UNIT III

THE INDIAN CONTRACT ACT, 1872 – INTRODUCTION

The word CONTRACT is common to all of us and virtually no business transactions can take place without any contracts. The Indian Contract Act, 1872, deals with various types of contracts entered into by various people and defines the extremely important aspects of business transactions relating to contracts. In business dealings offers for sale are made and accepted, consideration is agreed, and conditions of sale are specified. Disputes arise when an offer or acceptance is violated, consideration is unpaid, and conditions of transactions are violated.

The Indian Contract Act 1872 takes care of all these matters and provides remedies for all such disputes. Before enactment of The Indian Contract Act,1872 the courts in India used to apply English Common Laws as suited to Indian conditions, customs and usages. Some difficulties were noticed in using English Common Laws. Accordingly, later on the courts started deciding cases based on Hindu personal laws and Muslim personal laws. But the same were still not found fit to address the then business complexities. Accordingly, a separate The Indian Contract Act, 1872 was enacted. This Act is based on English Common Law which is to a large extent made up of judicial proceedings. Before 1930, the Act contained provisions relating to contract of sale of goods and partnership. Section 76 to 123 relating to Sale of Goods were deleted from the Indian Contract Act, 1872 and enacted in another act, The Sale of Goods Act, 1930. Similarly, section 239-266 relating to partnership were repealed in 1932 and separate act, The Indian Partnership Act, 1932 was passed. The Indian Contract Act,1872 is not an exhaustive Act as it does not cover all branches of the law of contract. There are other acts to deal with other types of contract like the Sale of Goods Act for Sales of Goods, Partnership Act for Partnership Contract, Transfer of Property Act for contract relating to Sale of Immovable Property, etc. Again, it does not deal with all types of agreements, it deals with only those agreements which are enforceable by law or which give rise to legal consequences.

Social agreements wherein the parties do not intend to create legal obligations to be enforceable by law, like promise to attend marriage ceremony, promise to throw dinner etc are outside the ambit of the Indian Contract Act, 1872.

NATURE OF CONTRACT AND ESSENTIALS OF VALID CONTRACT

Definition of contract

Section 2(h) of the Act defines the term contract as an agreement between two or more parties enforceable by law. This definition of contract is influenced by the definition of contract given by Pollock who define contract as "Every agreement and promise enforceable at law is a contract" Another definition of Contract given by Salmond is "contract is an agreement creating and defining obligations between the parties."

From the above analysis of the definition of contract, it is clear that contract is based on enforceability of an agreement. So, agreement and its enforceability are two essential components of a contract. If either of these two is missing there is no contract.

Will all agreements give rise to a contract?

An agreement to become a contract must give rise to a legal obligation. Agreement can be social obligation or legal obligation.

An agreement giving rise to social obligation is not a contract. That is why it is said that the term agreement is a wide term it includes both social and legal obligations but only those agreements which the parties intend to enforce legally culminates into contract.

An agreement is regarded as a contract when it is enforceable by law.

Legal obligations arise to make an agreement, a contract. It means that an agreement must give rise to legal obligations. There must be an intention to create legal obligation. In case of agreement regulating business relation it is assumed that the parties intended legal consequences. Thus,

Agreement = Offer + Acceptance

Contract = Agreement+Enforceability at Law

Essential Elements of a Valid Contract

(i) **Agreement:** In order to constitute a contract, there must be an agreement in first place. An agreement in turn is composed of two elements-offer and acceptance. Thus, there must be at least two parties-one making the offer and another accepting it. The terms of offer must be definite and the acceptance must be absolute and unconditional.

(ii) **Free Consent:** According to Sec 14, 'Consent is said to be free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake. If consent is not free, then no valid contract comes into existence.

(iii) **Lawful consideration:** The agreement must be supported by a lawful consideration. Consideration means 'something in return'. 'Something in return' may be an act or abstinence. But it must be real and lawful.

(iv) **Parties are competent**: The parties to an agreement must be capable of entering into a contract. A person is considered competent if he is (a) eighteen years of age (b) of sound mind (c) not disqualified from contracting by any law to which he is subject. Existence of free consent implies the consent of the parties must be free and genuine i.e. not induced by coercion, undue influence, fraud or misrepresentation.

(v) **Legality of object**: There must be legality of object and consideration failing which it will not be a valid contract. This will be discussed in detail subsequently.

(vi) **The parties must intend to create a legal relationship**. Agreements of social or domestic nature do not contemplate legal relationship, so they are not contracts. Example: A husband promising his wife to buy her a 'necklace' on occasion of her birthday is not a contract.

(vii) **The agreement not expressly declared void or illegal by law.**

(viii) **The terms of agreement must be certain and capable of performance**. Example: D agrees to sell C garments. The type, quality, value etc are not discussed. The agreement cannot be enforced as terms are uncertain. Similarly, if A promises B to bring rainfall through magic. Such agreement cannot be enforced.

(ix) **Legal formalities**: Where nature of agreement is such that it requires compliance of certain formalities, such requirements should be fulfilled. A contract may require registration in addition of being in writing. However as regards to legal effects, an oral contract has same effect as a contract in writing.

Classification of Contract:

Contracts can be classified in terms of their enforceability or form or extent of performance.

Based on Enforceability

(i) **Valid Contract**: An agreement enforceable by law is a valid contract. In other words, it satisfies all the requirements of a valid contract as laid down in section 10. If any of the essential requirements is missing it becomes a void contract.

(ii) **Void agreement:** An agreement not enforceable by law is said to be void. A void agreement has no legal consequences. A void agreement is void from the very beginning; it is null from the very beginning.

(iii) **Voidable contract**: An agreement which is enforceable at the option of one or more parties thereto but not at the option of other or others is a voidable contract. **Example:** A threatens to shoot B if he does not sell his goods to him at the price offered by A. B agrees to sell the same. This contract is voidable at the option of B.

(iv) **Void contract:** A Contract which ceases to be enforceable by law becomes void when it ceases to be so enforceable. Void agreement and void contract are different. Void agreement is void ab-initio but void contract is a valid contract at the beginning but subsequently becomes void when it ceases to be enforceable.

(v) **Unenforceable contracts:** These are the contracts which cannot be enforced in a court of law because of some technical defects, these contracts become fully enforceable if the technical defects are removed. According to Sir William Anson 'an unenforceable contract is one which is good in substance through by reasons of some technical defect; one or both of the parties cannot be sued on it. **For example,** a contract may be good, but incapable of enforceable because it is not evidenced by writing as required by statute. The defect may be curable e.g. the subsequent execution of written agreement may satisfy the requirements of the law and render the contract enforceable.

(vi) **Illegal agreement**: An illegal agreement is destitute of any legal effect from the very beginning. All illegal agreements are void agreements but all void agreements are not illegal. According to section 23 an agreement is illegal or unlawful if its object or consideration (a) is forbidden by law or (b) is of such nature that if permitted would defeat the provision of law or (c) is fraudulent or (d) involves or implies injury to the person or property of another or (e) the court regards it as immoral or opposed to public policy. **Example:** Sale of smuggled goods is illegal so an agreement to sell smuggled goods is an illegal agreement. As an illegal agreement is one which is against a law in force in India. It is also void-An agreement to commit robbery, murder, smuggling etc are illegal agreements.

Based on method of formation

(i) **Formal contracts:** This term is usually found in English laws. Validity of these contracts depends upon their form. They are valid even if they lack consideration. These contracts are of two types; Contract under seal and Contract of Records. Contract under seal are in writing and signed by the parties to them. Contract of Records includes the court judgments and recognizance; obligations in such cases arise out of judgment and not under **the contract.**

(ii) **Simple** Contract: All contracts other than formal are called simple contracts or parole contracts

Based on extent of performance

(i) Executed contracts: An executed contract is one which has been totally completed by both the parties. An agrees to supply some goods to B and B agreed to pay for the price thereof. A supplied the goods and B paid the price. This is an executed contract as both the parties have fulfilled their contractual obligations.

(ii) Executory contracts: It is a contract which is wholly unperformed. If one party has performed his part of obligation but the other party has not yet completed his obligation on the contract, the contract still remains executory contract. Example: A agree to sell some goods to B and B agrees to pay after ten days. A delivered the goods but is yet to pay the price. This is an executor contract as one party has performed his obligations whereas other party is yet to perform its part of obligation.

(D) Based on Obligation.

(i) Unilateral contract: Under this type of contract there is an obligation only on the part of only one party when the contract is concluded.

(ii) Bilateral Contract: Here there is an obligation on both the parties to the contract.

(iii) Multilateral Agreements/Contract: Contract or agreement need not be confined to two parties, it may spread over to more than two parties each not only bind itself to other parties but also bind other parties to itself. If three parties are involved in the contract it is known as tri-parties' agreement. When more than three parties are involved in an agreement it is called Multilateral Agreement. Most-commonly such Multi-lateral

agreements assume international character and are entered into between sovereign Governments.

(E) On the basis of mode of creation:

Express contract: According to section 9, in so far as the proposal or acceptance of any promise is made in words, the promise is said to be express. Therefore, the contracts entered into between the parties by words spoken or written are known as express contracts.

Example: A send a letter to B offering to sell his car to him for ` 50,000. B by written letter conveyed his acceptance of the offer. This is an express contract.

Implied or inferred contract: As per section 9, in so far, such proposal or acceptance is made otherwise than in words, the promise is said to be implied. Thus, the contracts which are made by an act or conduct of the parties and not by words are termed as implied contract. **Example:** When a person enters DMRC Metro station there is an implied offer and acceptance thereof between DMRC and the commuter once he enters the platform. This is a case of implied or inferred contract.

E-contract: This is a kind of contract formed in the course of E-commerce by interaction of two or more person competent to contract using electronic means, such as e-mail. This involves interaction of an individual with an electronic agent, such as computer program or interaction of at least two electronic agents that are programmed in such a way to generate contract. This contract is conceptually akin to the traditional paper contract and requires all the essential requirements of a valid contract like free consent, capacity of the parties, consideration and legality of objects and consideration.

OFFER

INTRODUCTION

A proposal is defined as, 'when one person signifies to another his willingness to do or abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal.'[Sec 2(a)]

The term proposal used in the Indian Contract Act is like the term "offer" used in English laws. The person making proposal or offer is called the promisor or offeror and the person to whom offer is made is called the offeree and the person accepting the offer is called the promisee or acceptor. An offer may be made either by words or by conduct. An offer, which is made by words, is called express offer and the one, which is inferred from the conduct of a person or the circumstances of the case, is called an implied offer.

An example of implied offer is "Delhi Metro Rail running Metro Rail on different routes to carry passengers at the scheduled tariff rates. This is a case of implied offer by DMRC and once a person board in the DMRC train he is said to have accepted the offer by his act/conduct."

Similarly, an offer is different from an invitation to offer.

In the case of invitation to offer the person sending out invitation does not make an offer but only invites the other parties to make an offer. An advertisement for sale of goods by auction, quotations,

catalogues of prices or display of goods at show room with price tag etc is invitation of offer rather than offer.

The main difference between an offer and an invitation to offer is that in the case of former there should be expression of willingness to do or to abstain from doing with a view to obtaining the assent of the other party, while in the later one, the party without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, he only invites the other party to make an offer on those terms. As already stated above in the preceeding para the display of goods in a shop window is not an offer to sell but simply an invitation to treat. The person who responds to the invitation to offer makes the offer which may or may not be accepted by the person inviting the offer. Invitation to offer also occurs for instance when tenders are invited, Advertisement for tender is merely an invitation to offer. The tender constitutes the offer which can be accepted or rejected. Simply putting goods up for auction, catalogue of goods, a prospectus of a company, invitation for jobs, invitation for public subscription etc are merely invitation to treat and not an offer.

Offer can be specific or general. An offer is said to be specific when it is addressed to a definite person or persons. Such offer can be accepted only by the person or persons to whom it is made. A general offer on the other hand is addressed to public in large and may be accepted by anybody fulfilling the terms and conditions.

Legal Rules for a Valid Offer:

1. **Offer must be made with an intention to create legal obligations;** an offer must give rise to legal relationship; if it does not create legal obligations it is not a valid offer.
2. **Offer can be expressed or implied:** an offer which is made in words written or spoken is called an express offer and an offer which is made by an act or conduct of the offerer is called an implied offer. As per section 9 "in so far as the proposal or acceptance of any promise is made in words, the promise is said to be express.
3. **The terms of offer must be definite and must not be vague.** All the terms and conditions of the offer must be definite and certain at the time of making offer. Therefore, an agreement to agree in future is not a valid offer due to uncertainty of terms.
4. **Silence cannot be prescribed as a mode of acceptance.** An offeree cannot put silence as a mode of acceptance as, if nothing is heard from the other party by a given time the offer will be deemed to have been accepted.
5. **If no time is fixed by the offeror within which the offer is to be accepted,** the offer does not remain open for an indefinite period. Where no time is specified, then the offer is to be accepted within a reasonable time. What is a reasonable time being a question of fact and would depend upon the circumstances of each case.
6. **Two identical cross offers do not result into a contract**: When two persons make identical offer in gross ignorance of offer of other party, there is no contract due to lack of acceptance on the part of either party.
7. **Offer may be general or specific:**
8. **Offer must be expression of willingness to do something or abstain from doing something;** it can be willing to do some positive thing or willingness to abstain from doing something in which it is called negative.

9. **Offer is different from invitation of offer**
10. **Communication of special terms and conditions:** Special terms and conditions attached to an offer must also be communicated to make the acceptor bound by them. The courts have laid down the following rules in this regard.

    (a) There must be reasonable notice of the special terms and conditions.

    (b) The notice of communication must be contemporaneous with the contract.

    (c) Unreasonable or illegal terms are excluded from the contract.

    (d) An exemption or exclusion clause or a similar provision in a contract should be construed as not applying to a situation created by a fundamental breach of contract because in a standard form of contract exemption clauses are generally laid down in extravagantly wide terms.

Acceptance of Offer

Once an offer has been made, it has to be accepted to make a valid contract.

Section 2(b) defines acceptance as "When the person to whom an offer is made signifies his assent thereto the proposal is said to be accepted, A proposal when accepted becomes a promise."

An offer can be accepted by only the person or persons for whom the offer is intended. An offer made to a particular person can only be accepted by him alone, on the other hand an offer made to a class of persons can be accepted by any member of that class of persons. An offer made to the world at large can be accepted by any person whatsoever.

What are essential elements of a valid acceptance?

1. **Acceptance must be absolute and unqualified; it must conform to the offer.** As per section 7 in order to convert a proposal into a promise, the acceptance must—**Be absolute and unqualified;** if the parties are not *ad idem* on all matters concerning the offer and acceptance, there is no contract.
2. **An invitation with variation is no acceptance**, it is simply a counter proposal, which must be accepted by the original proposer before any contract is made. A counter offer puts an end to the original offer and cannot be revived by subsequent acceptance unless it is renewed.
3. **Be expressed in some usual and reasonable manner,** unless the proposal prescribes the manner in which it is to be accepted. If the proposal prescribes a manner in which it is to be accepted, and the acceptance is not made in such a manner, the proposer may, within a reasonable time after the acceptance is communicated to him, insist that his proposal shall

be accepted in the prescribed manner, and not otherwise; but if he fails to do so, he accepts the acceptance.

4. **Specific offer can be accepted by the person to whom it is made**, whereas general offer can be accepted by anyone competent to contract and meeting the conditions of offer.
5. **Acceptance may be express or implied:** As per section 9 in so far as the proposal or acceptance of any promise is made in words, the promise is said to be express. In so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied. It can be inferred from the conduct of the parties. When a person boards in Metro Rail it is an implied acceptance.
6. **Acceptance should be of the whole proposal and not in part;** Acceptor should accept the whole proposal in total and not in parts. Part acceptance is no acceptance binding upon the proposer.
7. **Acceptance should be according to the mode prescribed or usual and reasonable mode;** acceptor cannot accept the proposal in a manner different from the manner prescribed in the offer. If no such mode is prescribed it should be usual and reasonable mode. Silence cannot be a mode of acceptance.
8. **Communication of acceptance is must;** a mental determination to accept unaccompanied by any external indication will not be sufficient acceptance. To constitute an acceptance such acceptance must be communicated to the offeror or his authorized agent.

CONSIDERATION

One of the essential elements of a contract is consideration. Consideration means something in return. When someone promises to do or not to do something for somebody else he also in turn needs some reciprocal gesture from other party in return which in common parlance we mean consideration. It may be either some benefit conferred on one party or some detriment suffered by other. It may be an act or abstinence or promise. For Example, if A agrees to sell goods to B for a price of ` 20,000/-, the amount is the consideration for A for parting with the goods similarly the consideration for B to pay ` 20,000 is goods sold by A.

Section 25 of the Indian Contract Act provides that "An agreement made without consideration is void" thus consideration is life blood of a valid contract. According to Salmond and Winfield "A promise without consideration is a gift, one made for consideration is a bargain."

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

An agreement without consideration is not enforceable and therefore is void. The reason why law enforces only those promises which are made for consideration is that *gratuitous* or voluntary promises are often made rashly and without due deliberation. To prevent the parties seeking legal recourse for dispute arising due to non-fulfillment of such rash contractual obligations which lack consideration, it is essential to put consideration as once of the essential element in order to be construed as a binding contract.

Legal Rules Regarding Consideration:

1. **It must move at the desire of the promisor.** Any act or abstinence at the desire of third party is not consideration. If the act is not at the desire of the promisor it will not be a good consideration.
2. **It may move from the promisee or any other person.** Even a stranger under the Indian Law may furnish consideration.
3. **Consideration must be something of value.** Consideration must be something of some value in the eyes of law. consideration shall be something which not only the parties regard but the law also regards as having some value.
4. **It must be real and not illusory.** If the consideration of some value in the eyes of law the court will not enquire whether it was equivalent to the promise which the party gave in return.
5. **It may be an act, abstinence or forbearance or a return promise.** An act i.e. doing of something is an affirmation of doing something is a positive consideration and is good enough to support any promise.
6. **It may be past, present or future which the promisor** is already not bound to do. **Past consideration**: When consideration for the present promise was given in the past, it is said to be a past consideration. **Present consideration**: When consideration is given simultaneously with promise, at the time of promise, it is said to be a present consideration.

Future or executor consideration: When consideration from one party to another is to pass sometime in future it is said to be future consideration.

7. **It must not be unlawful-**The consideration or object of an agreement is lawful, unless— It is forbidden by law; or is of such a nature that, if permitted, it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another; or the Court regards it as immoral, or opposed to public policy. This is discussed in detail under 'Legality of Object and Consideration'.
8. **Consideration need not be adequate:** As we have already discussed above that consideration is something in return. That something in return being offered need not be adequate only condition to be satisfied is that it must be something having some real value. So long as consideration exists, the courts are not bound to go into its adequacy or otherwise. The issue of adequacy or otherwise arises when it is alleged that the consent of one of the party to the contract was not free, only in such cases the courts may look into the adequacy or inadequacy of consideration.
9. **It must not be opposed to public policy:** The consideration should not only be real but also not be opposed to public policy. Where the consideration flowing from one of the party to the agreement is unlawful the court will not allow any action on such agreements.
10. **Pre-existing obligations:** Consideration must be something more than what the promisee is already bound to do by contract or by law. But doing or agreeing to do more than one's legal or official duty will serve as a consideration. However, it may be noted that pre-existing contract with a promisor can be no consideration for promise.

No Consideration (Section 25)-Exceptions

The general rule is **ex-nudo pacto non oritur** action i.e. an agreement made without consideration is void. For example, if A promises to pay B ` 1000 without any obligation from B. This is a void agreement for want of consideration. However, the Act itself provides exceptions to this rule in section 25 itself. As per section 25, an agreement made without consideration is not void in the following circumstances:

1. **Agreement without consideration void, unless it is in writing and registered:** If an agreement 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, it is valid despite being void of consideration. The expression the parties standing in near relation to each other means the parties are related to each other by blood relations. Nearness of relations does not always mean natural love and affection

2. **Or is a promise to compensate for something done:** If it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do, it is a good agreement despite no consideration from other party.
3. **Or is a promise to pay a debt barred by limitation law:** If it is a promise, made in writing and signed by the person to be charged therewith, or by his agent generally or specially authorized in that behalf, to pay wholly or in part a debt of which the creditor might have enforced payment but for the law for the limitation of suits.
4. **Gift actually made:** Explanation 1 to section 25 provides that absence of consideration does not affect the validity of any gift between donor and done if actually made.
5. **Creation of agency:** Section 185 of the Act provides that no consideration is required to create Agency.
6. **Charitable subscription:** No consideration is required where promise is for some charitable purpose.

CAPACITY TO CONTRACT

Who are Competent to Contract? (Section 11)

One of the essentials of a valid contract is the competency of the parties to make contract. Law has laid down certain rules as to who are competent to enter into a valid 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.

From the above provisions of the section it means the following types of persons are not competent to contract:

(a) A person who has not attained the age of majority, i.e. minor.

(b) A person of unsound mind

(c) A person who is disqualified from contracting by some law.

POSITION OF MINOR

As per section 3 of the Indian Majority Act of 1875, every person in India is a minor if he has not attained the age of 18 years of age. However, in case of a minor of whose person or property or both a guardian has been appointed under the Guardian and Wards Act, 1890 or whose property is under the superintendence of any court of wards before he attains 18 years of age is 21 years.

The position of Minor's agreement and effect thereof is as under:

1. An agreement with a minor is void ab-initio.
2. The law of estoppels does not apply against a minor. *It means a minor can always his plead his minority despite earlier misrepresenting to be a major.* In other words, he cannot be held liable on an agreement on the ground that since earlier he had asserted that he had attained majority.
3. Doctrine of Restitution does not apply against a minor. In India the rules of restitution by minor are similar to those found in English laws. The scope of restitution of contract by minor was examined by the privy council in Mohiri Bibi case when it has held that the restitution of money under section 64 of the Indian Contract Act cannot be granted under section 65 because a minor's agreement is not voidable but absolutely void ab-initio.
4. No Ratification on Attaining Majority. Ratification means approval or confirmation. A minor cannot confirm an agreement made by him during minority on attaining majority. If he wants to ratify the agreement, a fresh agreement and fresh consideration for the new agreement is required.
5. Contract beneficial to Minor: A minor is entitled to enforce a contract which is of some benefit to him. Minority is a personal privilege and a minor can take advantage of it and bind other parties.
6. Minor as an agent: A minor can be appointed an agent, but he is not personally liable for any of his acts.
7. Minor's liability for necessities. If somebody has supplied a minor or his dependents with necessities, minor's property is liable but a minor cannot be held personally liable
8. A minor cannot be adjudged insolvent as he is incapable of entering into a contract.

9. Where a minor and an adult jointly enter into an agreement with another person the minor is not liable and the contract can be enforced against the major person.
10. Liability for tort: A tort means a civil wrong other than a breach of contract and is redressible by an action for unliquidated damages. A minor is generally liable in tort but he cannot be made liable for what was a truth in a breach of contract.
11. Position of Minor's Guardian: An agreement entered into by the guardian of a minor on his behalf stands on a different footing from an agreement entered into by the minor himself. An agreement with a minor is void but an agreement by his guardian on his behalf is valid provided the obligations undertaken are within the powers of the guardian. The powers of a guardian are determined by the personnel law of the minor and by the Guardian and Wards Act. An agreement made by the guardian is binding on the minor if it is for the benefit of the minor or is for legal necessity.
12. Minor as a shareholder: A minor cannot apply for public subscription of a company's share and hence cannot become a member or shareholder. If his name by mistake has been recorded as a member of a company he can rescind the transaction and get his name removed from the register of members. But where a minor was made member of a company after attaining the age of majority and he received and accepted dividends, he will be stopped from denying that he is a member.

What is a Sound Mind for the Purposes of Contracting? (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.

A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind.

A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

Other Disqualified Persons:

The persons who are disqualified from entering into contract due to certain other reasons may be from

legal status, political status or corporate status. Some of such categories of persons are given below:

(a) Alien Enemy: An agreement with an Alien Enemy is void. But agreement with an Alien friend is perfectly valid and enforceable. When the Government of an Alien is at war with the Government of India, the alien is called Alien enemy who cannot enter into any contract with any Indian citizen without the permission of Government of India as the same is against the public policy. Contract entered into with an alien before war is put into suspension during the duration of war.

(b) Foreign Sovereign and Ambassadors: Foreign sovereigns and their representatives enjoy certain privileges and immunities in every country. They cannot enter into contract except through their agents residing in India. They can sue the Indian citizen but an Indian citizen cannot sue them.

(c) Convicts: A convict cannot enter into a contract while he is undergoing imprisonment.

(d) Insolvents: An insolvent person is one who is unable to discharge his liabilities and therefore has applied for being adjudged insolvent or such proceedings have been initiated by any of his creditors. An insolvent person cannot enter into any contract relating to his property.

(e) Company or Statutory bodies: A contract entered into by a corporate body or statutory body will be valid only to the extent it is within its Memorandum of Association.

FREE CONSENT

According to section 10 consensus ad idem or identify of mind is an essential requirement of a valid contract. One of the essential elements of a valid contract is that there should be free consent of the concerned parties to the contract. **'Two or more persons are said to consent when they agree upon the same thing in the same sense.'** [See 13]. If the parties have not agreed upon the same thing in the same sense there is no real consent and hence no contract is formed.

If the parties have not agreed upon the same thing in the same sense there is no real consent and hence no contract is formed. According to Pollock and Mulla the expression "the same things" means "the whole content of the agreement, whether it consists, wholly or in part or

Delivery of material objects or payment or other executed acts of promises" For formation of a contract parties must agree upon the same things in the same sense, there must be real consent. If there is no real consent the contract does not come into existence. When there is no consent at all, Salmond describes it as 'Error in Consensus" However, in certain cases there is real consent but once the parties have given his consent, not out of his free will but due to factors in the absence of which he might not have given his consent, consent so given is said to be not free.

As per section 14 of the Contract act consent is said to be free when it is not caused by—

(1) Coercion (Sec 15), or

(2) Undue influence (Sec 16), or

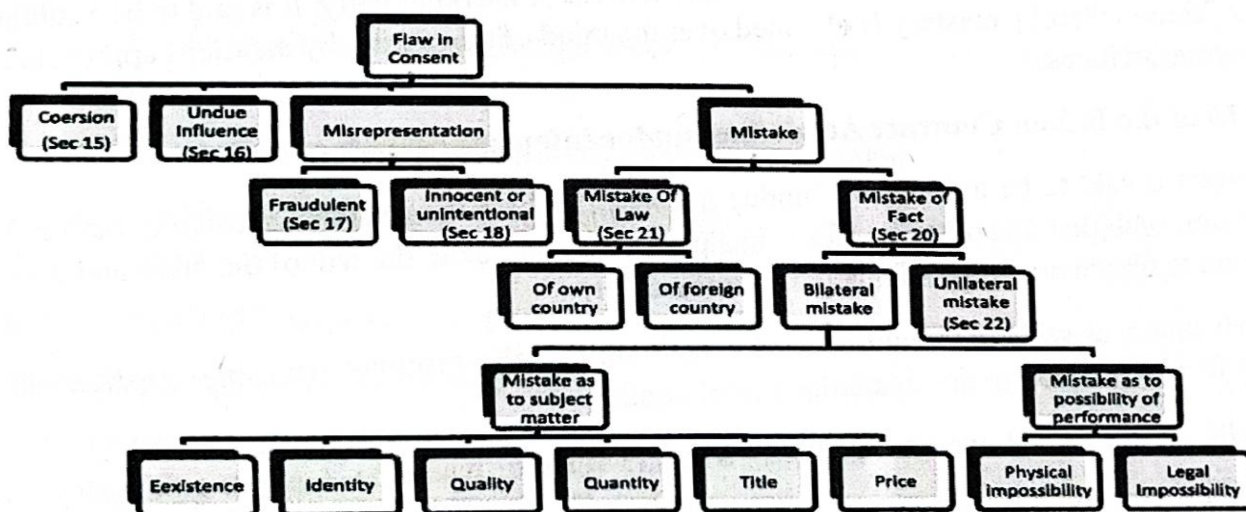
(3) Fraud (Sec 17), or

(4) Misrepresentation (Sec 18), or

(5) Mistake, subject to provisions of Sec 20, 21 and 22.

Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake.

Figure 1 Free consent



Coercion [Sec 15]

The term coercion has been defined in section 15 of the Act as "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.

Explanation: It is immaterial whether the Indian Penal Code (45 of 1860) is or is not in force in the place where the coercion is employed.

From the above definition of coercion given in section 15, consent is said to be caused by coercion

when it is obtained by any one of the following;

(i) committing or threatening to commit any act forbidden by Indian Penal Code;

(ii) unlawful detaining or threatening to detain the property of another person.

Coercion may come from a person party to the contract or even third person not connected with the contract directly.

Unlawful detaining also amounts to coercion: If a person unlawfully detains or give a threat to detain any property to the prejudice of any person whatever with the intention of causing any person to enter into an agreement amount to coercion.

Effect of coercion:

According to section 19 when the consent is caused by coercion, fraud, misrepresentation, the agreement is avoidable at the option of the party whose consent was so caused. The aggrieved party may opt to rescind the contract. If the aggrieved party seeks to rescind the contract he must restore the benefit so obtained under the contract from other party.

Undue Influence [See 16]

Undue influence is another way of causing forced consent of the other party. It is said to be a subtle species of fraud whereby mastery is obtained over the mind of the victim, by insidious approaches and seductive artifices.

Section 16 of the Indian Contract Act defines undue influence as under:

(i) 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.

(ii) In particular and without prejudice to the generality of the forgoing principle, 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.

(iii) Where a person, who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other

Nothing in this sub-section shall affect the provisions of section 111 of the Indian Evidence Act, 1872

(1 of 1872). There is presumption of undue influence in the following relationships:

(i) Parent and child

(ii) Guardian and ward

(iii) Doctor and patient

(iv) Solicitor and client

(v) Trustee and beneficiary

(vi) Religious advisor and disciple

(vii) Fiancé and fiancée

There is however no presumption of undue influence in case of relationship of— (i) landlord and tenant

(ii) debtor and creditor (iii) husband and wife. The wife has to be *pardanashin* for such presumption. In these relationships undue influence has to be proved.

Going through the definition of undue influence in section 16 we find that two elements are found in undue influence:

(i) The relationship subsisting between the parties is such that one is in a position to dominate the will of other and

(ii) He uses that position to obtain an unfair advantage over the other.

The person intending to avoid the contract on the ground of undue influence must prove both the above two elements.

Effect of undue influence: Section 19 A provides that when the consent is caused by undue influence, the agreement is avoidable at the option of the party whose consent was so caused. The aggrieved party may opt to rescind the contract. If the aggrieved party seeks to rescind the contract he must restore the benefit so obtained under the contract from other party, upon such terms and conditions as to the court may seem just.

Fraud [See 17]

Fraud is an intentional misrepresentation of a material fact which induces the other party to enter into a contract. This happens when one person makes misrepresentation of material facts known to him to be untrue or made with reckless indifference as to whether it is true or false with the intention of causing other party to enter into a contract relying upon the same.

In the words of Lord Herschell in the case of *Derry v Peek(1889)14 Ac 337* fraud is a false statement made knowingly or without belief in its truth or recklessly whether it is true or false.

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

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

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

(iii) A promise made without any intention of performing it;

(iv) Any other act fitted to deceive;

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

As evident from the above statutory definition of the term fraud, the following are essential elements of a fraud.

(a) The act must have been committed by a party to the contract or with his connivance or by his agent. The fraud committed by a stranger to contract does not vitiate the contract.

(b) The act constituting fraud must have been committed with the intention to deceive the other party.

(c) The act must have induced the other party to enter into a contract.

(d) The other party must have acted upon the statement and have suffered damages or loss.

(e) The act constituting fraud must be either of the following:

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

(ii) Active concealment of facts one having knowledge or belief of fact.

(iii) A promise made without intention of performing it.

(iv) Any other act fitted to deceive.

(v) Any other act or omission as the law specially declares to be fraud.

Effect of Fraud: According to 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.

A party to a contract, whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been, if the representations made had been true.

Misrepresentation

A statement of fact which one party makes in the course of negotiation with a view to inducing the other party to enter into a contract is known as misrepresentation. It must relate to some fact which is material to the contract. It may be expressed by words spoken or written or implied from the acts and conduct of the parties.

A representation when wrongly made either innocently or intentionally is a misrepresentation. When it is made innocently or unintentionally it is misrepresentation and when made intentionally or willfully it is fraud.

Misrepresentation has been defined in **section 18** of the Act as under:

"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 anyone 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.

Effect of Misrepresentation:

As per section 19 when consent to an agreement is caused by misrepresentation, the agreement is a contract avoidable at the option of the party whose consent was so caused. A party to a contract, whose consent was caused by misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been, if the representations made had been true.

Mistake

Mistake means an erroneous belief about something. It has not been defined in the Indian Contract Act.

Mistake can be -

(A) Mistake of law, or

(B) Mistake of fact

(A) Mistake of law: maybe (i) mistake of law of the country(ii) mistake of law of a foreign country

(i) Mistake of law of the country: When a party enters into a contract, without the knowledge of law in the country, the contract is affected by such mistake but it is not void. A contract is not voidable because it was caused by a mistake as to any law in force in India. The reason here is that ignorance of law is not an excuse at all. However, if a party is *induced* to enter into a contract by the mistake of law then such a contract may be avoided.

(ii) Mistake of law of foreign country: Such a mistake is treated as mistake of fact and agreement is such case is void.

(B) Mistake of fact: maybe(I)a bilateral mistake, or(II)unilateral mistake

(I) Bilateral mistake

Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void.

(a) Mistake must be mutual: Both the parties must misunderstand each other and should be at cross purpose

(b) Mistake must relate to a matter of fact essential to the agreement: What is essential fact of an agreement depends upon the nature of promise in each case.

The various types of mistakes falling under bilateral mistakes are as under:

(i) Mistake as to subject matter covers following cases:

(a) Mistake as to ***existence*** of subject matter: If both the parties are at mutual mistake as to existence of the subject matter the agreement is void.

(b) Mistake as to ***identity*** of subject matter: It usually happens when both the parties have different subject matter of contract in their mind. The contract is void due to mistake of identify of subject matter.

(c) Mistake as to the ***quality*** of the subject matter: If the subject matter is something essentially different from what the parties thought to be, the agreement is void.

(d) Mistake as to ***quantity*** of subject matter: Bilateral mistake as to quantity of subject matter would render the contract void.

e) Mistake as to ***title*** of subject matter: The agreement is void due to bilateral mistake as to title of the subject matter

(f) Mistake as to ***price*** of the subject matter: Mutual mistake as to price of the subject matter would render the agreement void.

ii) Mistake as to possibility of performance of Contract. Impossibility may be:

(a) Physical impossibility: A contract is void if it is identified to be non-feasible due to physical factors, like time, distance, height, etc.

(b) Legal impossibility: A contract is void if it provides that something shall be done which as a matter of law cannot be done.

(II) Unilateral Mistake as to fact:

As per section 22 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. A unilateral mistake is not allowed as a defense in avoiding a contract unless the mistakes brought about by another party's fraud or misrepresentation.

Legality of Object

In order to make a valid contract in addition to various other conditions like free consent, competency of parties and existence of consideration other important requirement is legality of objects and considerations. For the validity of a contract the object as well consideration must be lawful.

Section 23 declares that the object and consideration of an agreement is not lawful in certain cases.

What considerations and objects are lawful and what are not lawful are provided in section 23 of the Act. As per section 23 the consideration or object of an agreement is lawful, unless: it is forbidden by law; or is of such a nature that, if permitted, it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another or; the Court regards it as immoral, or opposed to public policy. In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void.

From **section 23** it is evident that the consideration or object of an agreement is unlawful:

(a) If it is forbidden by law: An act is forbidden by law when it is punishable by the criminal law of the country or when it is prohibited by special legislation or regulations made by a competent authority;
(b) If it is of such a nature that, if permitted would defeat the provision of any law.
(c) If it is fraudulent: An agreement made for fraudulent purpose is void
(d) If it involves or implies injury to the person or property of another person.
(e) If the court regards it as immoral: An agreement between husband and wife for future separation is immoral hence void.
(f) Where the court regards it opposed to public policy

An agreement is unlawful for immorality in the following cases:

UNIT IV: COMPANY LAW

Introduction

Industrial has revolution led to the emergence of large scale business organizations. These organization require big investments and the risk involved is very high. Limited resources and unlimited liability of partners are two important limitations of partnerships of partnerships in undertaking big business. Joint Stock Company form of business organization has become extremely popular as it provides a solution to overcome the limitations of partnership business. The Multinational companies like Coca-Cola and, General Motors have their investors and customers spread throughout the world. The giant Indian Companies may include the names like Reliance, Talco Bajaj Auto, Infosys Technologies, Hindustan Lever Ltd., Ranbaxy Laboratories Ltd., and Larsen and Tubro etc.

MEANING OF COMPANY

Section 3 (1) (i) of the Companies Act, 1956 defines a company as "a company formed and registered under this Act or an existing company". Section 3(1) (ii) Of the act states that "an existing company means a company formed and registered under any of the previous companies' laws". This definition does not reveal the distinctive characteristics of a company.

According to Chief Justice Marshall of USA, "A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation of its creation confers upon it either expressly or as incidental to its very existence".

Another comprehensive and clear definition of a company is given by Lord Justice Lindley, "A company is meant 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 (as the case may be) arising there from. The common stock contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted".

According to Haney, "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership".

From the above definitions, it can be concluded that a company is registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.

CHARACTERISTICS OF A COMPANY

The main characteristics of a company are:-

Incorporated association. A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation. It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of

business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.
For forming a public company at least seven persons and for a private company at least two persons are persons are required. These persons will subscribe their names to the Memorandum of association and also comply with other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability

Artificial legal person. A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by shareholders. But for many purposes, a company is a legal person like a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name, and can sue and be sued in its own name.

Separate Legal Entity: A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members.
Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and nor for the personal benefit of the shareholders. On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up. At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognized by the Income Tax Act.

Perpetual Existence. A company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder (s) or director (s). Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever.

Common Seal. As was pointed out earlier, a company being an artificial person has no body similar to natural person and as such it cannot sign documents for itself. It acts through natural person who are called its directors. But having a legal personality, it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company.

Limited Liability: A company may be company limited by shares or a company limited by guarantee. In company limited by shares, the liability of members is limited to the unpaid value of the shares.

Transferable Shares. In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be ultra vires.

Separate Property: As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property. The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.

Delegated Management: A joint stock company is an autonomous, self-governing and self-controlling organization. Since it has a large number of members, all of them cannot take part in the management of the affairs of the company. Actual control and management is, therefore, delegated by the shareholders to their elected representatives, known as directors. They look after the day-to-day working of the company. Moreover, since shareholders, by majority of votes, decide the general policy of the company, the management of the company is carried on democratic lines.

KINDS OF COMPANIES

Joint stock company can be of various types. The following are the important types of company:

1. Classification of Companies by Mode of Incorporation

Depending on the mode of incorporation, there are three classes of joint stock companies?
Chartered companies. These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it.
Statutory Companies. These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act.
Registered or incorporated companies. These are formed under the Companies Act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar of Companies. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories of the following.

i. **Companies limited by Shares:** These types of companies have a share capital and the liability of each member or the company is limited by the Memorandum to the extent of face value of share subscribed by him.
ii. **Companies Limited by Guarantee:** These types of companies may or may not have a share capital. Each member promises to pay a fixed sum of money specified in the Memorandum in the event of liquidation of the company for payment of the debts and liabilities of the company This amount promised by him is called 'Guarantee'. The Articles of Association of the company state the number of member with which the company is to be registered. Such a company is called a company limited by guarantee.

iii. **Unlimited Companies:** Section 12 gives choice to the promoters to form a company with or without limited liability. A company not having any limit on the liability of its members is called an 'unlimited 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.

II. On the Basis of Number of Members

On the basis of number of members, a company may be:
(1) Private Company, and (2) Public Company.

Private Company

According to Sec. 3(1) (iii) of the Indian Companies Act, 1956, a private company is that company which by its articles of association:

i) limits the number of its members to fifty, excluding employees who are members or ex-employees who were and continue to be members;
ii) restricts the right of transfer of shares, if any;
iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

Public company

According to Section 3 (1) (iv) of Indian Companies Act. 1956 "A public company which is not a Private Company",

If we explain the definition of Indian Companies Act. 1956 in regard to the public company, we note the following:

i) The articles do not restrict the transfer of shares of the company
ii) It imposes no restriction no restriction on the maximum number of the members on the company.
iii) It invites the general public to purchase the shares and debentures of the companies

III. On the basis of Control

On the basis of control, a company may be classified into:
1. Holding companies, and
2. Subsidiary Company

Holding Company [Sec. 4(4)]. A company is known as the holding company of another company if it has control over the other company. According to Sec 4(4) a company is deemed to be the holding company of another if, but only if that other is its subsidiary.

A company may become a holding company of another company in either of the following three ways: -

a) by holding more than fifty per cent of the normal value of issued equity capital of the company; or
b) By holding more than fifty per cent of its voting rights; or
c) by securing to itself the right to appoint, the majority of the directors of the other company, directly or indirectly.

Subsidiary Company. [Sec. 4 (I)]. A company is known as a subsidiary of another company when its control is exercised by the latter (called holding company) over the (25) former called a subsidiary company. Where a company (company S) is subsidiary of another company (say

Company H), the former (Company S) becomes the subsidiary of the controlling company (company H).

IV. On the basis of Ownership of companies

a) Government Companies. A Company of which not less than 51% of the paid-up capital is held by the Central Government of by State Government or Government singly or jointly is known as a Government Company. It includes a company subsidiary to a government company. The share capital of a government company may be wholly or partly owned by the government, but it would not make it the agent of the government.

b) Non-Government Companies. All other companies, except the Government Companies, are called non-government companies. They do not satisfy the characteristics of a government company as given above.

V. On the basis of Nationality of the Company

a) Indian Companies: These companies are registered in India under the Companies Act. 1956 and have their registered office in India. Nationality of the members in their case is immaterial.

b) Foreign Companies: It means any company incorporated outside India which has an established place of business in India [Sec. 591 (I)]. A company has an established place of business in India if it has a specified place at which it carries on business such as an office, store house or other premises with some visible indication premises.

FORMULATION OF COMPANIES AND INCORPORATION OF COMPANY

Company is an artificial person created by following a legal procedure. Before a company is formed, a lot of preliminary work is to be performed. The lengthy process of formation of a company can be divided into four distinct stages: (I) Promotion; (ii) Incorporation or Registration; (iii) Capital subscription; and (iv) Commencement of business. However, a private company can start business as soon as it obtains the certificate of incorporation. It needs to go through first two stages only. The reason is that a private company cannot invite public to subscribe to its share capital. But a public company having a share capital, has to pass through all the four stages mentioned above before it can commence business or exercise any borrowing powers

These four stages are discussed as follow:

Promotion

The term 'promotion' is a term of business and not of law. It is frequently used in business. Haney defines promotion as "the process of organizing and planning the finances of a business enterprise under the corporate form". Gerstenberg has defined promotion as "the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom." First of all, the idea of carrying on a business is conceived by promoters. Promoters are persons engaged in, one or the other way; in the formation of a company. Next, the promoters make detailed study to assess the feasibility of the business idea and the amount of financial and other resources required. When the promoters are satisfied about practicability of the business idea, they take necessary steps for assembling the business elements and making provision of the funds required to launch the business enterprise. Law does not require any qualification for the promoters. The promoters stand in a fiduciary

position towards the company about to be formed. From the fiduciary position of promoters, the following important results follow:

1. A promoter cannot be allowed to make any secret profits. If any secret profit is made in violation of this rule, the company may, on discovering it, compel the promoter to account for and surrender such profit.
2. The promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed. If he contracts to sell his own property to the company without making a full disclosure, the company may either rescind the sale or affirm the contract and recover the profit made out of it by the promoter.
3. The promoter must not make an unfair or unreasonable use of his position and must take care to avoid anything which has the appearance of undue influence or fraud.

Incorporation

This is the second stage of the company formation. It is the registration that brings a company into existence. A company is legally constituted on being duly registered under the Act and after the issue of Certificate of Incorporation by the Registrar of Companies. For the incorporate on of a company the promoters take the following preparatory steps:

i. To find out form the Registrar of companies whether the name by which the new company is to be started is available or not. To take approval of the name, an application has to be made in the prescribed form along with requisite fee;

ii. To get a letter of Intent under Industries (Development and Regulation) Act, 1951, if the company's business comes within the purview of the Act.

iii. To get necessary documents i.e. Memorandum and Articles of Association prepared and printed.

iv. to prepare preliminary contracts and a prospectus or statement in lieu of a prospectus.

Registration of a company is obtained by filing an application with the Registrar of Companies of the State in which the registered office of the company is to be situated. The application should be accompanied by the following documents:

1. Memorandum of association properly stamped, duly signed by the signatories of the memorandum and witnessed.
2. Articles of Association, if necessary.
3. A copy of the agreement, if any, which the company proposes to enter into with any individual for his appointment as managing or whole-time director or manager.
4. A written consent of the directors to act in that capacity, if necessary.
5. A statutory declaration stating that all the legal requirements of the Act prior to incorporation have been complied with.

The Registrar will scrutinize these documents. If the Registrar finds the document to be satisfactory, he registers them and enters the name of the company in the Register of Companies and issues a certificate called the certificate of incorporation.

The certificate of incorporation is the birth certificate of a company. The company comes into existence from the date mentioned in the certificate of incorporation and the date appearing in it is conclusive.

Capital Subscription

A private company can start business immediately after the grant of certificate of incorporation but public limited company has to further go through 'capital subscription stage' and 'commencement of business stage'. In the capital subscription stage, the company makes

necessary arrangements for raising the capital of the company. With a view to ensure protection on investors, Securities and Exchange Board of India (SEBI) has issued 'guidelines for the disclosure and investor protection'. The company making a public issue of share capital must comply with these guidelines before making a public offer for sale of shares and debentures.

Commencement of Business

A private company can commence business immediately after the grant of certificate of incorporation, but a public limited company will have to undergo some more formalities before it can start business. The certificate for commencement of business is issued by Registrar of Companies, the certificate to commence business granted by the Registrar is a conclusive evidence of the fact that the company has complied with all legal formalities and it is legally entitled to commence business.

Company Documents

The formation of a public company involves preparation and filing of several essential documents. Two of basic documents are:

1. Memorandum of Association
2. Articles of Association

Memorandum of Association

The preparation of Memorandum of Association is the first step in the formation of a company. It is the main document of the company which defines its objects and lays down the fundamental conditions upon which alone the company is allowed to be formed. It is the charter of the company. It governs the relationship of the company with the outside world and defines the scope of its activities. Its purpose is to enable shareholders, creditors and those who deal with the company to know what exactly is its permitted range of activities. It enables these parties to know the purpose, for which their money is going to be used by the company and the nature and extent of risk they are undertaking in making investment. Memorandum of Association enable the parties dealing with the company to know with certainty as whether the contractual relation to which they intend to enter with the company is within the objects of the company.

Contents of Memorandum

Name clause

Promoters of the company have to make an application to the registrar of Companies for the availability of name.

Registered Office Clause

Memorandum of Association must state the name of the State in which the registered office of the company is to be situated. It will fix up the domicile of the company. Further, every company must have a registered office either from the day it begins to carry on business or within 30 days of its incorporation, whichever is earlier, to which all communications and notices may be addressed. Registered Office of a company is the place of its residence for the purpose of delivering or addressing any communication, service of any notice or process of court of law and for determining question of jurisdiction of courts in any action against the company. It is also the place for keeping statutory books of the company.

Object Clause
This is the most important clause in the memorandum because it not only shows the object or objects for which the company is formed but also determines the extent of the powers which the company can exercise in order to achieve the object or objects.
Stating the objects of the company in the Memorandum of Association is not a mere legal technicality but it is a necessity of great practical importance. It is essential that the public who purchase its shares should know clearly what are the objects for which they are paying.
In the case of companies which were in existence immediately before the commencement of the Companies (Amendment) Act. 1965, the object clause has simply to state the objects of the company. But in the case of a company to be registered after be amendment, the objects clause must state separately.
i) Main Objects: This sub-clause has to state the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of main objects.
ii) Other objects: This sub-clause shall state other objects which are not included in the above clause.
Capital Clause
In case of a company having a share capital unless the company is an unlimited company, Memorandum shall also state the amount of share capital with which the company is to be registered and division thereof into shares of a fixed amount. The capital with which the company is registered is called the authorized or nominal share capital. The nominal capital is divided into classes of shares and their values are mentioned in the clause. The amount of nominal or authorized capital of the company would be normally, that which shall be required for the attainment of the main objects of the company. In case of companies limited by guarantee, the amount promised by each member to be contributed by them in case of the winding up of the company is to be mentioned. No subscriber to the memorandum shall take less than one share. Each subscriber of the Memorandum shall write against his name the number of shares he takes.
Liability Clause
In the case of company limited by shares or by guarantee, Memorandum of Association must have a clause to the effect that the liability of the members is limited.
It implies that a shareholder cannot be called upon to pay any time amount more than the unpaid portion on the shares held by him. He will no more be liable if once he has paid the full nominal value of the share.
The Memorandum of Association of a company limited by guarantee must further state that each member undertakes to contribute to the assets of the company if wound up, while he is a member or within one year after he ceased to be so, towards the debts and liabilities of the company as well as the costs and expenses of winding up and for the adjustment of the rights of the contributories among themselves not exceeding a specified amount.

ARTICLES OF ASSOCIATION

Every company is required to file Articles of Association along with the Memorandum of Association with the Registrar at the time of its registration. Companies Act defines 'Articles as Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies Acts. They also include, so far as they apply to the company.

Articles of Association are the rules, regulations and bye-laws for governing the internal affairs of the company. They may be described as the internal regulation of the company governing its management and embodying the powers of the directors and officers of the company as well as the powers of the shareholders. They lay down the mode and the manner in which the business of the company is to be conducted.

In framing Articles of Association care must be taken to see that regulations framed do not go beyond the powers of the company itself as contemplated by the Memorandum of Association nor should they be such as would violate any of the requirements of the companies Act, itself. All clauses in the Articles ultra vires the Memorandum or the Act shall be null and void.

Article of Association are to be printed, divided into paragraphs, serially numbered and signed by each subscriber to Memorandum with the address, description and occupation. Each subscriber shall sign in the presence of at least one witness who shall attest the signatures and also mention his own address and occupation.

Contents of Articles of Association

Articles generally contain provision relating to the following matters;

1. the exclusion, whole or in part of Table A;
2. share capital different classes of shares of shareholders and variations of these rights
3. execution or adoption of preliminary agreements, if any;
4. allotment of shares;
5. lien on shares calls on shares;
6. forfeiture of shares;
7. issue of share certificates;
8. issue of share warrants;
9. transfer of shares;
10. transmission of shares;
11. alteration of share capital;
12. borrowing power of the company;
13. rules regarding meetings;
14. voting rights of members;
15. notice to members;
16. dividends and reserves;
17. accounts and audit;
18. arbitration provision, if any;
19. directors, their appointment and remuneration; the appointment and reappointment of the managing director, manager and secretary;
20. fixing limits of the number of directors
21. payment of interest out of capital;
22. common seal; and
23. winding up.

COMPANY MANAGEMENT

DIRECTORS

On incorporation, a company becomes a person in the eyes of law, it has a perpetual succession, its members may come and may go but the company lives till its death as aforementioned. It has a common seal, which is affixed on all the legal documents executed on behalf of the company in the presence of and signed by authorised signatory or signatories. It is empowered to hold all properties in its own name and in its own right. It can sue others and can be sued by others in its own name.
With all the strapping of a legal person, a company is unlike a living human being. It has no physical existence. It has no eyes to see, no ears to hear, no hands to sign and execute documents, no brain to think and no nerves to communicate among its various limbs. In order to enable a company to live and to achieve its objects as enshrined in the objects clause of its Memorandum of Association, it has necessarily to depend upon some agency, known as Board of directors.

The Board of directors of a company is a nucleus, selected according to the procedure prescribed in the Act and the Articles of Association. Members of the Board of directors are known as directors, who unless especially authorised by the Board of directors of the Company, do not possess any power of management of the affairs of the company. Acting collectively as a Board of directors, they can exercise all the powers of the company except those, which are prescribed by the Act to be specifically exercised by the company in general meeting.

The directors of a company are its eyes, ears, brain, hands, nerves and other essential limbs, upon whose efficient functioning depends the success of the company. The directors formulate policies and establish organisational set up for implementing those policies and to achieve the objectives is contained in the Memorandum, muster resources for achieving the company objectives and control, guide, direct and manage the affairs of the company.

The Companies Act, 2013 does not contain an exhaustive definition of the term "director". Section 2 (34) of the Act prescribed that "director" means a director appointed to the Board of a company.

Minimum/Maximum Number of Directors in a Company- Section 149(1)

Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One-Person Company. A company can appoint maximum 15 fifteen directors. A company may appoint more than fifteen directors after passing a special resolution in general meeting and approval of Central Government is not required.

APPOINTMENT OF DIRECTORS

First Director

The first directors of most of the companies are named in their articles. If they are not so named in the articles of a company, then subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed.

In the case of a One-Person Company, an individual being a member shall be deemed to be its first director until the director(s) are duly appointed by the member in accordance with the provisions of Section 152.

DIRECTOR APPOINTED AT ANNUAL GENERAL MEETING

Articles of the Company may provide the provisions relating to retirement of the all directors. If there is no provision in the article, then not less than two-thirds of the total number of directors of a public company shall be persons whose period of office is liable to determination by retirement by rotation and eligible to be reappointed at annual general meeting. Further independent directors shall not be included for the computation of total number of directors. At the annual general meeting of a public company one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office.

The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment. At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto. If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

Appointment of Additional Director

The board of directors can appoint additional directors, if such power is conferred on them by the articles of association. Such additional directors hold office only up to the date of next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier. A person who fails to get appointed as a director in a general meeting cannot be appointed as Additional Director.

Appointment of Alternate Director

I. The Board of Directors of a company must be authorised by its articles or by a resolution passed by the company in general meeting for appointment of alternate director.
II. The person in whose place the Alternate Director is being appointed should be absent for a period of not less than 3 months from India.
III. The person to be appointed as the Alternate Director shall be the person other than the person holding any alternate directorship for any other Director in the Company.
IV. If it is proposed to appoint an Alternate Director to an Independent Director, it must be ensured that the proposed appointee also satisfies the criteria for Independent Directors.
V. An alternate director shall not hold office for a period longer than that permissible to the director in whose place he has been appointed and shall vacate the office if and when the director in whose place he has been appointed returns to India.

VI. If the term of office of the original director is determined before he so returns to India, any provision for the automatic re- appointment of retiring directors in default of another appointment shall apply to the original, and not to the alternate director

Duties of directors

A director of a company shall:

1. Act in accordance with the articles of the company.
2. 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 interests of the company, its employees, the shareholders, the community and for the protection of environment.
3. Exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
4. Not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
5. Not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.
6. Not assign his office and any assignment so made shall be void.

Power of DIRECTOR

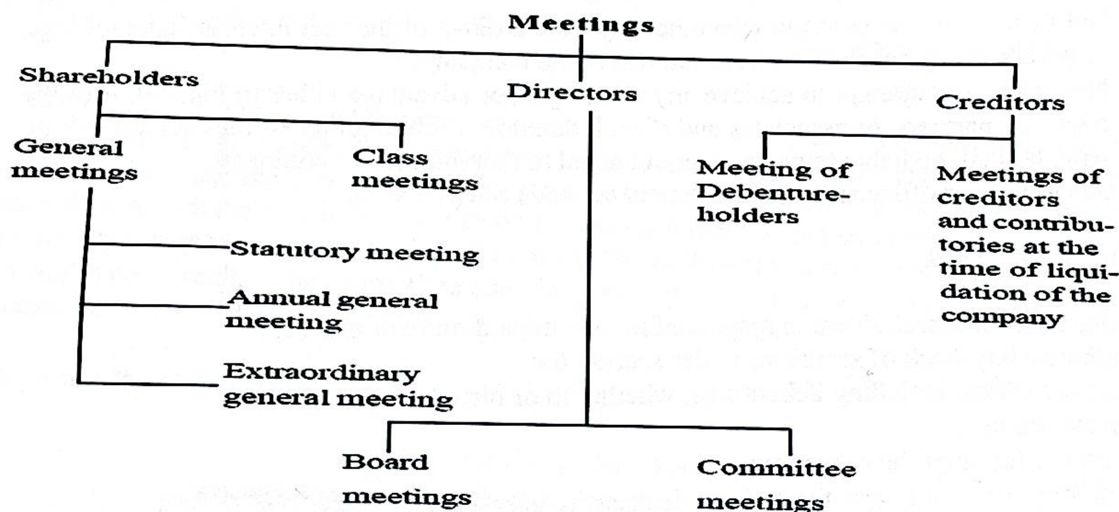
(1) to make calls on shareholders in respect of money unpaid on their shares;
(2) to authorise buy-back of securities under section 68;
(3) to issue securities, including debentures, whether in or outside India;
(4) to borrow monies;
(5) to invest the funds of the company;
(6) to grant loans or give guarantee or provide security in respect of loans;
(7) to approve financial statement and the Board's report;
(8) to diversify the business of the company;
(9) to approve amalgamation, merger or reconstruction;
(10) to take over a company or acquire a controlling or substantial stake in another company;
(11) to make political contributions;
(12) to appoint or remove key managerial personnel (KMP);
(13) to take note of appointment(s) or removal(s) of one level below the Key Management Personnel;
(14) to appoint internal auditors and secretarial auditor;
(15) to take note of the disclosure of director 's interest and shareholding;
(16) to buy, sell investments held by the company (other than trade investments), constituting five percent or more of the paid–up share capital and free reserves of the investee company;
(17) to invite or accept or renew public deposits and related matters;
(18) to review or change the terms and conditions of public deposit
(19) to approve quarterly, half yearly and annual financial statements or financial results as the case may be.

KINDS OF MEETINGS

The meetings of a company are of three kinds:

1. Meetings of the shareholders
(i) General meetings
(ii) Class meetings
2. Meetings of the Directors
3. Meetings of the Creditors

Figure 1 Meetings



STATUTORY MEETING

Every public company limited by shares and every company limited by guarantee and having a share capital, shall, within a period of not less than one month nor more than six months from the date on which the company is entitled to commence business hold a general meeting of the members of the company. This meeting is called 'the statutory meeting'.

A meeting held prior to the statutory period of one month from the date of entitlement of a company to commence business cannot be called the statutory meeting. The notice for such a meeting should state it to be statutory. The statutory meeting is held only once in the life time of a company. Private companies, public companies limited by guarantee and not having a share capital and unlimited companies are not required to hold the statutory meeting.

ANNUAL GENERAL MEETING

Every company must in each year hold in addition to any other meeting a general meeting, as its annual general meeting and must specify the meeting as such in the notices calling it. The annual general meeting is to be held in addition to any other general meeting that might have been held in a year. It appears that holding of an annual general meeting in every calender year is a statutory

necessity. Calender year is to be calculated from Ist January to 31st December and not twelve months from the date of incorporation of the company.

EXTRA ORDINARY GENERAL MEETING

All general meetings other than annual general meetings shall be called extraordinary general meetings. An extraordinary general meeting is called to consider those transactions or business which cannot be postponed till the next annual general meeting. Hence, it is a meeting of a company which is held between two consecutive annual general meetings for transacting some urgent or special business.

CLASS MEETINGS

Class meetings are the meetings of the shareholders and the creditors. Class meetings are held to pass resolutions which will bind only the members of the particular class concerned. According to regulation 3(1), if the rights attached to any class of shares are to be varied, it can be done with the consent of the holders of 3/4 of the issued shares of that class in a separate meeting of that class of holders.

REQUISITES OF A VALID MEETING

A meeting to be in order must fulfil certain requirements

Proper Authority

The Board of Directors is the proper authority to convene a general meeting of a company and for this purpose the board should pass a resolution at a duly convened meeting of the board.

Notice of Meetings

A proper notice of the meetings must be given to the members of the company. The notice must be given 21 days before the date of the meeting. The period of 21 days excludes the day of service of the notice and also the day on which the meeting is to be held.

Quorum

Quorum means the minimum number of members that must be present at the meeting. The quorum is generally fixed by the company's article. Unless the articles provide for a large number, five members personally present in the case of a public company and two members personally present in the case of any other company.

Chairman of meeting

Before a meeting of a company can start its business, it is required to have a Chairman. It is the Chairman who is to preside at the meeting of the company. He is to conduct the meeting and to maintain the order. It is the Chairman who is to put up the resolution, count the votes and declare the result. Usually the articles provide for the appointment of a Chairman but if there is no provision in the articles to this effect, the members present in the meeting shall elect one of themselves to be the Chairman of such meeting on a show of hands.

Minutes of the meeting

Every company must keep a record of all proceedings of every general meeting and of all proceedings of every meeting of its Board of Directors and of every committee of the board. These records are known as minutes and the books in which these records are written are called 'minute books'.

RESOLUTIONS

The decisions of a meeting take the form of resolutions carried by a majority of votes. A question on which a vote is proposed to be taken is called a 'motion'. Once a 'motion' has been put to the members and they have opted in favour of it, it becomes a resolution. A resolution may, thus, be defined as the formal decision of a meeting on a particular proposal before it.

Types of Resolutions

Resolutions are of the following types:

1. Ordinary Resolutions;
2. Special Resolutions; and
3. Resolutions requiring special notice.

Ordinary Resolution

At a general meeting of which notice has been given, if votes cast in favour of the resolution by members exceed the votes, if any, cast against the resolution by members, the resolution so passed is an ordinary resolution.

Important matters for which an ordinary resolution is enough are as follows:

(i) Issue of shares at a discount

(ii) Alteration of the share capital

(iii) Approval of the statutory report

(iv) The consideration of accounts, the Balance Sheet and the report of the Board of Directors and of the auditors

(v) Appointment of auditors and fixation of their remuneration

(vi) Appointment of the first directors who are to retire by rotation

(vii) Increase or decrease in the number of directors within the limits prescribed by the Articles

(viii) Adoption of the appointment of sole selling agents

(ix) Removal of a director and appointment of another director in his place

(x) Declaration of dividend

(xi) Appointment of liquidator in case of voluntary winding up and fixing his remuneration

(xii) To rectify the name of company

(xiii) To cancel or redeem debentures

(xiv) To cancel directors by rotation

(xv) To approve the remuneration of directors

(xvi) To fill the vacancy in the office of Liquidator.

Special Resolution

The resolution is a special resolution, if

(i) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting;

(ii) the notice required has been duly given of the general meeting; and

(iii) the votes cast in favour of the resolution by members are three times the number of the votes, if any, cast against the resolution by the members.

A copy of the special resolution must be filed with the Registrar within 30 days of its passing.

Special Resolution Matters

In addition to the matters given in the articles of the company, the Companies Act specifies certain matters for which a special resolution must be passed; for example,

(i) to alter the memorandum of the company

(ii) to alter the articles of the company

(iii) to issue further shares without pre-emptive rights

(iv) for creation of a reserve capital

(v) to reduce the share capital

(vi) to pay interest out of the capital to members

(vii) for authorizing a director to hold an office or place of profit

(viii) for voluntary winding-up of a company

Resolutions Requiring Special Notice

A resolution requiring special notice is not an independent class of resolutions. It is a kind of ordinary resolution, with the only difference that here the mover of the proposed resolution is required to give a special notice of 14 days to the company before moving the resolution, and the company shall then immediately give its members notice of the resolution in the same manner as it gives notice of the meeting. If that is not practicable, the company shall give not less than seven days' notice before the meeting either by advertisement in a newspaper or in any other mode allowed by the articles.

MODES OF WINDING-UP OF A COMPANY

Concept of Winding-Up

Winding up (which is more commonly called liquidation in Scotland) is proceeding for the realisation of the assets, the payment of creditors, and the distribution of the surplus, if any, among the shareholders, so that the company may be finally dissolved. Professor Gover in his book *Principles of Modern Company Law* has described the winding up of a company in the following words:

"Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator called a liquidator is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights."

Thus, winding up is the last stage in the life of a company. It means a proceeding by which a company is dissolved.

Winding up should not be taken as if it is dissolution of a company. The winding up of a company precedes its dissolution. Prior to dissolution and after winding up, the legal entity of the company remains and it can be sued in a Court of law. On dissolution the company ceases to exist, its name is actually struck off from the Register of Companies by the Registrar and the fact is published in the official Gazette.

MODES OF WINDING UP

A company can be wound up in three ways:
1. Compulsory winding up by the Court;
2. Voluntary winding up: (i) Members' voluntary winding up; (ii) Creditors' voluntary winding up;
3. Voluntary winding up subject to the supervision of the Court.

WINDING UP BY THE COURT

A company may be wound up by an order of the Court. This is called compulsory winding up or winding up by the Court. Section 433 lays down the following grounds where a company may be wound up by the Court. A petition for winding up may be presented to the Court on any of the grounds stated below:

1. Special resolution
2. Default in filing statutory report or holding statutory meeting
3. Failure to commence business within one year or suspension of business for a whole year
4. Reduction of membership below the minimum
5. Company's inability to pay its debts
6. Just and Equitable

VOLUNTARY WINDING UP

Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up'. In voluntary winding up, the company and its creditors are left free to settle their affairs without going to the Court, although they may apply to the Court for directions or orders if and when necessary.

A company may be wound up voluntarily under the circumstances given hereunder:

Kinds of Voluntary Winding up

Voluntary winding up may be:
(a) A members' voluntary winding up; or
(b) A creditors' voluntary winding -up.

Members' voluntary winding up

A members' voluntary winding up takes place only when the company is solvent. It is initiated by the members and is entirely managed by them. The liquidator is appointed by the members. No meeting of creditors is held and no committee of inspection is appointed. To obtain the benefit of this form of winding up, a declaration of solvency must be filed.

Creditors' Voluntary Winding up

In creditors' voluntary winding up, it is the creditors who move the resolution for voluntary winding up of a company, and there is no solvency declaration made by the directors of the company. In other words, when a company is insolvent, that is, it is not able to pay its debts, it is the creditors' voluntary winding up.