by which he derives title; or
  - b. Where that person is entitled to any other interest in the patent, enter in the
  - c. Register notice of his interest, with particulars of the instrument if any creating it.

**Power of registered grantee or proprietor to deal with patent (70)**

Subject to the provisions contained in this Act relating to co-ownership of patents and subject also to any rights vested in any other person of which notice is entered in the register, the person or persons registered as grantee or proprietor of patent shall have power to assign, grant licences under, or otherwise deal with the patent and to give effectual receipts for consideration for any such assignment, licence or dealing:

PROVIDED that any equities in respect of the patent may be enforced in like manner as in respect of any other movable property.





## 5.10 PATENT OFFICE AND WORKING OF PATENTED INVENTIONS

### Controller and other officers (73)

1. The Controller General of Patents, Designs and Trade Marks appointed under subsection (1) of section 4 of the Trade and Merchandise Marks Act, 1958 (43 of 1958) shall be the Controller of Patents for the purposes of this Act.
2. For the purposes of this Act the Central Government may appoint as many examiners and other officers and with such designations as it thinks fit.
3. Subject to the provisions of this Act, the officers appointed under sub-section (2) shall discharge under the superintendence and directions of the Controller such functions of the Controller under this Act as he may, from time to time, by general or special order in writing, authorize them to discharge.
4. Without prejudice to the generality of the provisions of sub-section (3), the Controller may, by order in writing and for reasons to be recorded therein withdraw any matter pending before an officer appointed under sub-section (2) and deal with such matter himself either de novo or from the stage it was so withdrawn or transfer the same to another officer appointed under sub-section (2) who may, subject to special directions in the order of transfer, proceed with the matter either de novo or from the stage it was so transferred.

### Patent office and its branches (74)

1. For the purposes of this Act, there shall be an office which shall be known as the patent office.
2. The patent office provided by the Central Government under the Indian Patents and Designs Act, 1911 (2 of 1911) shall be the patent office under this Act.
3. The head office of the patent office shall be at such place as the Central Government may specify, and for the purpose of facilitating the registration of patents there may be established, at such other places as the Central Government may think fit, branch offices of the patent office.
4. There shall be a seal of the patent office.

### Powers of Controller Generally

#### Controller to have certain powers of a civil court (77)

1. Subject to any rules made in this behalf, the Controller in any proceedings before him under this Act have the powers of a civil court while trying a suit under the Code of Civil Procedure, 1908 (5 of 1908) in respect of the following matters, namely, -
  - a. Summoning and enforcing the attendance of any person and examining him on oath.
  - b. Requiring the discovery and production of any document.
  - c. Receiving evidence on affidavits.

- d. Issuing commissions for the examination of witnesses of documents.
  - e. Awarding costs.
  - f. T. Reviewing his own decision on application made within the prescribed time and in the prescribed manner.
  - g. Setting aside an order passed expert on application made within the prescribed time and in the prescribed manner.
  - h. Any other matter which may be prescribed.
2. Any order for costs awarded by the Controller in exercise of the powers conferred upon him under sub-section (1) shall be executable as a decree of a civil court.

#### **Power of Controller to correct clerical errors, etc. (78)**

1. Without prejudice to the provisions contained in sections 57 and 59 as regards amendment of applications for patents or complete specifications and subject to the provisions of section 44, the Controller may, in accordance with the provisions of this section, correct any clerical error in any patent or in any specification or other document filed in pursuance of such application or in any application for a patent or any clerical error in any matter which is entered in the register.
2. A correction may be made in pursuance of this section either upon a request in writing made by any person interested and accompanied by the prescribed fee, or without such a request.
3. Where the Controller proposes to make any such correction as aforesaid otherwise than in pursuance of a request made under this section, he shall give notice of the proposal to the patentee or the applicant for the patent, as the case may be, and to any other person who appears to him to be concerned, and shall give them an opportunity to be heard before making the correction.
4. Where a request is made under this section for the correction of any error in a patent or application for a patent or any document filed in pursuance of such an application, and it appears to the Controller that the correction would materially alter the meaning or scope of the document to which the request relates and ought not to be made without notice to persons affected thereby, he shall require notice of the nature of the proposed correction to be advertised in the prescribed manner.
5. Within the prescribed time after any such advertisement as aforesaid any person interested may give notice to the Controller of opposition to the request, and, where such notice of opposition is given, the Controller shall give notice thereof to the person by whom the request was made, and shall give to him and to the opponent an opportunity to be heard before he decides the case.

#### **Working of patented inventions**

##### **The term “Patent”**

In respect of an invention claiming process of manufacture of a substance intended to be used as food or medicine the term of patent is 5yrs from the date of sealing or 7yrs from the date of patent whichever is shorter. In case of any other invention the term of patent is 14 years from the date of patent.





### How does a patent get expire?

A patent can expire in the following ways:

- a. The patent has lived its full term.
- b. The patentee has failed to pay the renewal fee.
- c. The validity of the patent has been successfully challenged by an opponent by filing an opposition either with the patent office or with the courts.

As soon as the patent expires, it passes to the general public domain and now anybody can use

### What Does Patent System Do?

- a. It encourages RESEARCH.
- b. Induces an inventor to disclose his inventions instead of keeping them as secret.
- c. Provides inducement for capital investment
- d. Encouraging technological development.
- e. It encourages establishment of new industries.

### Why one should access the patent literature?

Before the start of the research and development project, one should scan the patent literature

- a. To stop re-inventing the wheel or
- b. During the development phase, when stuck up with a technical problem, to find a technical solution, or
- c. Once the research is complete i.e., at the time of filing the patent application, to narrow down or broaden the claims and/or to draft the application for getting a patent.

### Which are the main sources for patent information?

National Patent offices, International Information vendors like Dialog, Orbit, Quester 8 TN, free of charge-based patent web sites on Internet.

### General principles applicable to working of patented inventions (83)

Without prejudice to the other provisions contained in this Act, in exercising the powers conferred by this Chapter regard shall be had to the following general considerations, namely, -

- a. That patents are granted to encourage inventions and to secure that the inventions are worked in India on a commercial scale and to the fullest extent that is reasonably practicable without undue delay; and
- b. That they are not granted merely to enable patentees to enjoy a monopoly for the importation of the patented article.



### Compulsory licenses (84)

1. At any time after the expiration of three years from the date of the sealing of a patent, any person interested may make an application to the Controller alleging at the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price and praying for the grant of a compulsory license to work the patented invention.
2. An application under this section may be made by any person notwithstanding that he is already the holder of a license under the patent and no person shall be estopped from alleging that the reasonable requirements of the public with respect to the patented invention are not satisfied or that the patented invention is not available to the public at a reasonable price by reason of any admission made by him, whether in such a license or otherwise or by reason of his having accepted such a license.
3. Every application under sub-section (1) shall contain a statement setting out the nature of the applicant's interest together with such particulars as may be prescribed and the facts upon which the application is based.
4. In considering the application filed under this section the Controller shall take into account the matters set out in section 85.
5. The Controller, if satisfied that the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price, may order the patentee to grant a licence upon such terms as he may deem fit.
6. Where the Controller directs the patentee to grant a licence he may as incidental thereto exercise the powers set out in section 93.

### Endorsement of patent with the words "licenses of right" (86)

1. At any time after the expiration of three years from the date of the sealing of a patent, the Central Government may make an application to the Controller for an order that the patent may be endorsed with the words "licences of right" on the ground that the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price.
2. The Controller, if satisfied that the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price, may make an order that the patent be endorsed with the words "licences of right".
3. Where a patent of addition is in force, any application made under this section for an endorsement either of the original patent or of the patent of addition shall be treated as an application for the endorsement of both patents, and where a patent of addition is granted in respect of a patent which is already endorsed under this section, the patent of addition shall also be so endorsed.



4. All endorsements of patents made under this section shall be entered in the register and published in the Official Gazette and in such other manner as the Controller thinks desirable for bringing the endorsement to the notice of manufacturers.

#### **Effect of endorsement of patent with the words “licences of right” (88)**

1. Where a patent had been endorsed with the words “licences of right”, any person who is interested in working the patented invention in India may require the patentee to grant him a licence for the purpose on such terms as may be mutually agreed upon, notwithstanding that he is already the holder of a licence under the patent.
2. If the parties are unable to agree on the terms of the licence, either of them may apply in the prescribed manner to the Controller to settle the terms thereof.
3. The Controller shall, after giving notice to the parties and hearing them and after making such enquiry as he may deem fit, decide the terms on which the licence shall be granted by the patentee.
4. The Controller may at any time before the terms of the licence are mutually agreed upon or decided by the Controller, on application made to him in this behalf by any person who has made any such requisition as is referred to in sub-section (1), permit him to work the patented invention on such terms as the Controller may, pending agreement between the parties or decision by the Controller, think fit to impose.
5. In the case of every patent in respect of an invention referred to in sub-clause (i), sub-clause (if), or clause (a) of sub-section (1) of section 87 and deemed to be endorsed with the words “licences of right” under clause (a) or clause (b) of that sub-section, the royalty and other remuneration reserved to the patentee under a licence granted to any person after such commencement shall in no case exceed four per cent of the net ex-factory sale price in bulk of the patented article (exclusive of taxes levied under any law for the time being in force and any commission payable) determined in such manner as may be prescribed.
6. Save as otherwise provided in sub-section (5), the provisions of sub-sections (1), (2), (4) and (5) of section 93 (regarding the powers of the Controller) and of sections 94 and 95 shall apply to licenses granted under this section as they apply to licenses granted under section 84.

#### **Revocation of patents by the Controller for non-working (89)**

1. Where in respect of a patent, a compulsory license has been granted or the endorsement “licenses of right” has been made or is deemed to have been made, the Central Government or any person interested- may, after the expiration of two years from the date of the order granting the first compulsory license or, as the case may be, the date of the grant of the first license under section 88, apply to the Controller for an order revoking the patent on the ground that the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price.

2. Every application under sub-section (1) shall contain such particulars as may be prescribed and the facts upon which the application is based and, in the case of an application other than by the Central Government, shall also set out the nature of the applicant's interest.
3. The Controller, if satisfied that the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price, may make an order revoking the patent.
4. Every application under sub-section (1) shall ordinarily be decided within one year of its being presented to the Controller.

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#### **Powers of Controller in granting compulsory licenses (93)**

1. Where the Controller is satisfied on application made under section 84 that the manufacture, use or sale of materials not protected by the patent is prejudiced by reason of conditions imposed by the patentee upon the grant of licences under the patent, or upon the purchase, hire or use of the patented article or process, he may, subject to the provisions of that section, order the grant of licences under the patent to such customers of the applicant as he thinks fit as well as to the applicant.
2. Where an application under section 84 is made by a person being the holder of a licence under the patent, the Controller may, if he makes an order for the grant of a licence to the applicant, order the existing licence to be cancelled, or may, if he thinks fit, instead of making an order for the grant of a licence to the applicant, order the existing licence to be amended.
3. Where on an application made under section 84, the Controller orders the grant of a licence, he may, for reasons to be recorded in writing, direct that the licence shall operate-
  - a. To deprive the patentee of any right which he may have as patentee to make, use, exercise or vend the invention or to grant licenses under the patent;
  - b. To revoke all existing licenses in respect of the invention.
4. Where two or more patents are held by the same patentee and an applicant for a compulsory licence establishes that the reasonable requirements of the public have not been satisfied with respect to some only of the said patents, then, if the Controller is satisfied that the applicant cannot efficiently or satisfactorily work the licence granted to him under those patents without infringing the other patents held by the patentee, he may, by order, direct the grant of a licence in respect of the other patents also to enable the licensee to work the patent or patents in regard to which a licence is granted under section 84.
5. Where the terms and conditions of a licence have been settled by the Controller, the licensee may, at any time after he has worked the invention on a commercial scale for a period of not less than twelve months, make an application to the Controller for the revision of the terms and conditions on the ground that the terms and conditions settled have proved to be more onerous than originally expected and that in consequence thereof the licensee is unable to work the invention except at a loss:

*LAWS RELATED  
TO INTELLECTUAL  
PROPERTY RIGHTS,  
INDIAN PATENTS  
ACT, 1970 AND  
PARTNERSHIP LAWS*



PROVIDED that no such application shall be entertained a second time.

#### **Terms and conditions of compulsory licenses (95)**

1. In settling the terms and conditions of a license under section 84, the Controller shall endeavour to secure-
  - a. That the royalty and other remuneration, if any, reserved to the patentee or other person beneficially entitled to the patent, is reasonable, having regard to the nature of the invention, the expenditure incurred by the patentee in making the invention or in developing it and obtaining a patent and keeping it in force and other relevant factors;
  - b. That the patented invention is worked to the fullest extent by the person to whom the license is granted and with reasonable profit to him;
  - c. That the patented articles are made available to the public at reasonable prices.
2. No license granted by the Controller shall authorize the licensee to import the patented article or an article or substance made by a patented process from abroad where such importation would, but for such authorization, constitute an infringement of the rights of the patentee.
3. Notwithstanding anything contained in sub-section (2), the Central Government may, if in its opinion it is necessary so to do in the public interest, direct the Controller at any time to authorise any licensee in respect of a patent to import the patented article or an article or substance made by a patented process from abroad (subject to such conditions as it considers necessary to impose relating among other matters to the royalty and other remuneration, if any, payable to the patentee, the quantum of import, the sale price of the imported article and the period of importation), and thereupon the Controller shall give effect to the directions.

#### **Licensing of related patents (96)**

1. Notwithstanding anything contained in the other provisions of this chapter, at any time after the sealing of a patent, any person who has the right to work any other patented invention either as patentee or as licensee thereof, exclusive or otherwise, may apply to the Controller for the grant of a license of the first- mentioned patent on the ground that he is prevented or hindered without such license from working the other invention efficiently or to the best advantage possible.
2. No order under sub-section (1) shall be made unless the Controller is satisfied-
  - a. That the applicant is able and willing to grant, or procure the grant to the patentee and his licensees if they so desire, of a license in respect of the other invention on reasonable terms; and
  - b. That the other invention has made a substantial contribution to the establishment or development of commercial or industrial activities in India.
3. When the Controller is satisfied that the conditions mentioned in sub-section (1) have been established by the applicant, he may make an order on such terms as he thinks fit granting a license under the first-mentioned patent and a similar order

under the other patent if so requested by the proprietor of the first-mentioned patent or his licensee.

4. The provisions of sections 92 and 110 shall apply to licenses granted under this section as they apply to licenses granted under section 84.

**Power of Central Government to use inventions for purposes of government (100)**

1. Notwithstanding anything contained in this Act, at any time after an application for a patent has been filed at the patent office or a patent has been granted, the Central Government and any person authorized in writing by it may use the invention for the purposes of government in accordance with the provisions of this chapter.
2. Where an invention has, before the priority date of the relevant claim of the complete specification, been duly recorded in a document, or tested or tried, by or on behalf of the government or a government undertaking, otherwise than in consequence of the communication of the invention directly or indirectly, by the patentee or by a person from whom he derives title, any use of the invention by the Central Government or any person authorized in writing by it for the purposes of government may be made free of any royalty or other remuneration to the patentee.

3. If and so far as the invention has not been so recorded or tried or tested as aforesaid, any use of the invention made by the Central Government of any person authorized by it under sub-section (1), at any time after the acceptance of the complete specification in respect of the patent or in consequence of any such communication as aforesaid, shall be made upon terms as may be agreed upon either before or after the use, between the Central Government or any person authorized under sub-section (1) and the patentee, or, as may in default of agreement be determined by the High Court on a reference under section 103:

PROVIDED that in the case of any such use of any patent in respect of any medicine or drug or article of food the royalty and other remuneration shall in no case exceed four per cent of the net ex-factory sale price in bulk of the patented article (exclusive of taxes levied under any law for the time being in force and any commissions payable) determined in such manner as may be prescribed.

4. The authorization by the Central Government in respect of an invention may be given under this section, either before or after the patent is granted and either before or after the acts in respect of which such authorization is given or done, and may be given to any person, whether or not he is authorized directly or indirectly by the applicant or the patentee to make, use, exercise or vend the invention or import the machine, apparatus or other article or medicine or drug covered by such patent.
5. Where an invention has been used by or with the authority of the Central Government for the purposes of government under this section, then unless it appears to the government that it would be contrary to the public interest so to do, the government shall notify the patentee as soon as practicable of the fact and furnish him with such information as to the extent of the use of the invention as





## NOTES



he may, from time to time, reasonably require; and where the invention has been for the purposes of a government undertaking, the Central Government may call for such information as may be necessary for this purpose from such undertaking.

6. The right to make, use, exercise and vend an invention for the purposes of government under sub-section (1) shall include the right to sell the goods which have been made in exercise of that right, and a purchaser of goods so sold, and a person claiming through him, shall have the power to deal with the goods as if the Central Government or the person authorized under sub-section (1) were the patentee of the invention.
7. Where in respect of a patent which has been the subject of an authorization under this section, there is an exclusive licensee as is referred to in sub-section (3) of section (3) of section 101, or where such patent has been assigned to the patentee in consideration of royalties or other benefits determined by reference to the use of the invention (including payments by way of minimum royalty), the notice directed to be given under sub-section (5) shall also be given to such exclusive licensee or assignor, as the case may be, and the reference to the patentee in subsection (3) shall be deemed to include a reference to such assignor or exclusive licensee.

#### Acquisition of inventions and patents by the Central Government (102)

1. The Central Government may, if satisfied that it is necessary that an invention which is the subject of an application for a patent or a patent should be acquired from the applicant or the patentee for a public purpose, publish a notification to that effect in the Official Gazette, and thereupon the invention or patent and all rights in respect of the invention or patent shall, by force of this section, stand transferred to and be vested in the Central Government.
2. Notice of the acquisition shall be given to the applicant, and, where a patent has been granted, to the patentee and other persons, if any, appearing in the register as having an interest in the patent.
3. The Central Government shall pay to the applicant, or as the case may be, the patentee and other persons appearing on the register as having an interest in the patent such other compensation as may be agreed upon between the Central Government and the applicant or the patentee and other persons; or, as may, in default of agreement, be determined by the High Court on a reference under section 103 to be just having regard to the expenditure incurred in connection with the invention and, in the case of a patent, the term thereof, the period during which and the manner in which it has already been worked (including the profits made during such period by the patentee or by his licensee whether exclusive or otherwise) and other relevant factors,

### 5.11 INFRINGEMENT OF A PATENT, PENALTIES AND PATENT AGENTS

#### Jurisdiction (104)

No suit for a declaration under section 105 or for any relief under section 106 or for

infringement of a patent shall be instituted in any court inferior to a district court having jurisdiction to try the suit:

PROVIDED that where a counter-claim for revocation of the patent is made by the defendant, the suit, along with the counter-claim, shall be transferred to the High Court for decision.

#### **Power of court to make declaration as to non-infringement (105)**

1. Notwithstanding anything contained in section 34 of the Specific Relief Act, 1963, (47 of 1963), any person may institute a suit for a declaration that the use by him of any process, or the making, use or sale of any article by him does not, or would not, constitute an infringement of a claim of a patent against the patentee or the holder of an exclusive license under the patent, notwithstanding that no assertion to the contrary has been made by the patentee or the licensee, if it is shown-
  - a. That the plaintiff has applied in writing to the patentee or exclusive licensee for a written acknowledgment to the effect of the declaration claimed and has furnished him with full particulars in writing of the process or article in question; and
  - b. That the patentee or licensee has refused or neglected to give such an acknowledgment.
2. The costs of all parties in a suit for a declaration brought by virtue of this section shall, unless for special reasons the court thinks fit to order otherwise, be paid by the plaintiff.
3. The validity of a claim of the specification of a patent shall not be called in question in a suit for declaration brought by virtue of this section, and accordingly the making or refusal of such a declaration in the case of a patent shall not be deemed to imply that the patent is valid or invalid.
4. A suit for a declaration may be brought by virtue of this section at any time after the date of advertisement of acceptance of the complete specification of a patent, and references in this section to the patentee shall be construed accordingly.

#### **Reliefs in suits for infringement (108)**

The reliefs which a court may grant in any suit for infringement include an injunction (subject to such terms, if any, as the court thinks fit) and, at the option of the plaintiff either damages or an account of profits.

#### **Right of exclusive licensee to take proceedings against infringement (109)**

1. The holder of an exclusive licence shall have the like right as the patentee to institute a suit in respect of any infringement of the patent committed after the date of the licence, and in awarding damages or an account of profits or granting any other relief in any such suit the court shall take into consideration any loss suffered or likely to be suffered by the exclusive licensee as such or, as the case may be, the profits earned by means of the infringement so far as it constitutes an infringement of the rights of the exclusive licensee as such.



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2. In any suit for infringement of a patent by the holder of an exclusive licence under sub-section (1), the patentee shall, unless he has joined as a plaintiff in the suit, be added as a defendant, but a patentee so added as defendant shall not be liable for any costs unless he enters an appearance and takes part in the proceedings.

**Relief for infringement of partially valid specification (114)**

1. If in proceedings for infringement of a patent it is found that any claim of the specification, being a claim in respect of which infringement is alleged, is valid but that any other claim is invalid, the court may grant relief in respect of any valid claim which is infringed: PROVIDED that the court shall not grant relief except by way of injunction save in the circumstances mentioned in sub-section (2).
2. Where the plaintiff proves that the invalid claim was framed in good faith and with reasonable skill and knowledge, the court shall grant relief in respect of any valid claim which is infringed subject to the discretion of the court as to costs and as to the date from which damages or an account of profits should be reckoned, and in exercising such discretion the court may take into consideration the conduct of the parties in inserting such invalid claim in the specification or permitting them to remain there.

**Appeals****Appeals (116)**

1. No appeal shall lie from any decision, order or direction made or issued under this Act by the Central Government, or from any act or order of the Controller for the purpose of giving effect to any such decision, order or direction.
2. Save as otherwise expressly provided in sub-section (1), an appeal shall lie to a High Court from any decision, order or direction of the Controller under any of the following provisions, that is to say, section 15, section 16, section 17, section 18, section 19, section 20, section 25, section 27, section 28, section 51, section 54, section 57, section 60, section 61, section 63, sub-section (3) of section 69, section 78, section 84, section 86, section 88(3), section 89, section 93, section 96 and section 97.
3. Every appeal under this section shall be in writing and shall be made within three months from the date of the decision, order or direction, as the case may be, of the Controller, or within such further time as the High Court may in accordance with the rules made by it under section 15 8 allow.

**Procedure for hearing of appeals (117)**

1. Every appeal before a High Court under section 116 shall be by petition and shall be in such form and shall contain such particulars as may be prescribed by rules made by the High Court under section 158.
2. Every such appeal shall be heard by a single judge of the High Court: PROVIDED that any such Judge may, if he so thinks fit, refer the appeal at any stage of the proceeding to a Bench of the High Court.

3. Every such appeal shall be heard as expeditiously as possible and endeavour shall I be made to decide the appeal within a period of twelve months from the date on which it is filed.

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### Penalties

#### Contravention of secrecy provisions relating to certain inventions (118)

If any person fails to comply with any direction given under section 35,5, he shall be punishable with imprisonment for a term which may extend to two years, or with fine, or with both.

#### Falsification of entries in register, etc. (119)

If any person makes, or causes to be made, a false entry in any register kept under this Act, or a writing falsely purporting to be a copy of an entry in such a register, or produces or tenders, or causes to be produced or tendered, in evidence any such writing knowing the entry or writing to be false, he shall be punishable with imprisonment for a term which may extend to two years, or with fine, or with both.

#### Unauthorized claim of patent rights (120)

If any person falsely represents that any article sold by him is patented in India or is the subject of an application for a patent in India, he shall be punishable with fine which may extend to five hundred rupees. ‘

**Explanation 1:** For the purposes of this section, a person shall be deemed to represent

- a. That an article is patented in India if there is stamped, engraved or impressed on, or otherwise applied to, the article the word “patent” or “patented” or some other word expressing or implying that a patent for the article has been obtained in India;
- b. That an article is the subject of an application for a patent in India if there are stamped, engraved or impressed on, or otherwise applied to, the article the words “patent applied for”, “patent pending”, or some other words implying that an application for a patent for the article has been made in India

**Explanation 2:** The use of words “patent”, “patented”, “patent applied for”, “patent pending” or other words expressing or implying that an article is patented or that a patent has been applied for shall be deemed to refer to a patent in force in India, or to a pending application for a patent in India, as the case may be, unless there is an accompanying indication that the patent has been obtained or applied for in any country outside India.

#### Wrongful use of words, “patent office” (121)

If any person uses on his place of business or any document issued by him or otherwise the words “patent office” or any other words which would reasonably lead to the belief that his place of business is or is officially connected with, the patent office, he shall be punishable with imprisonment for a term which may extend to six months, or with fine, or with both.

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### Refusal or failure to supply information (122)

1. If any person refuses or fails to furnish
  - a. To the Central Government any
  - b. To the Controller any information or statement which he is required to furnish by or under section 146.

He shall be punishable with fine which may extend to one thousand rupees.

2. If any person, being required to furnish any such information as is referred to in sub-section (1), furnishes information or statement which is false and which he either knows or has reason to believe to be false or does not believe to be true, he shall be punishable with imprisonment which may extend to six months, or with fine, or with both.

### Practice by non-registered patent agents (123)

If any person contravenes the provisions of section 129, he shall be punishable with fine which may extend to five hundred rupees in the case of a first offence and two thousand rupees in the case of a second or subsequent offence.

### Offences by companies (124)

1. If the person committing an offence under this Act is a company, the company as well as every person in charge of, and responsible to, the company for the conduct of its business at the time of the commission of the offence shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

PROVIDED that nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

2. Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or that the commission of the offence is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

**Explanation:** For the purposes of this section-

- a. "Company" means anybody corporate and includes a firm or other association of individuals; and
- b. "Director", in relation to a firm, means a partner in the firm.

### Patent agents

#### Register of patent agents (125)

The Controller shall maintain a register to be called the register of patent agents in which

shall be entered the names and addresses of all persons qualified to have their names so entered under section 126.

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### Qualifications for registration as patent agents (126)

1. A person shall be qualified to have his name entered in the register of patent agents if he fulfils the following conditions, namely, -
  - a. He is a citizen of India;
  - b. He has completed the age of 21 years;
  - c. He has obtained a degree from any university in the territory of India or possesses such other equivalent qualifications as the Central Government may specify in this behalf, and, in addition-
    - Is an advocate within the meaning of the Advocates Act, 1961 (25 of 1961);
    - Has passed the qualifying examination prescribed for the purpose;
  - d. He has paid such fee as may be prescribed.
2. Notwithstanding anything contained in sub-section (1), a person who has been practicing as a patent agent before the 1st day of November, 1966 and has filed not less than five complete specifications before the said day, shall, on payment of prescribed fee, be qualified to have his name entered in the register of patent agents.

### Rights of patent agents (127)

Subject to the provisions contained in this Act and to any rules made thereunder, every patent agent whose name is entered in the register shall be entitled-

- To practice before the Controller; and
- To prepare all documents, transact all business and discharge such other functions as may be prescribed in connection with any proceedings before the Controller under this Act.

### Subscription and verification of certain documents by patent agents (128)

3. Subject to the provisions contained in sub-section (2) and to any rules made under this Act all applications and communications to the Controller under his Act may be signed by a patent agent authorised in writing in this behalf by the person concerned.
4. The following documents namely, -
  - Applications for patents;
  - Applications for the restoration of lapsed patents;
  - Applications for the sealing of patents after the time allowed for that purpose by or under sub-section (2), or sub-section (3) of section 43 has expired;
  - Applications for leave to amend;
  - Applications for compulsory licenses or for revocation; and
  - Notices of surrender of patents,

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Shall be signed and verified in the manner prescribed by the person making such applications or giving such notices:

PROVIDED that if such person is absent from India, they may be signed and verified on his behalf by a patent agent authorised by him in writing in that behalf.

**Restrictions on practice as patent agents (129)**

1. No person, either alone or in partnership with any other person, shall practice, describe or hold himself out as a patent agent or permit himself to be so described or held out, unless he is registered as patent agent or, as the case may be, unless he and all his partners are so registered.
2. No company or other body corporate shall practice, describe itself or hold itself out as patent agents or permit itself to be so described or held out.

**Explanation:** For the purposes of this section, practice, as a patent agent includes any of the following acts, namely, -

- a. Applying for or obtaining patents in India or elsewhere;
- b. Preparing specifications or other documents for the purposes of this Act or of the patent law of any other country;
- c. Giving advice other than of scientific or technical nature as to the validity of patents or their infringement.

**Removal from register of patent agents and restoration (130)**

1. The Central Government may remove the name of any person from the register when it is satisfied, after giving that person a reasonable opportunity of being heard and after such further inquiry, if any, as it thinks fit to make-
  - a. That his name has been entered in the register by error or on account of misrepresentation or suppression of material fact; or
  - b. That he has been convicted of any offence and sentenced to a term of imprisonment or has been guilty of misconduct in his professional capacity which in the opinion of the Central Government renders him unfit to be kept in the register.
2. The Central Government may, on application and on sufficient cause being shown, restore to the register the name of any person removed there from.

## 5.12 INTERNATIONAL ARRANGEMENTS AND IMPORTANT MENDMENTS

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**Notification as to convention countries (133)**

1. With a view to the fulfilment of a treaty, convention or arrangement with any country outside India which affords to applicants for patents in India or to citizens of India similar privileges as are granted to its own citizens in respect of the grant of patents and the protection of patent rights, the Central Government may, by notification in the Official Gazette, declare such country to be a convention

country for the purposes of this Act.

2. A declaration under sub-section (I) may be made for the purpose's either of all or of some only of the provisions of this Act, and a country in the case of which a declaration made for the purposes of some only of the provisions of this Act is in force shall be deemed to be a convention country for the purposes of those provisions only.

#### **Notification as to countries not providing for reciprocity (134)**

Where any country specified by the Central Government in this behalf by notification in the Official Gazette does not accord to citizens of India the same rights in respect of the grant of patents and the protection of patent rights as it accords to its own nationals, no national of such country shall be entitled, either solely or jointly with any other person-

- a. To apply for the grant of a patent or be registered as the proprietor of a patent;
- b. To be registered as the assignee of the proprietor of a patent; or
- c. To apply for a license or hold any license under a patent granted under this Act.

#### **Convention applications (135)**

1. Without prejudice to the provisions contained in section 6, where a person has made an application for a patent in respect of an invention in a convention country (hereinafter referred to as the "basic application"), and that person or the legal representative or assignee of that person makes an application under this Act for a patent within twelve months after the date on which the basic application was made, the priority date of a claim of the complete specification, being a claim based on matter disclosed in the basic application, is the date of making of the basic application.

**Explanation:** Where applications have been made for similar protection in respect of an invention in two or more convention countries, the period of twelve months referred to in this sub-section shall be reckoned from the date on which the earlier or earliest of the said applications was made.

2. Where applications for protection have been made in one or more convention countries in respect of two or more inventions which are cognate or of which one is a modification of another, a single convention application may, subject to the provisions contained in section 10, be made in respect of those inventions at any time within twelve months from the date of the earliest of the said applications for protection:

PROVIDED that the fee payable on the making of any such application shall be the same as if separate applications have been made in respect of each of the said inventions, and the requirements of clause (b) of sub-section (1) of section 136 shall, in the case of any such application, apply separately to the applications for protection in respect of the said inventions.

#### **Special provisions relating to convention applications (136)**

1. Every convention application shall-
  - Be accompanied by a complete specification; and







- Specify the date on which and the convention country in which the application for protection, or as the case may be, the first of such applications was made; and
  - State that no application for protection in respect of the invention had been made in a convention country before that date by the applicant or by any person from whom he derives title.
2. Subject to the provisions contained in section 10, a complete specification filed with a convention application may include claims in respect of developments of, or additions to, the invention in respect of which the application for protection was made in a convention country, being developments or additions in respect of which the applicant would be entitled under the provisions of section 6 to make a separate application for a patent.
  3. A convention application shall not be post-dated under sub-section (1) of section 17 to a date later than the date on which under the provisions of this Act the application could have been made.

#### **Multiple priorities (137)**

1. Where two or more applications for patents in respect of inventions have been made in one or more convention countries and those inventions are so related as to constitute one invention, one application may be made by any or all of the persons referred to in sub-section (1) of section 135 within twelve months from the date on which the earlier or earliest of those applications was made, in respect of the inventions disclosed in the specifications which accompanied the basic applications.
2. The priority date of a claim of the complete specification, being a claim based on matters disclosed in one or more of the basic applications, is the date on which that matter was first so disclosed.
3. For the purposes of this Act, a matter shall be deemed to have been disclosed in a basic application for protection in a convention country if it was claimed undisclosed (otherwise than by way of disclaimer or acknowledgment of a prior art) in that application, or any documents submitted by the applicant for protection in support of and at the same time as that application, but no account shall be taken of any disclosure effected by any such document unless a copy of the document is tiled at the patent office with the convention application or within such period as may be prescribed after the filing of that application.

#### **Supplementary provisions as to convention applications (138)**

1. Where a convention application is made in accordance with the provisions of this chapter, the applicant shall furnish, in addition to the complete specification, copies of the specifications or corresponding documents filed or deposited by the applicant in the patent office of the convention country in which the basic application was made, certified by the official chief or head of the patent office of the convention country, or otherwise verified to the satisfaction of the Controller, along with the application or within three months thereafter, or within such further period as the Controller may on good cause allow.

2. If any such specification or other document is in a foreign language, a translation into English of the specification or document, verified by affidavit or otherwise to the satisfaction of the Controller, shall be annexed to the specification or document.
3. For the purposes of this Act, the date on which an application was made in a convention country is such date as the Controller is satisfied, by certificate of the official chief or head of the patent office of the convention country or otherwise is the date on which the application was made in that convention country.

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### Other provisions of Act to apply to convention applications (139)

Save as otherwise provided in this chapter, all the provisions of this Act shall apply in relation to convention application and a patent granted in pursuance thereof as they apply in relation to an ordinary application and a patent granted in pursuance thereof.

### India as a Global Player

- a. India acceded to the Paris Convention on Industrial Property on 7 December 1998.
- b. India acceded to Patent Cooperation Treaty also on same date.
- c. Plays active role in World Trade Organisation and World Intellectual Property Organisation.
- d. Doha Round and Public Health Concerns.
- e. Development Agenda in WIPO.
- f. Mandatory Disclosure of Source in Patent applications.

### Important amendments

#### First Amendment in 1999

Introduced transitional facility to receive and hold patent applications of pharmaceutical and agricultural chemical products (mail box) till 1 January 2005 and for grant of Exclusive Marketing Rights for 5 years or till grant of patent.

#### Second Amendment Bill passed in 2002

##### Major changes

- a. 20-year patent period
- b. Reversal of burden of proof on the infringer
- c. Establishment of an Appellate Board
- d. Public interest safeguards and measures for protecting Traditional Knowledge.

#### Third Amendment 2005 Based on Observations of JPC

- a. Widespread consultations through country wide interactive sessions with interest groups
- b. Extensive inter-ministerial consultations
- c. Removed transitory provisions

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- d. Introduced various flexibilities provided in the TRIPS Agreement including the Doha Round.

#### Patent Law -Salient Features

- a. Both product and process patent provided.
- b. Term of patent-20years.
- c. Examination on request.
- d. Both pre-grant and post-grant opposition.
- e. Fast track mechanism for disposal of appeals.
- f. Provision for protection of bio-diversity and traditional knowledge.
- g. Publication of applications after 18 months with facility for early publication.

#### Safeguards in the Patent Law

- a. Compulsory licences to ensure availability of drugs at reasonable prices
- b. Bolar Provision for early manufacture of generics
- c. Parallel, import to check prices.
- d. Provision to deal with public health emergency.
- e. Revocation of patent in public interest and also on security considerations.
- f. Provisions to prevent grant of patents based on frivolous or trivial inventions.
- g. Provisions to prevent misappropriation of Genetic Resources and Traditional Knowledge.

#### Patent Protection: Policy Trends

- a. Become part of the Global Patent Regime
- b. Meet International Obligations.
- c. Safeguard the Rights of Patent Holders as also Protect Public Interest.
- d. Modernise the Patent Administration.
- e. Create Awareness regarding Patents.

#### Modernization of Patent Administration

- a. Number of Patent Examiners increased four-fold
- b. Patent search facilities improved.
- c. IT enabled efficient systems established.
- d. E-filing facility for patent applications launched on 18 July 2007.
- e. Foundation Stone for a National Institute of Intellectual Property Management laid on 20 August, 2007 in Nagpur
- f. Indian Patent Office recognized as an International Searching Authority (ISA).
- g. International Preliminary Examining Authority (IPEA) under the Patent Cooperation Treaty by the World Intellectual Property Organization in early October 2007.

- h. 45,000 patent documents uploaded on Patent Office website, viz. <http://ipindia.nic.in> in November 2007

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### Impact

- a. Time lines for patent and trademark processing reduced.
- b. Possible to obtain a patent in 8 months as against 6-8 years earlier and a trade mark in
- c. 10-12 months as against 8-10 years earlier.
- d. Backlog of over 44,000 patent applications liquidated in the last three years.

### International Cooperation for Improving Patent Administration

- a. Cooperation with WIPO.
- b. EU — India Technology and Investment Development Programme.
- c. Bilateral Agreements signed with UK Patent Office, France, European Patent Office,
- d. US PTO, Japan Patent Office, Switzerland, Germany.

### Main Elements of Co-operation

- a. Human Resource Development.
- b. Public awareness programmes.
- c. Development of IP-profession.
- d. Joint studies and research.
- e. Exchange of experience in the area of protection of traditional knowledge.
- f. Capacity building.

## 5.13 INTRODUCTION AND DEFINITION OF THE INDIAN PARTNERSHIP ACTS

The Indian Partnership Act and Limited Liability Partnership Act, 2008 are the two laws dealing with partnership firms. Under Partnership Act the partners had unlimited liability jointly and severally. To remove this disadvantage Limited Liability Partnership Act, 2008 was introduced.

### The Indian partnership acts

According to Section 4 of the Partnership Act “Partnership” is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually “partners” and collectively “a firm”. The name under which their business is carried on is called the “firm name”. People coming together for some social or religious purposes do not constitute ‘partnership’.

### Example of Partnership:

Mr. Ram and Mr. Krishna have together started a firm called “R K Traders” and agreed to

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share the profits/losses of business earned on by them. Mr. Ram and Mr. Krishna are called individually “partners” and collectively “a firm” “R K Traders” is called the “firm name”.

A partnership firm is not a distinct legal entity. However, a partnership firm is legal entity for the purpose of Taxation.

As far as The Indian Partnership Act is concerned there is mention about the number of partners: But Section 11 of the Indian Companies Act prohibits partnership consisting of more than 20 members. It means a firm can have Minimum 2 and Maximum 20 partners.

### **What is the real “Test of a Partnership Firm”?**

The real test of ‘partnership firm’ is ‘mutual agency’, i.e., whether a partner can bind the firm by his act, In other words, whether he can act as agent of all other partners? According to section 18, “A partner is the agent of the firm for the purposes of the business of the firm. In the earlier example both Mr. Ram and Krishna are the agents of the firm RK Traders and also, they are the agent of each other.

### **Rules of evidence**

#### **According to Section 68**

- a. Any statement, intimation or notice recorded or noted in the Register of Firms shall, as against any person by whom or on whose behalf such statement, intimation or notice was signed, be conclusive proof of any fact therein stated.
- b. A certified copy of an entry relating to a firm in the Register of Firms may be produced in proof of the fact of the registration of such firm, and of the contents of any statement, intimation or notice recorded or noted therein

## **5.14 RIGHTS, AUTHORITIES AND LIABILITIES OF PARTNERS**

### **The rights and duties of the Partners**

According to Section 11, The mutual rights and duties of the partners of a firm may be determined by contract between the partners. It means Mr. Ram and Mr. Krishna can decide by mutual agreement what are the rights and duties of Mr. Ram and Mr. Krishna

You must remember that according to section 12(a), “Every partner has right to take part in the conduct of the business.” By virtue of being a partner every partner has an implied authority.

According to Section 19(1), “The act of a partner to carry on business of the firm, binds the firm. The authority of a partner to bind the firm confined by this section is called his “implied authority”. If Mr. Ram has taken a business decision on behalf of the firm in the capacity of a partner, then the decision is binding on Mr. Krishna also and on the firm “RK Trading” also.

### **Extension and restriction of partners implied authority**

According to Section 20, “The partners in a firm may, by contract between the parties, extend or restrict the implied authority of any partner. Notwithstanding any such restriction,

any act done by a partner on behalf of the firm which falls within his implied authority binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner.”

### **Extension and restriction of partners implied authority**

According to Section 20, “The partners in a firm may, by contract between the parties, extend or restrict the implied authority of any partner. Notwithstanding any such restriction, any act done by a partner on behalf of the firm which falls within his implied authority binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner.”

### **Example of Implied Authority:**

Mr. Ram and Mr. Krishna are partners of a firm called “R K Traders”. They have opened a current account to be operated by Mr. Ram only. Mr. Ram has issued a cheque for Rs. 10,000/-. Mr. Krishna has issued a letter requesting stop payment of this cheque. Will Bank stop the payment?

The Answer is Yes: A partner has implied authority to give stop payment instructions.

Mr. Ram and Mr. Krishna are partners of a firm called “R K Traders”. They have taken a loan of Rs.50,000/-. Mr. Ram has signed the Acknowledgement of Debt on behalf of the firm. Will this acknowledgement bind Mr. Krishna?

The Answer is No: A partner has no implied authority to acknowledge the liability on behalf of the firm.

### **Mode of doing act to bind firm.**

According to Section 22, “In order to bind a firm, an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm.”

It means a partner has to sign to show that he is signing in the capacity of a partner as under:

### **For RK Traders**

**Mr. Ram**

**Partner**

### **Registration of partnership**

Registration of partnership is not compulsory. However, Registration brings certain advantages.

Let us look at the consequences of non-registration.

According to Section 69(1), “No suit to enforce a right shall be instituted in any court by or on behalf of any person suing as a partner in a firm against the firm or any person alleged to be or to have been a partner in the firm unless the firm is registered.”



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According to Section 69 (2) No suit shall be instituted in any Court by or on behalf of a firm against any third party unless the firm is registered.

If third party files suit against the unregistered firm, the firm cannot claim set off or institute other proceeding to enforce a right arising from a contract.

Thus, it is clear that the unregistered firm or partner of the firm cannot file suits against the third parties but the third parties can file suits against the firm and the partners of unregistered firm.

Because of this disadvantage to the unregistered firm, the firms prefer to get themselves registered.

### **The liability of the Partners**

According to Section 25, "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." It means the Liability of the firm and that of the partners for the debts and liabilities of the firm is Unlimited. In fact, this is one of the disadvantages of a Partnership Firm.

It property of partnership firm is insufficient to meet liabilities, personal property of any partner can be attached to pay the debts of the firm. Mr. Ram has contributed Rs. 40,000 and Mr. Krishna has contributed Rs. 60,000 to the capital of R K Traders. Let us assume the liability of the firm is Rs. 1,50,000 and the property of the firm can fetch Rs. 80,000/-. It means there is a short fall of Rs.70,000 to meet the liability of the firm. In this case Mr. Ram and Mr. Krishna both are individually liable for Rs. 70,000 and also jointly liable for Rs. 70,000/-. The creditors of the firm can recover Rs.70,000 either from Mr. Ram or from Mr. Krishna

## **5.15 MINOR AS A PARTNER**

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### **Whether a minor can become a partner?**

According to Section 30(1), "a person who is a minor according to the law to which he is subject may not be a partner in a firm, but with the consent of all the partners for the time being, he may be admitted to the benefits of partnership."

### **What are the rights of a minor who is admitted to benefit of partnership?**

According to Section 30(2), a minor (who is admitted to benefit of partnership) has a right to such share of the property and of the profits of the firm as may be agreed upon and he may have access to and inspect and copy any of the accounts of the firm.

### **The liabilities of a minor who has been admitted to benefits of partnership**

According to section 30(3), Such minor's share is liable for the acts of the firm, but the minor is not personally liable for any such act. Thus, a minor can be admitted to the benefits of partnership but he cannot be held personally liable as a partner.



## 5.16 RECONSTRUCTION AND DISSOLUTION OF PARTNERSHIP

The effect of death or insolvency of a partner.

A partnership firm is not a legal entity. It has no perpetual existence as in case of a company incorporated under Companies Act. In absence of specific provision in

partnership deed, death or insolvency of a partner means dissolution of the firm. However, partnership can provide that the firm will not dissolve in such case.

The circumstances leading to the **Reconstitution of a Partnership Firm.**

Change in partners may occur due to various reasons like death, retirement, admission of new member, expulsion, insolvency, transfer of interest by partner etc. After such change, the rights and liabilities of each partner are determined afresh. This is termed as reconstitution of a firm.

### **Revocation of continuing guarantee by Reconstitution of the firm**

According to section 38, “A continuing guarantee given to a third party in respect of the transactions of a firm, is, in the absence of agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm.”

### **Example:**

R K Traders have given a continuing Guarantee for a Cash Credit Limit of Rs.50,000. The Debit Balance as on 3-12-2017 is Rs.20,000 when the partnership was reconstituted. The old Partners will be liable for only up to 20,000 and not for the debits after that date. Any credits in the account after that will reduce their liability to that extent.

### **The circumstances when a partnership firm can be dissolved.**

According to section 39, The dissolution of partnership between all the partners of a firm is called the dissolution of the firm.

Dissolution of a firm can be done in the following ways:

- a. By agreement (section 40)
- b. By insolvency (section 41)
- c. On happening of certain contingency (section 42)
- d. By notice if partnership is at will (section 43).
- e. By Court u/s 44.

### **Settlement of accounts after dissolution**

According to section 55(1), “In settling the accounts of a firm after dissolution, the goodwill shall, subject to contract between the partners, be included in the assets, and it may be sold either separately or along with other property of the firm.”

Accounts are settled after a firm is dissolved as provided in the Act. A firm is said to be ‘wound up’ only after accounts are fully settled.





## 5.17 LIMITED LIABILITY PARTNERSHIP ACT, 2008 AND INCORPORATION BY REGISTRATION

The concept of the Limited Liability Partnership (LLP) came to India in the year 2008. An LLP has the characteristics of both the partnership firm and company. It is the most preferred form of organization among entrepreneurs as it incorporates the benefits of both partnership firm and company into a single form of organization. LLPs in India are regulated by the Limited liability Partnership Act, 2008. The concept of the Limited Liability Partnership (LLP) came to India in the year 2008. An LLP has the characteristics of both the partnership firm and company. It is the most preferred form of organization among entrepreneurs as it incorporates the benefits of both partnership firm and company into a single form of organization. LLPs in India are regulated by the Limited liability Partnership Act, 2008.

### Features of LLP are –

1. LLP has a separate legal entity just like companies.
2. Low cost and Less compliances and regulations are applicable on LLP.
3. The liability of each partner is limited to the contribution made by the partner.
4. The cost of forming an LLP is low and Name Reservation is also for a longer period of time (3 months)
5. On LLP, under Income Tax Act, 1961, deemed dividend (Dividend Distribution Tax) is not applicable.
6. For LLP, under LLP Act, 2008, there is no provision like Rotation of partners, like in case of companies.
7. Stamp Duty on LLP Agreement is fixed as per the Capital Contribution by all the partners.
8. LLPs are required to have its accounts audited by a practicing Chartered Accountant only if its annual turnover, in any financial year exceeds Rs. 40 lakhs or its contribution exceeds Rs. 25 lakhs.

“SMALL LIMITED LIABILITY PARTNERSHIP” means a limited liability partnership—

- a. The contribution of which, does not exceed twenty-five lakh rupees or such higher amount, not exceeding five crore rupees, as may be prescribed
- b. The turnover of which, as per the statement of accounts and solvency for the immediately preceding financial year, does not exceed forty lakh rupees or such higher amount, not exceeding fifty crore rupees, as may be prescribed
- c. Which meets such other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed

**How to incorporate a LLP** – The incorporation of LLP is to be done through the form FILLIP and the agreement for the same is filed through the form 3.

**Name reservation of LLP** is done through RUN and the name applied for LLP will be

valid/ available of a period of 3 months in which the LLP is to be incorporated.

After incorporation of LLP, LLP AGREEMENT is to be file with the REGISTRAR OF COMPANY (ROC) through FORM 3 within a period of 30 days.

**For incorporation of LLP, the following information and documents are required –**

- Proposed name and objects of the LLP.
- Minimum two partners are required to incorporate an LLP. However, there is no upper limit on the maximum number of partners of an LLP.
- In LLP, there should be minimum of two designated partners who shall be individuals, and at least one of them should be resident in India.

**Explanation – Meaning of Resident of India for the purpose of Designated Partner the term resident in India means a person who has stayed in India for a period of not less than 120 days during the financial year.**

- The total capital contribution and ratio of capital contribution amongst the partners and designated partners.
- DSC of any one the designated partners.
- Identity proof and residential proof of all the partners.
- Proposed Registered office of the LLP.
- MAIL ID and Contact details of the proposed LLLP.
- Board Resolution of the company, if anybody corporate is the partner of the LLP.
- Consent of existing LLP as a proof of no objection, if any LLP is a partner in an proposed LLP. Consent of the partners.
- Detail of LLP(s) and/ or company(s) in which partner/ designated partner is a director/partner. Approval of the owner of the trademark or the applicant of such application for registration of Trademark.

**What are the qualifications for becoming a partner in LLP?**

Any individual or body corporate may be a partner in an LLP. However, an individual shall not be capable of becoming a partner of a LLP, if –

- a. He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- b. He is an undischarged insolvent; or
- c. He has applied to be adjudicated as an insolvent and his application is pending.

**Who can be a “designated partner” in LLP?**

Every LLP shall be required to have at least two Designated Partners who shall be individuals and at least one of the Designated Partner shall be a resident of India. In case of a LLP in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such body's corporate shall act as designated partners.





### Persons not permitted to be a designated partner –

- Any individual who was declared bankrupt in the last five years.
- He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force.
- If an individual has served a prison term for more than six months, then he is not eligible.
- Any individual who has been involved in any fraud.
- Minors.
- Individuals who have a history of credit defaults over the last five years without reaching an agreement with the creditors.

### Difficulty to raise capital

The LLP does not have the concept of equity or shareholders like a company. Angel investors and venture capitalists cannot invest in the LLP as shareholders. This is because the shareholders must be partners in the LLP and have to take up all the responsibilities of a partner. Thus, angel investors and venture capitalists prefer to invest in a company rather than an LLP making it difficult for the LLPs to raise capital.

### Incorporation by registration

#### Important definitions

1. “limited liability partnership agreement” means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership; A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
2. A limited liability partnership shall have perpetual succession.
3. Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

The provisions of the Indian Partnership Act, 1932 (9 of 1932) shall not apply to a limited liability partnership.

### Partners

1. Partner”, in relation to a limited liability partnership, means any person who becomes a partner in the limited liability partnership in accordance with the limited liability partnership agreement;

Any individual or body corporate may be a partner in a limited liability partnership except the following:

- a. He has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- b. He is an undischarged insolvent; or

- c. He has applied to be adjudicated as an insolvent and his application is pending.

Every limited liability partnership shall have at least two partners.

### Designated partners

1. Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India:
2. Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of sections 266A to 266G (both inclusive) of the Companies Act, 1956 (1 of 1956) shall apply mutatis mutandis for the said purpose.

### A designated partner shall be—

- a. Responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and
- b. Liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

A limited liability partnership may appoint a designated partner within thirty days of a vacancy arising for any reason if at any time there is only one designated partner, each partner shall be deemed to be a designated partner.

1. If the limited liability partnership contravenes the provisions of sub-section (1) of section 7, the limited liability partnership and its every partner shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.
2. If the limited liability partnership contravenes the provisions of sub-section (4) and sub-section (5) of section 7, section 8 or section 9, the limited liability partnership and its every partner shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

### Incorporation document

1. For a limited liability partnership to be incorporated, —
  - a. Two or more persons associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document;
  - b. The incorporation document shall be filed in such manner and with such fees, as may be prescribed with the registrar of the state in which the registered office of the limited liability partnership is to be situated; and
  - c. There shall be filed along with the incorporation document, a statement in the prescribed form, made by either an advocate, or a company secretary or a chartered accountant or a cost accountant, who is engaged in the formation of the limited liability partnership and by anyone who subscribed his name



- to the incorporation document, that all the requirements of this Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.
2. The incorporation document shall—
    - a. Be in a form as may be prescribed;
    - b. State the name of the limited liability partnership;
    - c. State the proposed business of the limited liability partnership;
    - d. State the address of the registered office of the limited liability partnership;
    - e. State the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
    - f. State the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;
    - g. Contain such other information concerning the proposed limited liability partnership as may be prescribed.
  3. If a person makes a statement under clause (c) of sub-section (1) which he
    - a. Knows to be false; or
    - b. Does not believe to be true, shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.

#### **Incorporation by registration**

1. When the requirements imposed by clauses (b) and (c) of sub-section (1) of section 11 have been complied with, the Registrar shall retain the incorporation document and, unless the requirement imposed by clause (a) of that sub-section has not been complied with, he shall, within a period of fourteen days—
  - a. Register the incorporation document; and name specified therein.
2. The Registrar may accept the statement delivered under clause (c) of subsection (1) of section 11 as sufficient evidence that the requirement imposed by clause (a) of that sub-section has been complied with.
3. The certificate issued under clause (b) of sub-section (1) shall be signed by the Registrar and authenticated by his official seal.
4. The certificate shall be conclusive evidence that the limited liability partnership is incorporated by the name specified therein.

#### **Registered office of limited liability partnership and change therein**

1. Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received.
2. A document may be served on a limited liability partnership or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other manner, as may be prescribed, at the registered

office and any other address specifically declared by the limited liability partnership for the purpose in such form and manner as may be prescribed.

3. A limited liability partnership may change the place of its registered office and file the notice of such change with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.
4. If the limited liability partnership contravenes any provisions of this section, the limited liability partnership and its every partner shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.

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### Effect of registration

On registration, a limited liability partnership shall, by its name, be capable of

- a. Suing and being sued;
- b. Acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;
- c. Having a common seal, if it decides to have one; and
- d. Doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.

### Name

1. Every limited liability partnership shall have either the words “limited liability partnership” or the acronym “LLP” as the last words of its name.
2. No limited liability partnership shall be registered by a name which, in the opinion of the Central Government is—
  - a. Undesirable; or
  - b. Identical or too nearly resembles to that of any other partnership firm or limited liability partnership or body corporate or a registered trade mark, or a trade mark which is the subject matter of an application for registration of any other person under the Trade Marks Act, 1999 (47 of 1999).

### Reservation of name.

1. A person may apply in such form and manner and accompanied by such fee as may be prescribed to the Registrar for the reservation of a name set out in the application as—
  - a. The name of a proposed limited liability partnership; or
  - b. The name to which a limited liability partnership proposes to change its name.
2. Upon receipt of an application under sub-section (1) and on payment of the prescribed fee, the Registrar may, if he is satisfied, subject to the rules prescribed by the Central Government in the matter, that the name to be reserved is not one which may be rejected on any ground referred to in sub-section (2) of section 15, reserve the name for a period of three months from the date of intimation by the Registrar.

*LAWS RELATED  
TO INTELLECTUAL  
PROPERTY RIGHTS,  
INDIAN PATENTS  
ACT, 1970 AND  
PARTNERSHIP LAWS*

**Change of name of limited liability partnership.**

1. Notwithstanding anything contained in sections 15 and 16, where the Central Government is satisfied that a limited liability partnership has been registered (whether through inadvertence or otherwise and whether originally or by a change of name) under a name which—
  - a. Is a name referred to in sub-section (2) of section 15?
  - b. Is identical with or too nearly resembles the name of any other limited liability partnership or body corporate or other name as to be likely to be mistaken for it.
  - c. The Central Government may direct such limited liability partnership to change its name, and the limited liability partnership shall comply with the said direction within three months after the date of the direction or such longer period as the Central Government may allow.
2. Any limited liability partnership which fails to comply with a direction given under sub-section (1) shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees and the designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

**Application for direction to change name in certain circumstances**

1. Any entity which already has a name similar to the name of a limited liability partnership which has been incorporated subsequently, may apply, in such manner as may be prescribed, to the Registrar to give a direction to any limited liability partnership, on a ground referred to in section 17 to change its name.
2. The Registrar shall not consider any application under sub-section (1) to give a direction to a limited liability partnership on the ground referred to in clause (b) of sub-section (1) of section 17 unless the Registrar receives the application within twenty-four months from the date of registration of the limited liability partnership under that name.

**Change of registered name**

Any limited liability partnership may change its name registered with the Registrar by filing with him a notice of such change in such form and manner and on payment of such fees as may be prescribed.

**Penalty for improper use of words “limited liability partnership” or “LLP”**

If any person or persons carry on business under any name or title of which the words “Limited Liability Partnership” or “LLP” or any contraction or imitation thereof is or are the last word or words, that person or each of those persons shall, unless duly incorporated as limited liability partnership, be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.



### Publication of name and limited liability

1. Every limited liability partnership shall ensure that its invoices, official correspondence and publications bear the following, namely: —
  - a. The name, address of its registered office and registration number of the limited liability partnership; and
  - b. A statement that it is registered with limited liability.
2. Any limited liability partnership which contravenes the provisions of subsection (1) shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.

## 5.18 RELATIONSHIP OF PARTNERS, FINANCIAL DISCLOSURES AND INVESTIGATION

### Eligibility to be partners

On the incorporation of a limited liability partnership, the persons who subscribed their names to the incorporation document shall be its partners and any other person may become a partner of the limited liability partnership by and in accordance with the limited liability partnership agreement.

### Relationship of partners

1. Save as otherwise provided by this Act, the mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners.
2. The limited liability partnership agreement and any changes, if any, made therein shall be filed with the Registrar in such form, manner and accompanied by such fees as may be prescribed.
3. An agreement in writing made before the incorporation of a limited liability partnership between the persons who subscribe their names to the incorporation document may impose obligations on the limited liability partnership, provided such agreement is ratified by all the partners after the incorporation of the limited liability partnership.
4. In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of the limited liability partnership and the partners shall be determined by the provisions relating to that matter as are set-out in the First Schedule.

### Cessation of partnership interest

1. A person may cease to be a partner of a limited liability partnership in accordance with an agreement with the other partners or, in the absence of agreement with the other partners as to cessation of being a partner, by giving a notice in writing of not less than thirty days to the other partners of his intention to resign as partner.





2. A person shall cease to be a partner of a limited liability partnership -
  - a. On his death or dissolution of the limited liability partnership; or
  - b. If he is declared to be of unsound mind by a competent court; or
  - c. If he has applied to be adjudged as an insolvent or declared as an insolvent.
3. Where a person has ceased to be a partner of a limited liability partnership (hereinafter referred to as "former partner"), the former partner is to be regarded (in relation to any person dealing with the limited liability partnership) as still being a partner of the limited liability partnership unless -
  - a. The person has notice that the former partner has ceased to be a partner of the limited liability partnership; or
  - b. Notice that the former partner has ceased to be a partner of the limited liability partnership has been delivered to the Registrar.
4. The cessation of a partner from the limited liability partnership does not by itself discharge the partner from any obligation to the limited liability partnership or to the other partners or to any other person which he incurred while being a partner.
5. Where a partner of a limited liability partnership ceases to be a partner, unless otherwise provided in the limited liability partnership agreement, the former partner or a person entitled to his share in consequence of the death or insolvency of the former partner, shall be entitled to receive from the limited liability partnership-
  - a. An amount equal to the capital contribution of the former partner actually made to the limited liability partnership; and
  - b. His right to share in the accumulated profits of the limited liability partnership, after the deduction of accumulated losses of the limited liability partnership, determined as at the date the former partner ceased to be a partner.
6. A former partner or a person entitled to his share in consequence of the death or insolvency of the former partner shall not have any right to interfere in the management of the limited liability partnership.

#### **Registration of changes in partners**

1. Every partner shall inform the limited liability partnership of any change in his name or address within a period of fifteen days of such change.
2. A limited liability partnership shall -
  - a. Where a person becomes or ceases to be a partner, file a notice with the Registrar within thirty days from the date he becomes or ceases to be a partner; and
  - b. Where there is any change in the name or address of a partner, file a notice with the Registrar within thirty days of such change.
3. A notice filed with the Registrar under sub-section (2)
  - a. Shall be in such form and accompanied by such fees as may be prescribed;
  - b. Shall be signed by the designated partner of the limited liability partnership

and authenticated in a manner as may be prescribed; and

- c. If it relates to an incoming partner, shall contain a statement by such partner that he consents to becoming a partner, signed by him and authenticated in the manner as may be prescribed.
4. If the limited liability partnership contravenes the provisions of sub-section (2), the limited liability partnership and every designated partner of the limited liability partnership shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.
5. If any partner contravenes the provisions of sub-section (1), such partner shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.
6. Any person who ceases to be a partner of a limited liability partnership may himself file with the Registrar the notice referred to in sub-section (3) if he has reasonable cause to believe that the limited liability partnership may not file the notice with the Registrar and in case of any such notice filed by a partner, the Registrar shall obtain a confirmation to this effect from the limited liability partnership unless the limited liability partnership has also filed such notice:

Provided that where no confirmation is given by the limited liability partnership within fifteen days, the registrar shall register the notice made by a person ceasing to be a partner under this section.

## Liabilities of Partners

### Partner as agent

Every partner of a limited liability partnership is, for the purpose of the business of the limited liability partnership, the agent of the limited liability partnership, but not of other partners.

### Extent of liability of limited liability partnership.

1. A limited liability partnership is not bound by anything done by a partner in dealing with a person if—
  - a. The partner in fact has no authority to act for the limited liability partnership in doing a particular act; and
  - b. The person knows that he has no authority or does not know or believe him to be a partner of the limited liability partnership.
2. The limited liability partnership is liable if a partner of a limited liability partnership is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the limited liability partnership or with its authority.
3. An obligation of the limited liability partnership whether arising in contract or otherwise, shall be solely the obligation of the limited liability partnership.
4. The liabilities of the limited liability partnership shall be met out of the property of the limited liability partnership.





### Extent of liability of partner

1. A partner is not personally liable, directly or indirectly for an obligation referred to in sub-section (3) of section 27 solely by reason of being a partner of the limited liability partnership.
2. The provisions of sub-section (3) of section 27 and sub-section (1) of this section shall not affect the personal liability of a partner for his own wrongful act or I omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the limited liability partnership.

### Holding out

1. Any person, who by words spoken or written or by conduct, represents himself, or knowingly permits himself to be represented to be a partner in a limited liability partnership is liable to any person who has on the faith of any such representation given credit to the limited liability partnership, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit: Provided that where any credit is received by the limited liability partnership as a result of such representation, the limited liability partnership shall, without prejudice to the liability of the person so representing himself or represented to be a partner, be liable to the extent of credit received by it or any financial benefit derived thereon.
2. Where after a partner's death the business is continued in the same limited liability partnership name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the limited liability partnership done after his death.

### Unlimited liability in case of fraud

1. In the event of an act earned out by a limited liability partnership, or any of its partners, with intent to defraud creditors of the limited liability partnership or other person, or for any fraudulent purpose, the liability of the limited liability partnership and partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the limited liability partnership:

Provided that in case any such act is carried out by a partner, the limited liability | partnership is liable to the same extent as the partner unless it is established by the limited liability partnership that such act was without the knowledge or the authority of the limited liability partnership.

2. Where any business is carried on with such intent or for such purpose as mentioned in sub-section (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.
3. Where a limited liability partnership or any partner or designated partner or employee of such limited liability partnership has conducted the affairs of the limited liability partnership in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in

force, the limited liability partnership and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct: Provided that such limited liability partnership shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the limited liability partnership.

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### Whistleblowing

1. The Court or Tribunal may reduce or waive any penalty leviable against any partner or employee of a limited liability partnership, if it is satisfied that—
  - a. Such partner or employee of a limited liability partnership has provided useful information during investigation of such limited liability partnership; or
  - b. When any information given by any partner or employee (whether or not during investigation) leads to limited liability partnership or any partner or employee of such limited liability partnership being convicted under this Act or any other Act.
2. No partner or employee of any limited liability partnership may be discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his limited liability partnership or employment merely because of his providing information or causing information to be provided pursuant to sub-section (1).

### Contribution of partners

#### Form of contribution

1. A contribution of a partner may consist of tangible, movable or immovable or intangible property or other benefit to the limited liability partnership, including money, promissory notes, other agreements to contribute cash or property, and contracts for services performed or to be performed.
2. The monetary value of contribution of each partner shall be accounted for and disclosed in the accounts of the limited liability partnership in the manner as may be prescribed.

#### Obligation to contribute. —

1. The obligation of a partner to contribute money or other property or other benefit or to perform services for a limited liability partnership shall be as per the limited liability partnership agreement.
2. A creditor of a limited liability partnership, which extends credit or otherwise acts in reliance on an obligation described in that agreement, without notice of any compromise between partners, may enforce the original obligation against such partner.

### Financial disclosures

#### Maintenance of books of account, other records and audit, etc.

1. The limited liability partnership shall maintain such proper books of account as may be prescribed relating to its affairs for each year of its existence on cash basis

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or accrual basis and according to double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed.

2. Every limited liability partnership shall, within a period of six months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year in such form as may be prescribed, and such statement shall be signed by the designated partners of the limited liability partnership.
3. Every limited liability partnership shall file within the prescribed time, the Statement of Account and Solvency prepared pursuant to sub-section (2) with the Registrar every year in such form and manner and accompanied by such fees as may be prescribed.
4. The accounts of limited liability partnerships shall be audited in accordance with such rules as may be prescribed: Provided that the Central Government may, by notification in the Official Gazette, exempt any class or classes of limited liability partnerships from the requirements of this sub-section.
5. Any limited liability partnership which fails to comply with the provisions of this section shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

#### Annual return

1. Every limited liability partnership shall file an annual return duly authenticated with the Registrar within sixty days of closure of its financial year in such form and manner and accompanied by such fee as may be prescribed.
2. Any limited liability partnership which fails to comply with the provisions of this section shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.
3. If the limited liability partnership contravenes the provisions of this section, the designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

#### Inspection of documents kept by Registrar

The incorporation document, names of partners and changes, if any, made therein, Statement of Account and Solvency and annual return filed by each limited liability partnership with the Registrar shall be available for inspection by any person in such manner and on payment of such fee as may be prescribed.

#### Penalty for false statement

If in any return, statement or other document required by or for the purposes of any of the provisions of this Act, any person makes a statement

- a. Which is false in any material particular, knowing it to be false; or
- b. Which omits any material fact knowing it to be material?

he shall, save as otherwise expressly provided in this Act, be punishable with imprisonment for a term which may extend to two years, and shall also be liable to fine which may extend to five lakh rupees but which shall not be less than one lakh rupees.

#### **Power of Registrar to obtain information**

1. In order to obtain such information as the Registrar may consider necessary for the purposes of carrying out the provisions of this Act, the Registrar may require any person including any present or former partner or designated partner or employee of a limited liability partnership to answer any question or make any declaration or supply any details or particulars in writing to him within a reasonable period.
2. In case any person referred to in sub-section (1) does not answer such question or make such declaration or supply such details or particulars asked for by the Registrar within a reasonable time or time given by the Registrar or when the Registrar is not satisfied with the reply or declaration or details or particulars provided by such person, the Registrar shall have power to summon that person to appear before him or an inspector or any other public officer whom the Registrar may designate, to answer any such question or make such declaration or supply such details, as the case may be.
3. Any person who, without lawful excuse, fails to comply with any summons or requisition of the Registrar under this section shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.

#### **Compounding of offences**

The Central Government may compound any offence under this Act which is punishable with fine only, by collecting from a person reasonably suspected of having committed the offence, a sum which may extend to the amount of the maximum fine prescribed for the offence.

#### **Destruction of old records**

The Registrar may destroy any document filed or registered with him in physical form or in electronic form in accordance with such rules as may be prescribed.

#### **Enforcement of duty to make returns, etc.**

1. If any limited liability partnership is in default in complying with—
  - a. Any provisions of this Act or of any other law which requires the filing in any manner with the Registrar of any return, account or other document or the giving of notice to him of any matter; or
  - b. Any request of the Registrar to amend or complete and resubmit any document or to submit a fresh document,





- c. And fails to make good the default within fourteen days after the service on the limited liability partnership of a notice requiring it to be done, the Tribunal may, on application by the Registrar, make an order directing that limited liability partnership or its designated partners or its partners to make good the default within such time as specified in the order.
2. Any such order may provide that all the costs of and incidental to the application shall be borne by that limited liability partnership.
3. Nothing in this section shall limit the operation of any other provision of this Act or any other law imposing penalties in respect of any default referred to in this section on that limited liability partnership.

### Assignment of Rights of a Partner

#### Partner's transferable interest

1. The rights of a partner to a share of the profits and losses of the limited liability partnership and to receive distributions in accordance with the limited liability partnership agreement are transferable either wholly or in part.
2. The transfer of any right by any partner pursuant to sub-section (1) does not by itself cause the disassociation of the partner or a dissolution and winding up of the limited liability partnership.
3. The transfer of right pursuant to this section does not, by itself, entitle the transferee or assignee to participate in the management or conduct of the activities of the limited liability partnership, or access information concerning the transactions of the limited liability partnership.

### Investigation

#### Investigation of the affairs of limited liability partnership

1. The Central Government shall appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report thereon in such manner as it may direct if:
  - a. The Tribunal, either sue moto, or on an application received from not less than one-fifth of the total number of partners of limited liability partnership, by order, declares that the affairs of the limited liability partnership ought to be investigated; or
  - b. Any Court, by order, declares that the affairs of a limited liability partnership ought to be investigated.
2. The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a limited liability partnership and to report on them in such manner as it may direct.
3. The appointment of inspectors pursuant to sub-section (2) may be made, —
  - a. If not less than one-fifth of the total number of partners of the limited liability partnership make an application along with supporting evidence and security amount as may be prescribed.

- b. If the limited liability partnership makes an application that the affairs of the limited liability partnership ought to be investigated.
- c. If, in the opinion of the Central Government, there are circumstances suggesting—
  - That the business of the limited liability partnership is being or has been conducted with an intent to defraud its creditors, partners or any other person, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive or unfairly prejudicial to some or any of its partners, or that the limited liability partnership was formed for any fraudulent or unlawful purpose.
  - That the affairs of the limited liability partnership are not being conducted in accordance with the provisions of this act; or (iii) that, on receipt of a report of the registrar or any other investigating or regulatory agency, there are sufficient reasons that the affairs of the limited liability partnership ought to be investigated.

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### **Application by partners for investigation**

An application by partners of the limited liability partnership under clause (a) of sub section (1) of section 43 shall be supported by such evidence as the Tribunal may require for the purpose of showing that the applicants have good reason for enquiring the investigation and the Central Government may, before appointing an inspector, require the applicants to give security, of such amount as may be prescribed, for payment of costs of the investigation.

### **Firm, body corporate or association not to be appointed as inspector**

No firm, body corporate or other association shall be appointed as an inspector.

### **Power of inspectors to carry out investigation into affairs of related entities, etc.**

1. If an inspector appointed by the Central Government to investigate the affairs of a limited liability partnership thinks it necessary for the purposes of his investigation to investigate also the affairs of an entity which has been associated in the past or is presently associated with the limited liability partnership or any present or former partner or designated partner of the limited liability partnership, the inspector shall have the power to do so and shall report on the affairs of the other entity or partner or designated partner, so far as he thinks that the results of his investigation thereof are relevant to the investigation of the affairs of the limited liability partnership.
2. In the case of any entity or partner or designated partner referred to in subsection (1), the inspector shall not exercise his power of investigating into, and reporting on, its or his affairs without obtaining the prior approval of the Central Government thereto: Provided that before according approval under this subsection, the Central Government shall give the entity or partner or designated partner a reasonable opportunity to show cause why such approval should not be accorded.

*LAWS RELATED  
TO INTELLECTUAL  
PROPERTY RIGHTS,  
INDIAN PATENTS  
ACT, 1970 AND  
PARTNERSHIP LAWS*





### Production of documents and evidence

1. It shall be the duty of the designated partner and partners of the limited liability partnership—
  - a. To preserve and to produce before an inspector or any person authorized by him in this behalf with the previous approval of the Central Government, all books and papers of, or relating to, the limited liability partnership or, as the case may be, the other entity, which are in their custody or power; and
  - b. Otherwise, to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.
2. The inspector may, with the previous approval of the Central Government, require any entity other than an entity referred to in sub-section (1) to furnish such information to, or produce such books and papers before him or any person authorized by him in this behalf, with the previous approval of that Government, as he may consider necessary, if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation.
3. The inspector may keep in his custody any books and papers produced under sub-section (1) or sub-section (2) for thirty days and thereafter shall return the same to the limited liability partnership, other entity or individual by whom or on whose behalf the books and papers are produced: Provided that the inspector may call for the books and papers if they are needed again: Provided further that if certified copies of the books and papers produced under sub-section (2) are furnished to the inspector, he shall return those books and papers to the entity or person concerned.
4. An inspector may examine on oath—
  - a. Any of the persons referred to in sub-section (1);
  - b. With the previous approval of the central government, any other person in relation to the affairs of the limited liability partnership or any other entity, as the case maybe; and
  - c. May administer an oath accordingly and for that purpose may require any of those persons to appear before him personally.
5. If any person fails without reasonable cause or refuses—
  - a. To produce before an inspector or any person authorised by him in this behalf with the previous approval of the Central Government any book or paper which it is his duty under sub-section (1) or sub-section (2) to produce; or
  - b. To furnish any information which is his duty under sub-section (2) to furnish; or
  - c. To appear before the inspector personally when required to do so under sub-section (4) or to answer any question which is put to him by the inspector in pursuance of that sub-section; or
  - d. To sign the notes of any examination, he shall be punishable with fine which

shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees and with a further fine which shall not be less than fifty rupees but which may extend to five hundred rupees for every day after the first day after which the default continues.

6. The notes of any examination under sub-section (4) shall be taken down in writing and signed by the person whose examination was made on oath and a copy of such notes shall be given to the person so examined on oath and thereafter be used as evidence by the inspector.

### Seizure of documents by inspector

1. Where in the course of investigation, the inspector has reasonable ground to believe that the books and papers of, or relating to, the limited liability partnership or other entity or partner or designated partner of such limited liability partnership may be destroyed, mutilated, altered, falsified or secreted, the inspector may make an application to the Judicial Magistrate of the first class, or, as the case may be, the Metropolitan Magistrate, having jurisdiction, for an order for the seizure of such books and papers.
2. After considering the application and hearing the inspector, if necessary, the Magistrate may, by order, authorize the inspector—
  - a. To enter, with such assistance, as may be required, the place or places where such books and papers are kept;
  - b. To search that place or those places in the manner specified in the order; and
  - c. To seize books and papers which the inspector considers it necessary for the purposes of his investigation.
3. The inspector shall keep in his custody the books and papers seized under this section for such period not later than the conclusion of the investigation as he considers necessary and thereafter shall return the same to the concerned entity or person from whose custody or power they were seized and inform the Magistrate of such return: Provided that the books and papers shall not be kept seized for a continuous period of more than six months: Provided further that the inspector may, before returning such books and papers as aforesaid, place identification marks on them or any part thereof.
4. Save as otherwise provided in this section, every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 (2 of 1974) relating to searches or seizures made under that Code.

### Inspector's report

1. The Inspector may, and if so, directed by the Central Government, shall make interim reports to that Government, and on the conclusion of the investigation, shall make a final report to the Central Government and any such report shall be written or printed, as the Central Government may direct.
2. The Central Government—





- a. Shall forward a copy of any report (other than an interim report) made by the inspectors to the limited liability partnership at its registered office, and also to any other entity or person dealt with or related to the report; and
- b. May, if it thinks fit, furnish a copy thereof, on request and on payment of the prescribed fee, to any person or entity related to or affected by the report.

### **Prosecution**

If, from the report under section 49, it appears to the Central Government that any person in relation to the limited liability partnership or in relation to any other entity whose affairs have been investigated, has been guilty of any offence for which he is liable, the Central Government may prosecute such person for the offence; and it shall be the duty of all partners, designated partners and other employees and agents of the limited liability partnership or other entity, as the case may be, to give the Central Government all assistance in connection with the prosecution which they are reasonably able to give.

### **Application for winding up of limited liability partnership**

If any such limited liability partnership is liable to be wound up under this Act or any other law for the time being in force, and it appears to the Central Government from any such report under section 49 that it is expedient to do so by reason of any such circumstances as are referred to in sub-clause (i) or sub-clause (ii) of clause (c) of sub-section (3) of section 43, the Central Government may, unless the limited liability partnership is already being wound up by the Tribunal, cause to be presented to the Tribunal by any person authorised by the Central Government in this behalf, a petition for the winding up of the limited liability partnership on the ground that it is just and equitable that it should be wound up.

### **Proceedings for recovery of damages or property**

If, from any report under section 49, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the limited liability partnership or any entity whose affairs have been investigated, —

- a. For the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation, or the management of the affairs, of such limited liability partnership or such other entity; or
- b. For the recovery of any property of such limited liability partnership or such other entity, which has been misapplied or wrongfully retained,

The Central Government may itself bring proceedings for that purpose.

### **Expenses of investigation**

1. The expenses of, and incidental to, an investigation by an inspector appointed by the Central Government under this Act shall be defrayed in the first instance by the Central Government; but the following persons shall, to the extent mentioned below, be liable to reimburse the Central Government in respect of such expenses, namely: —
  - a. Any person who is convicted on a prosecution, or who is ordered to pay dam-

ages or restore any property in proceedings brought by virtue of section 52, may, in the same proceedings, be ordered to pay the said expenses to such extent as may be specified by the court convicting such person, or ordering him to pay such damages or restore such property, as the case may be;

- b. Any entity in whose name proceedings is brought as aforesaid shall be liable, to the extent of the amount or value of any sums or property recovered by it as a result of the proceedings; and
- c. Unless, as a result of the investigation, a prosecution is instituted in pursuance of section 50, —
  - Any entity, a partner or designated partner or any other person dealt with by the report of the inspector shall be liable to reimburse the Central Government in respect of the whole of the expenses, unless and except in so far as, the Central Government otherwise directs; and
  - The applicants for the investigation, where the inspector was appointed in pursuance of the provisions of clause (a) of sub-section (1) of section 43, shall be liable to such extent, if any, as the Central Government may direct.
2. Any amount for which a limited liability partnership or other entity is liable by virtue of clause (b) of sub-section (1) shall be a first charge on the sums or property mentioned in that clause.
3. The amount of expenses in respect of which any limited liability partnership, other entity, a partner or designated partner or any other person is liable under sub-clause (i) of clause (c) of sub-section (1) to reimburse the Central Government shall be recoverable as arrears of land revenue.
4. For the purposes of this section, any costs or expenses incurred by the Central Government or in connection with the proceedings brought by virtue of section 52 shall be treated as expenses of the investigation giving rise to the proceedings.

#### **Inspector's report to be evidence**

A copy of any report of any inspector or inspectors appointed under the provisions of this Act, authenticated in such manner, if any, as may be prescribed, shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

#### **Conversion and reconstruction**

##### **Conversion from firm into limited liability partnership**

A firm may convert into a limited liability partnership in accordance with the provisions of this Chapter and the Second Schedule.

##### **Conversion from private company into limited liability partnership**

A private company may convert into a limited liability partnership in accordance with the provisions of this Chapter and the Third Schedule.



**Conversion from unlisted public company into limited liability partnership**

An unlisted public company may convert into a limited liability partnership in accordance with the provisions of this Chapter and the Fourth Schedule.

**Registration and effect of conversion**

1. The Registrar, on satisfying that a firm, private company or an unlisted public company, as the case may be, has complied with the provisions of the Second Schedule, the Third Schedule or the Fourth Schedule, as the case may be, shall, subject to the provisions of this Act and the rules made thereunder, register the documents submitted under such Schedule and issue a certificate of registration in such form as the Registrar may determine stating that the limited liability partnership is, on and from the date specified in the certificate, registered under this Act: Provided that the limited liability partnership shall, within fifteen days of the date of registration, inform the concerned Registrar of Firms or Registrar of Companies, as the case may be, with which it was registered under the provisions of the Indian Partnership Act, 1932 (9 of 1932) or the Companies Act, 1956 (1 of 1956) as the case may be, about the conversion and of the particulars of the limited liability partnership in such form and manner as may be prescribed.
2. Upon such conversion, the partners of the firm, the shareholders of private company or unlisted public company, as the case may be, the limited liability partnership to which such firm or such company has converted, and the partners of the limited liability partnership shall be bound by the provisions of the Second Schedule, the Third Schedule or the Fourth Schedule, as the case may be, applicable to them.
3. Upon such conversion, on and from the date of certificate of registration, the effects of the conversion shall be such as specified in the Second Schedule, the Third Schedule or the Fourth Schedule, as the case may be.
4. Notwithstanding anything contained in any other law for the time being in force, on and from the date of registration specified in the certificate of registration issued under the Second Schedule, the Third Schedule or the Fourth Schedule, as the case may be —
  - a. There shall be a limited liability partnership by the name specified in the certificate of registration registered under this act.
  - b. All tangible (movable or immovable) and intangible property vested in the firm or the company, as the case may be, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the company, as the case may be, and the whole of the undertaking of the firm or the company, as the case may be, shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed.
  - c. The firm or the company, as the case may be, shall be deemed to be dissolved and removed from the records of the Registrar of Firms or Registrar of Companies, as the case may be.

**Foreign limited liability partnerships**

The Central Government may make rules for provisions in relation to establishment of place of business by foreign limited liability partnerships within India and carrying on their business therein by applying or incorporating, with such modifications, as appear appropriate, the provisions of the Companies Act, 1956 (I of 1956) or such regulatory mechanism with such composition as may be prescribed.

**Compromise, or arrangement of limited liability partnerships**

1. Where a compromise or arrangement is proposed—
  - a. Between a limited liability partnership and its creditors.
  - b. Between a limited liability partnership and its partners.
2. The Tribunal may, on the application of the limited liability partnership or of any creditor or partner of the limited liability partnership, or, in the case of a limited liability partnership which is being wound up, of the liquidator, order a meeting of the creditors or of the partners, as the case may be, to be called, held and conducted in such manner as may be prescribed or as the Tribunal directs.
3. If a majority representing three-fourths in value of the creditors, or partners, as the case may be, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Tribunal, by order be binding on all the creditors or all the partners, as the case may be, and also on the limited liability partnership, or in the case of a limited liability partnership which is being wound up, on the liquidator and contributories of the limited liability partnership; Provided that no order sanctioning any compromise or arrangement shall be made by the Tribunal unless the Tribunal is satisfied that the limited liability partnership or any other person by whom an application has been made under sub-section (1) has disclosed to the Tribunal, by affidavit or otherwise, all material facts relating to the limited liability partnership, including the latest financial position of the limited liability partnership and the pendency of any investigation proceedings in relation to the limited liability partnership.
4. An order made by the Tribunal under sub-section (2) shall be filed by the limited liability partnership with the Registrar within thirty days after making such an order and shall have effect only after it is so filed.
5. If default is made in complying with sub-section (3), the limited liability partnership, and every designated partner of the limited liability partnership shall be punishable with fine which may extend to one lakh rupees.
6. The Tribunal may, at any time after an application has been made to it under this section, stay the commencement or continuation of any suit or proceeding against the limited liability partnership on such terms as the Tribunal thinks fit, until the application is finally disposed of.

**Power of Tribunal to enforce compromise or arrangement**

1. Where the Tribunal makes an order under section 60 sanctioning a compromise or an arrangement in respect of a limited liability partnership, it—



- a. Shall have power to supervise the carrying out of the compromise or an arrangement; and
  - b. May, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement.
2. If the Tribunal aforesaid is satisfied that a compromise or an arrangement sanctioned under section 60 cannot be worked satisfactorily with or without modifications, it may, either on its own motion or on the application of any person interested in the affairs of the limited liability partnership, make an order for winding up the limited liability partnership, and such an order shall be deemed to be an order made under section 64 of this Act.

#### **Provisions for facilitating reconstruction or amalgamation of limited liability partnerships**

1. Where an application is made to the Tribunal under section 60 for sanctioning of a compromise or arrangement proposed between a limited liability partnership and any such persons as are mentioned in that section, and it is shown to the Tribunal that—
  - a. Compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of any limited liability partnership or limited liability partnerships, or the amalgamation of any two or more limited liability partnerships; and
  - b. Under the scheme the whole or any part of the undertaking, property or liabilities of any limited liability partnership concerned in the scheme (in this section referred to as a “transferor limited liability partnership”) is to be transferred to another limited liability partnership (in this section referred to as the “transferee limited liability partnership”), the Tribunal may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provisions for all or any of the following matters, namely:
    - The transfer to the transferee limited liability partnership of the whole or any part of the undertaking, property or liabilities of any transferor limited liability partnership;
    - The continuation by or against the transferee limited liability partnership of any legal proceedings pending by or against any transferor limited liability partnership;
    - The dissolution, without winding up, of any transferor limited liability partnership;
    - The provision to be made for any person who, within such time and in such manner as the tribunal directs, dissent from the compromise or arrangement; and
    - Such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out:

Provided that no compromise or arrangement proposed for the purposes of, or in connection with, a scheme for the amalgamation of a limited liability partnership, which is being wound up, with any other limited liability partnership or limited liability partnerships, shall be sanctioned by the Tribunal unless the Tribunal has received a report from the Registrar that the affairs of the limited liability partnership have not been conducted in a manner prejudicial to the interests of its partners or to public interest:

Provided further that no order for the dissolution of any transferor limited liability partnership under clause (iii) shall be made by the Tribunal unless the Official Liquidator has, on scrutiny of the books and papers of the limited liability partnership, made a report to the Tribunal that the affairs of the limited liability partnership have not been conducted in a manner prejudicial to the interests of its partners or to public interest.

2. Where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to and vest in, and those liabilities shall be transferred to and become the liabilities of, the transferee limited liability partnership; and in the case of any property, if the order so directs, freed from any charge which is, by virtue of the compromise or arrangement, to cease to have effect.
3. Within thirty days after the making of an order under this section, every limited liability partnership in relation to which the order is made shall cause a certified copy thereof to be filed with the Registrar for registration.
4. If default is made in complying with the provisions of sub-section (3), the limited liability partnership, every designated partner of the limited liability partnership shall be punishable with fine which may extend to fifty thousand rupees.

**Explanation.** —In this section “property” includes property, rights and powers of every description; and “liabilities” includes duties of every description.

## 5.19 WINDING UP, DISSOLUTION AND PENALTIES

### Winding up and dissolution

The winding up of a limited liability partnership may be either voluntary or by the Tribunal and limited liability partnership, so wound up may be dissolved.

### Circumstances in which limited liability partnership may be wound up by Tribunal

A limited liability partnership may be wound up by the Tribunal, —

- a. If the limited liability partnership decides that limited liability partnership be wound up by the Tribunal.
- b. If, for a period of more than six months, the number of partners of the limited liability partnership is reduced below two.
- c. If the limited liability partnership is unable to pay its debts.





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- d. If the limited liability partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order.
- e. If the limited liability partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years.
- f. If the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up.

#### Rules for winding up and dissolution

The Central Government may make rules for the provisions in relation to winding up and dissolution of limited liability partnerships.

#### Business transactions of partner with limited liability partnership

A partner may lend money to and transact other business with the limited liability partnership and has the same rights and obligations with respect to the loan or other transactions as a person who is not a partner.

#### Application of the provisions of the Companies Act

1. The Central Government may, by notification in the Official Gazette, direct that any of the provisions of the Companies Act, 1956 (1 of 1956) specified in the notification—
  - a. Shall apply to any limited liability partnership; or
  - b. Shall apply to any limited liability partnership with such exception, modification and adaptation, as may be specified, in the notification.
2. A copy of every notification proposed to be issued under sub-section (1) shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.

#### Electronic filing of documents

1. Any document required to be filed, recorded or registered under this Act may be filed, recorded or registered in such manner and subject to such conditions as may be prescribed.
2. A copy of or an extract from any document electronically filed with or submitted to the Registrar which is supplied or issued by the Registrar and certified through affixing digital signature as per the Information Technology Act, 2000 (21 of 2000) to be a true copy of or extract from such document shall, in any proceedings, be admissible in evidence as of equal validity with the original document.
3. Any information supplied by the Registrar that is certified by the Registrar through affixing digital signature to be a true extract from any document filed with or

submitted to the Registrar shall, in any proceedings, be admissible in evidence and be presumed, unless evidence to the contrary is adduced, to be a true extract from such document.

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### Payment of additional fee

Any document or return required to be filed or registered under this Act with the Registrar, if, is not filed or registered in time provided therein, may be filed or registered after that time up to a period of three hundred days from the date within which it should have been filed, on payment of additional fee of one hundred rupees for every day of such delay in addition to any fee as is payable for filing of such document or return: Provided that such document or return may, without prejudice to any other action or liability under this Act, also be filed after such period of three hundred days on payment of fee and additional fee specified in this section.

### Enhanced punishment

In case a limited liability partnership or any partner or designated partner of such j limited liability partnership commits any offence, the limited liability partnership or any partner or designated partner shall, for the second or subsequent offence, be i punishable with imprisonment as provided, but in case of offences for which fine is prescribed either along with or exclusive of imprisonment, with fine which shall be, twice the amount of fine for such offence. ;

### Application of other laws not barred

The provisions of this Act shall be in addition to, and not in derogation of, the! provisions of any other law for the time being in force.

### Jurisdiction of Tribunal and Appellate Tribunal

1. The Tribunal shall exercise such powers and perform such functions as arc, or may be, conferred on it by or under this Act or any other law for the time being in force.
2. Any person aggrieved by an order or decision of Tribunal may prefer an appeal to the Appellate Tribunal and the provisions of sections 10FQ, 10FZA, 106,10GD, IO GE and 10GF of the Companies Act. 1956 (1 of 1956) shall be applicable in j respect of such appeal.

### Penalties

#### Penalty on non-compliance of any order passed by Tribunal

Whoever fails to comply with any order made by the Tribunal under any provision of; this Act shall be punishable with imprisonment which may extend to six months and shall also be liable to a fine which shall not be less than fifty thousand rupees.

#### General penalties

Any person guilty of an offence under this Act for which no punishment is expressly provided shall be liable to a fine which may extend to five lakh rupees but which shall not be less than five thousand rupees and with a further fine which may extend to fifty rupees

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I or every day after the first day after which the default continues.

### **Power of Registrar to strike defunct limited liability partnership off register**

Where the Registrar has reasonable cause to believe that a limited liability partnership is not carrying on business or its operation, in accordance with the provisions of this Act, the name of limited liability partnership may be struck off the register of limited liability partnerships in such manner as may be prescribed: Provided that the Registrar shall, before striking off the name of any limited liability partnership under this section, give such limited liability partnership a reasonable opportunity of being heard.

### **Offences to limited liability partnerships**

Where an offence under this Act committed by a limited liability partnership is proved:

- a. To have been committed with the consent or connivance of a partner or partners or designated partner or designated partners of the limited liability partnership.
- b. To be attributable to any neglect on the part of the partner or partners or designated partner or designated partners of that limited liability partnership, the partner or partners or designated partner or designated partners of the limited liability partnership, as the case may be, as well as that limited liability partnership shall be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

## **5.20 CHAPTER SUMMARY**

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The Trade Marks Act, 1999, Copyright Act 1957 and Indian Patents Act, 1970 deal with the Intellectual property rights in India. Copyright protects original works of authorship, while a patent protects inventions or discoveries. A trademark protects words, phrases, symbols, or designs identifying the source of the goods or services of one party and distinguishing them from those of others.

The Trade Marks Act, 1999 came into effect on September 15, 2003. The object of this law is to protect the goodwill and reputation of a business from encroachment by dishonest competitors. A trade mark is a visual symbol in the form of a word, a device, or a label applied to articles of commerce with a view to indicate to the purchasing public that they are the goods manufactured or otherwise dealt in by a particular person as distinguished from similar goods manufactured or dealt in by other persons.

### **Functions of a trade mark**

- a. It identifies the product and its origin,
- b. It guarantees its unchanged quality,
- c. It advertises the product, and
- d. It creates an image for the product.

An office called the Trade Marks Registry has been established for the purpose of registration of trademarks, maintenance of the register.

A registered trademark will be infringed if the person in course of the trade, in relation to the same goods for which the mark is registered, uses without authority the same mark or deceptively similar mark. The Indian Copyright Act, 1957 governs the system of copyrights in India. I [Amended in 1982,1984, 1992,1994 & 1999]. Copyright is a right which Grants protection to the unique expression of Ideas. “The exclusive right given by law for a certain term of years to an author, composer etc. (or his assignee) to print, publish and sell copies of his original work”.

The owner of the copyright can assign his rights to a third party. Term of copyright is 50 years. A patent law is a government issued right granted to individuals or groups that protects their original inventions from being made, used, or sold by others without their permission for a set period of time. The term patent usually refers to a right granted to anyone who invents or discovers any new and useful process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereof.

#### Why one should go for a getting a patent?

- a. To enjoy the exclusive rights over the invention.
- b. The patent is to ensure commercial returns to the inventor for the time and money spend in
- c. Generating a new product.

#### What can be patented?

In order to be patentable, an invention must pass four tests;

1. The invention must fall into one of the five “statutory classes’: Processes, Machines Manufactures Compositions of matter, and New uses of any of the above
2. The invention must be “useful”
3. The invention must be “novel”
4. The invention must be “nonobvious’

There are certain inventions which cannot be patented. A patent application is a request pending at a patent office for the grant of a patent for the invention described and claimed by that application. A patent can be made by any person whether a citizen of India or not, claiming to be the time or first inventor of the invention or by his “assignee” or legal representative.

A patent holder gets Exclusive Marketing rights. Every patent shall have effect throughout India. In respect of an invention claiming process of manufacture of a substance intended to be used as food or medicine the term of patent is 5yrs from the date of sealing or 7yrs from the date of patent whichever is shorter. In case of any other invention the term of patent is 14 years from the date of patent. Before the start of the research and development project, one should scan the patent literature. In case of infringement the suit should be filed in a district court or High Court. Patent Act provides for penalties for different offences under the Act. India plays an active role in World Trade Organisation and World Intellectual Property Organisation.

## NOTES



The Indian Partnership Act and Limited Liability Partnership Act, 2008 are the two laws dealing with partnership firms. “Partnership” is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. A partnership firm is not a distinct legal entity. However, a partnership firm is legal entity for the purpose of Taxation. A firm can have Minimum 2 and Maximum 20 partners. A partner is the agent of the firm. Every partner has right to take part in the conduct of the business. Any act done by a partner on behalf of the firm which falls within his implied authority binds the firm. Registration of partnership is not compulsory. However, Registration brings certain advantages.

Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm. A minor may be admitted to the benefits of partnership. Change in partners may occur due to various reasons like death, retirement, admission of new member, expulsion, insolvency, transfer of interest by partner etc. After such change, the rights and liabilities of each partner are determined afresh. This is termed as reconstitution of a firm. Limited Liability Partnership Act, 2008 was enacted to make provisions for the formation and regulation of limited liability partnerships.

“Limited liability partnership agreement” means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership;

A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners. Any individual or body corporate may be a partner in a limited liability partnership. A limited liability partnership shall be capable of suing and being sued, acquiring, owning, holding and developing or disposing of property. Every limited liability partnership shall have “LLP” as the last words of its name.

A person may cease to be a partner of a limited liability partnership by giving a notice in writing of not less than thirty days to the other partners of his intention to resign. Every partner of a limited liability partnership is, for the purpose of the business of the limited liability partnership, the agent of the limited liability partnership, but not of other partners. A partner a limited liability partnership is not personally liable, directly or indirectly for an obligation.

The liability of the limited liability partnership and partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited. A contribution of a partner may consist of tangible, movable or immovable or intangible property or other benefit to the limited liability partnership, including money, promissory notes.

## 5.21 KEY WORDS

Copyright	It is the exclusive right given by law for a certain term of years to an author, composer to print, publish and sell copies of his original work
Trade Mark	A trade mark is a visual symbol in the form of a word, a device, or a label applied to articles of commerce.
Infringement	Unauthorized use of copyright or trade mark.
Patent	Right granted to individuals or groups that protects their original inventions from being made, used, or sold by others without their permission for a set period of time.
Firm	A collective name for the partners.
Partner	Person who has entered into partnership with another.
Partnership	The relation between persons who have agreed to share the profits of business earned on by all or any to them acting for all.
United liability partnership agreement	Any written agreement between the partners of the limited liability partnership which determines the mutual rights and duties of the partners and their rights and duties.
Limited liability partnership	A body corporate formed and incorporated under Limited liability partnership Act.

## 5.22 REVIEW QUESTIONS

### SHORT ANSWER TYPE QUESTIONS

1. State the important provisions of The Trade Marks Act, 1999.
2. State the meaning of Infringement of trademarks and remedies available.
3. State the Exclusive Marketing rights of a patent holder.
4. What is the procedure for Incorporation by registration of a Limited Liability Partnership?
5. What is the Relationship of partners under Limited liability partnership Act?

### LONG ANSWER TYPE QUESTIONS

1. State the meaning of Infringement of Copyright and remedies available.
2. What are the Important Amendments to Patent Act?
3. What is the procedure for Conversion of a partnership Firm into a Limited Liability Partnership?
4. What is the procedure for Winding up and dissolution of a Limited Liability Partnership?



5. What are the Penalties for various offences under Limited liability partnership Act?

### 5.23 MULTIPLE CHOICE QUESTIONS

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1. An \_\_\_\_\_ called the Trade Marks Registry has been established for the purpose of registration of trademarks, maintenance of the register.
  - a. Office
  - b. House
  - c. Hospital
  - d. Building
2. The Indian Copyright Act, \_\_\_\_\_ governs the system of copyrights in India.
  - a. 1956
  - b. 1957
  - c. 1958
  - d. 1959
3. Copyright is a right which Grants \_\_\_\_\_ to the unique expression of Ideas.
  - a. Secure
  - b. Commission
  - c. Save
  - d. Protection
4. India plays an \_\_\_\_\_ role in World Trade Organisation.
  - a. Active
  - b. Passive
  - c. Deactivate
  - d. All of the above
5. \_\_\_\_\_ plays an active World Intellectual Property Organisation.
  - a. Pakistan
  - b. India
  - c. Russia
  - d. America
6. When was the Atomic Energy Act introduced?
  - a. 1962
  - b. 1963
  - c. 1964
  - d. 1965

7. “Limited liability partnership agreement” means any written agreement between the \_\_\_\_\_ and its partners which determines the mutual rights and duties of the partners.
- Founders of the Limited liability partnership
  - Producers of the Limited liability partnership
  - Partners of the Limited liability partnership
  - None of the above
8. Every limited liability partnership shall have “LLP” as the \_\_\_\_\_ words of its name.
- Last
  - First
  - Middle
  - Both A and B
9. A partner is the \_\_\_\_\_ of the firm.
- Head
  - Agent
  - Both A and B
  - None of the above
10. A firm can have Minimum 2 and Maximum \_\_\_\_\_ partners.
- 20
  - 30
  - 40
  - 50

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NOTES





## ANSWER KEY

### UNIT I

QUES. NO.	ANSWERS	QUES. NO.	ANSWERS
1.	a.	6.	b.
2.	b.	7.	a.
3.	c.	8.	c.
4.	c.	9.	a.
5.	b.	10.	b.

### UNIT II

QUES. NO.	ANSWERS	QUES. NO.	ANSWERS
1.	a.	6.	d.
2.	b.	7.	b.
3.	b.	8.	a.
4.	c.	9.	d.
5.	a.	10.	b.

### UNIT III

QUES. NO.	ANSWERS	QUES. NO.	ANSWERS
1.	c.	6.	c.
2.	a.	7.	a.
3.	a.	8.	b.
4.	c.	9.	a.
5.	a.	10.	b.

### UNIT IV

QUES. NO.	ANSWERS	QUES. NO.	ANSWERS
1.	b.	6.	d.
2.	d.	7.	a.
3.	a.	8.	a.
4.	c.	9.	a.
5.	a.	10.	b.

### UNIT V

QUES. NO.	ANSWERS	QUES. NO.	ANSWERS
1.	a.	6.	c.
2.	b.	7.	b.
3.	d.	8.	c.
4.	c.	9.	a.
5.	c.	10.	b.

## References and Suggested Reading

### Books

1. Business Law: Text and Cases by Kenneth W. Clarkson, Roger LeRoy Miller, Frank B. Cross
2. International Business Law and Its Environment by Richard Schaffer, Filiberto Agusti, Lucien J. Dhooge
3. Business Law Basics: A Legal Handbook for Online Entrepreneurs and Startup Businesses by James Hart
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10. "The Anatomy of Corporate Law: A Comparative and Functional Approach" By Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann

### Internet Links

- a) [Meaning and Characteristics/Features of Company| Saloman vs. Saloman Case| Corporate Law|Company Law \(youtube.com\)](#)
- b) [Unit I | Corporate Law | Companies Act, 2013 | Meaning and Definition of a Company \(youtube.com\)](#)
- c) [Incorporation of a Company| Companies Act 2013| Formation & Incorporation of Company- CS Payal Popli \(youtube.com\)](#)
- d) [Incorporation of a Company Meaning & Role of Promoters Part One by Advocate Sanyog Vyas \(youtube.com\)](#)
- e) [Company Law Lecture-7 | Incorporation process of company section 7 \(youtube.com\)](#)

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1. Khurana, R., & Pick, K. (2005). The social nature of boards. *Brooklyn Law Review*, 70(3), 1259–1285.

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6. Salwen, K. G. (1992, February 14). Shareholder groups cheer SEC's moves on disclosure of executive compensation. *Wall Street Journal*, p. A-4.
7. Public Ownership and the WTO in a Post Covid-19 Era: From Trade Disputes To a 'Social' Function, 125 WEST VIRGINIA LAW REVIEW, Fall 2022, pp. 644 – 688.