

LEGAL AND BUSINESS ENVIRONMENT (Micro and Macro)



Legal and Business Environment (Micro and Macro)

MIT | School of
Distance Education

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Course Objective and Learning Outcome

The course “Legal and Business Environment (Micro and Macro)” helps you to understand the basic concepts related to the legal environment of a business. The course introduces you to major laws and regulations to which a business is subject.

After studying this subject, you should be able to:

- Explain internal (micro) environment and its various components
- Discuss external (macro) environment and its various components
- Explain business environment analysis
- Discuss globalisation and its impact on businesses
- Explain the role of ethics and Corporate Social Responsibility business environment
- Discuss the legal aspects of business
- Describe various constituents of the Indian Legal System
- Explain the structure of the Indian Contract Act, 1872
- Discuss the rules of offer, acceptance and consideration regarding contracts
- List and explain various essential elements of a valid contract
- Explain the implications of a breach of contract as per the Indian Contract Act, 1872
- Explain the basic principles of special contract laws
- Explain the basic principles and definitions of the Sale of Goods Act, 1930
- Discuss formalities of a contract of sale
- Describe the evolution of and need for consumer protection regulations in India
- Describe the objective and scope of the Indian Consumer Protection Act, 2019
- Elaborate on the legal environment surrounding Intellectual Property Rights (IPR)
- Explain the concept of a company and its legal characteristics
- Describe the legal provisions regarding the formation and incorporation of a company
- Discuss the Right to Information Act, 2005
- Explain the different forms of business organisations
- Discuss the Partnership Act, 1932
- Describe Competition Act, 2002
- State the importance of Information Technology Act, 2000
- Outline the Negotiable Instruments Act, 1881
- Discuss the Minimum Wages Act, 1948
- Explain the provisions of Factories Act, 1948
- Describe the Workmen Compensation Act, 1923
- Elaborate the key provisions proposed in the Personal Data Protection (PDP) Bill, 2019

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Curriculum

LEGAL AND BUSINESS ENVIRONMENT (MICRO AND MACRO)

Legal Aspect of Business – Introduction to Business Laws – Business Management and Jurisprudence – Structure of the Indian Legal Systems – Sources of Law – Manager and Legal System – Fundamentals of Contract Laws – Formation of Contracts – Principles of Contract Laws – Legality of Object Consideration – Performance of Contract – Discharge of Contract – Breach of Contract – Quasi Contracts – Contract Management – Special Contracts – Laws of Agency – Principal-Agent Problem – Bailment – Pledge – Guarantee and Indemnity – Sales of Goods – Principles of Sales of Goods – Transfer of Ownership & Property – Performance of Contract – Consumer Protection Laws – Law Relating to Business Organizations – Partnership Trusts – Company Form of Organisation – Protecting the Property of Business – Copyright – Trademark – Secret – Geographical Indications – Alternate Dispute Resolution – Companies Act, 2013 – Formation and Incorporation of a Company – Memorandum of Association – Articles of Association – Prospectus – Shares – Right to Information Act, 2005 – Partnership Act, 1932 – Competition Act, 2002 – Information Technology Act, 2000 – Negotiable Instruments Act, 1881 – Minimum Wages Act, 1948 – Factories Act, 1948 – Workmen Compensation Act, 1923 – The Personal Data Protection (PDP) Bill, 2019.

The subject is divided into 12 chapters. A brief description of all the 12 chapters is given below:

Chapter 1: Business Environment – I
Introduction, Business Environment, Characteristics of Business Environment, Scope of Business Environment, Types of Business Environment, Internal (Micro) Environment, External (Macro) Environment
Chapter 2: Business Environment – II
Business Environment Analysis, Globalisation and its Impact on Businesses, Business Ethics and Corporate Social Responsibility, Creating an Ethical Environment in Organisations
Chapter 3: Legal Environment
Legal Aspects of Businesses, Introduction to Business Laws, Business Management and Jurisprudence, Indian Legal System, Legal Structure, Government Roles Affecting Business, Sources of Law, Why Managers Need to Understand Legal System?
Chapter 4: Contract Law-I
What is a Contract?, Types of Contracts, Agreements and Contracts, Legally Not Enforceable Agreements, Legally Enforceable Agreements, On the Basis of Validity, On the Basis of Formation, On the Basis of Performance, Indian Contract Act, 1872, Structure of the Indian Contract Act, 1872

Chapter 5: Contract Law-II
Formation of Contracts, Rules of Offer, Acceptance and Consideration, Essential Elements of a Valid Contract, Proposal/Offer, Acceptance, Communication of Offer and Acceptance, Communication of Performance, Revocation of Offer and Acceptance, Capacity to Contract, Free Consent, Consideration, Legality of Object and Consideration, Discharge of Contract, Performance of a Contract, Discharge by Impossibility or Unlawfulness of Contract, Discharge by Agreement and Consent (Consensual Discharge), Discharge by Lapse of Time, Discharge by Operation of Law, Discharge by Breach of Contract, Breach of Contract, Anticipatory Breach, Actual Breach, Damages, Quasi Contracts
Chapter 6: Special Contracts
Indemnity and Guarantee, Contract of Guarantee and Contract of Indemnity, Parties to Contract of Indemnity and Guarantee, Difference between Contract of Indemnity and Contract of Guarantee, Kinds of Guarantee, Rights and Obligations of the Creditor, Rights of Surety against Principle Debtor and Creditor, Discharge of Surety, Rights of the Indemnified, Commencement of Indemnifier's Liability, Bailment, Pledge and Finder of Goods, Nature and Essential Features of Bailment and Pledge, Kinds of Bailment, Bailment for Reward and Gratuitous Bailment, Duties and Rights of a Bailor, Duties and Rights of a Bailee, Termination of Bailment, Comparison between Pledge and Bailment, Rights and Duties of Pledgee (Pawnee) and Pledgor (Pawnor), Finder of Lost Goods, Contract of Agency, Essential Features of Agency, Creation of Agency, Termination of Agency, Agent and Principal, Contract of Employment
Chapter 7: Sales of Goods Act, 1930
Definition and Essentials of a Contract of Sale, Sale and Agreement to Sell, Sale of Goods and Work and Labour, Contract for Work and Labour, Hire Purchase, Rules for Transfer of Title, Doctrine of Caveat Emptor, Delivery in a Contract of Sale, Rights of Unpaid Seller, Formalities of the Contract of Sale, Goods – Subject Matter of Contract, Existing or Future Goods, Goods Perishing before the Making of Contract, Goods Perishing before Sale and after Agreement to Sell, Price, Ascertainment of Price, Agreement to Sell at Valuation, Conditions and Warranties in a Contract of Sale, Expressed Conditions and Warranties, Implied Conditions and Warranties
Chapter 8: Consumer Protection
Major Laws Concerning Consumer Protection, Rights of Consumers, Consumer Protection Act, 2019, Objective and Scope of Consumer Protection Act, 2019, Consumer Protection Act, 1986 vs. Consumer Protection Act, 2019, Key Features of the Consumer Protection Act, 2019, Consumer Disputes Redressal Mechanism Under Consumer Protection Act, 2019, Consumer Protection Councils (CPCs), Central Consumer Protection Authority (CCPA), Consumer Disputes Redressal Commissions (Three-Tier Consumer Dispute Redressal), Mediation, Product Liability, Offences and Penalties
Chapter 9: Intellectual Property Rights in India
Protecting the Intellectual Property Rights (IPR) of Business, Copyright, Trademark, Secret, Geographical Indications, Designs, WIPO and the Alternate Dispute Resolution, Global Challenges in IPR
Chapter 10: Company Law
Companies Act, 2013, Concept of Company, Characteristics of a Company, Kinds of Companies, Distinction between Private and Public Company, Lifting the Corporate Veil, Formation and Incorporation of a Company, Promotion, Incorporation of Company, Floatation / Raising of Capital, Commencement of Business, Memorandum of Association, Doctrine of "Ultra Vires", Alteration of Memorandum, Articles of Association, Alteration of Articles, Binding Force of Memorandum and Articles, Difference between Memorandum of Association and Articles of Association, Doctrine of Constructive Notice, Doctrine of Indoor Management, Prospectus,

Contents of Prospectus, Golden Rule of Prospectus, Mis-statements in Prospectus and Liability, Deemed Prospectus, Private Placement, Shelf Prospectus and Information Memorandum, Red Herring Prospectus, Membership, Rights of a Member, Register of Members, Concept of Shares, Equity Shares, Preference Shares, Share Warrant and Share Certificate, Transfer of Shares, Transmission of Shares, Nomination of Shares, Forfeiture of Shares, Borrowings, Loans, Debentures and Investments

Chapter 11: Right to Information Act, 2005

Salient Features of the Right to Information Act, 2005, Objectives, Public Authorities and their Obligations, Designation of Public Information Authority, Public Information Officers and their Duties, Procedure for Requests for Obtaining Information, Exemption from Disclosure, Central and State Information Commission, Central Information Commission, State Information Commission, Power of Information Commission, Appellate Authorities, Appeal, Penalties, Bar on Jurisdiction of Courts, Role of Central and State Governments

Chapter 12: Miscellaneous Acts

Different Forms of Business Organisations, Sole Proprietorship, Partnership, Corporation/ Company, Partnership Act, 1932, Scope of Partnership, Partnership Deed and Types of Partnerships, Competition Act, 2002, Objectives of Competition Act, 2002, Features of Competition Act, 2002, Non-Applicability of Competition Act, 2002, Information Technology Act, 2000, Objectives, Scope and Major Provisions, E-Governance, Digital Signature, Electronic Records, Certifying Authorities, Negotiable Instruments Act, 1881, Characteristics of Negotiable Instruments, Types of Negotiable Instruments, Minimum Wages Act, 1948, Objectives of the Minimum Wages Act, 1948, Scope and Major Provisions, Code on Wages, 2019, Factories Act, 1948, Objectives of the Factories Act, 1948, Applicability of the Act, Meaning of Manufacturing Process, Worker to be the Main Beneficiary of the Act, Workmen Compensation Act, 1923, Objectives of The Workmen Compensation Act, 1923, Scope of the Workmen Compensation Act, 1923, Employer's Liability to Pay Compensation, The Personal Data Protection (PDP) Bill, 2019

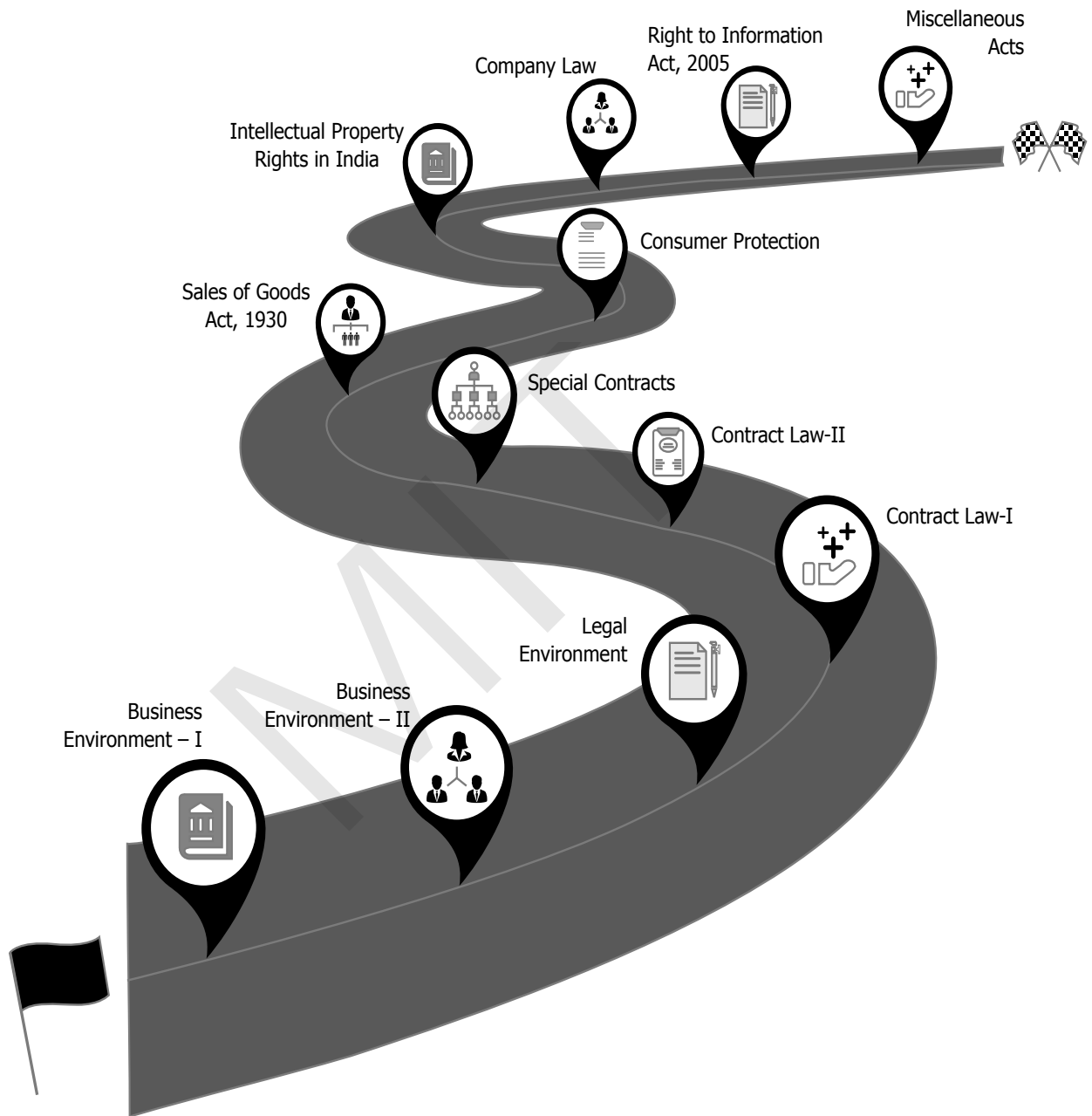
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ROAD MAP



BUSINESS ENVIRONMENT – I

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Explain the concept of a business environment
- ▶▶ Discuss the nature and characteristics of a business environment
- ▶▶ Describe the scope of a business environment
- ▶▶ Explain internal (micro) environment and its various components
- ▶▶ Discuss external (macro) environment and its various components

1.1 INTRODUCTION

For effective management of any business, it is vital to understand the surrounding environment for business operations. In other words, an organisation needs to analyse the environment in which it operates. An organisation is influenced by two types of environment – external and internal. The external environment includes factors that are beyond organisational control, whereas the internal environment includes factors that are within the control of the organisation.

An organisation cannot formulate effective strategies without analysing both the environments. The long-term sustainability and success of an organisation mostly depend on the favourability of different environmental factors.

This chapter focusses on the concept of the business environment, its nature and scope. In addition, the chapter explains the internal and external environments and their components.

1.2 BUSINESS ENVIRONMENT



Quick TIP

A business has to keep itself updated with the changing market all the time, otherwise it will end up losing its customers.

Business environment can be defined as the sum total of all individuals, institutions and other forces that are beyond the control of an organisation but the organisation still depends upon them as they affect its overall performance and sustainability. In other words, the business environment consists of all factors, influences and circumstances that directly or indirectly affect an organisation.

The environment of an organisation is basically categorised into external and internal environments. The external environment comprises political, economic, social, cultural, technological and legal factors. An organisation does not have direct control over these factors. On the other hand, there are some internal factors which affect the operations of the organisation. These include organisational culture, structure, capabilities and resources. The organisation has direct control over these internal factors.

By monitoring the business environment, organisations try to predict potential changes in terms of opportunities for and threats to their business. To cope with these changes, organisations continue to modify their strategies and plans. Understanding of the business environment helps an organisation retain its market position and have an upper hand over its competitors.

The long-term sustainability and success of an organisation mostly depend on the favourability of different environmental factors. For example, the Internet and e-commerce have totally changed the mode of business transactions. E-books and e-papers have also posed some serious challenges to the traditional publishing industry. Increasing concern for the eco-system is forcing organisations to become eco-friendly. Therefore, organisations which cannot adapt to these environmental changes find it difficult to survive in the competitive market place.

1.2.1 CHARACTERISTICS OF BUSINESS ENVIRONMENT

An organisation cannot function in a vacuum as it has to act and react according to changes happening inside and outside it. The internal and external changes in the

environment affect the functions and objectives of the organisation. Let's discuss the important characteristics of the organisation's environment:



NOTE

Businesses can control their internal environment to some extent, while it is extremely difficult to control their external environment.

- **Complexity:** An organisation's environment is a difficult concept to comprehend because it consists of various inter-dependent factors, events, and influences.
- **Vibrancy:** This implies the dynamic nature of the organisation's environment. Numerous forces that affect the environment do not remain stable and change over a period of time. Strategists might have the ability to control some of the forces; however, they fail to control all the forces. The understanding of the dynamic environment provides an opportunity for the organisation to gain an edge over its competitors.
- **Versatility:** Different strategists perceive the organisation's environment in different ways. For example, one strategist might perceive the change in an environment as a positive development, while the other might not hold the same viewpoint and consider the change as negative.
- **Uncertainty:** Environmental forces are unpredictable in nature. Strategists try to predict environmental forces to make strategies and update their plans.

Thus, these four characteristics form the major part of an organisation's environment. These characteristics are found in every component of the organisation's environment. Let us now discuss the scope of the business environment.

1.2.2 | SCOPE OF BUSINESS ENVIRONMENT

A clear understanding of the business environment can have the following effects on a business:

- **Identification of existing and potential opportunities and threats:** A close interaction and proximity between the organisation and its environment helps managers determine and analyse the situation for available opportunities and threats faced by the organisation's business. When there is a clear vision of opportunities or threats, the organisation can take advantage of opportunities or prepare to overcome threats.
- **Creation of a culture of continuous learning:** Analysis of the surrounding environment helps managers deal easily with business challenges. It acts as a motivation for managers to continuously learn and update their knowledge and skills to meet the demands of business.
- **Image-building:** Organisations that are sensitive towards their surrounding environment are considered to have a superior image in the society. For example, many organisations engage in corporate social responsibility activities like education and health for the betterment of the community in which they operate.
- **Ability to combat competition:** Organisations which are aware of their business environment undertake periodic analysis of strategies of their competitors and they formulate their strategies accordingly to deal with market competition.
- **Carry out SWOT analysis:** Organisations which undertake periodic assessment of their business environment are in a better position to analyse



NOTE

SWOT analysis is conducted to implement and control the business environment.

their strengths, weaknesses, opportunities and threats considering the rapid changes in the environment, such as technological development.



SELF ASSESSMENT QUESTIONS

1. _____ consists of all factors, influences and circumstances that directly or indirectly affect an organisation.
2. Understanding of the business environment helps an organisation retain its market position and have an upper hand over its competitors. (True/False)
3. Environmental forces are predictable in nature. (True/False)

1.3 TYPES OF BUSINESS ENVIRONMENT

Important Concept

As per **Arthur M. Weimer**, a business environment encompasses the 'climate' or a set of conditions, economic, social, political or institutional, in which business operations are conducted.

As discussed, an organisation cannot survive in isolation from its business environment. The business environment can be broadly classified into internal (micro) and external (macro) environment. The nearby environment under which an organisation operates is called internal environment. On the other hand, the general environment that affects the working of all organisations is called external environment.

The internal or micro-environmental factors represent the strengths and weaknesses of an organisation, whereas the external or macro-environmental factors represent the opportunities for and threats to an organisation. For example, the highly efficient distribution channel of Coca-Cola is an internal strength of the organisation. On the other hand, increasing awareness about the presence of pesticides in soft drinks poses a serious challenge to the organisation. Therefore, it is an external threat to Coca-Cola.

An organisation needs to scan and analyse both internal and external environments before formulating any strategy. The organisation needs to analyse its strengths and weaknesses as compared to external opportunities and threats. If the organisation does not make a proper assessment of its internal environment, it cannot formulate effective strategies. On the other hand, incomplete understanding of the external environment may lead to loss of opportunities. The analysis of the external environment of the organisation is known as external environment analysis, whereas the analysis of the internal environment is known as internal environment analysis.

Let us discuss the internal and external business environments in detail:

1.3.1 INTERNAL (MICRO) ENVIRONMENT

The internal or micro environment directly affects the organisation by influencing its routine activities and operations. This environment type is usually limited to the functioning of the organisation. It includes factors which are directly associated with the organisation and affect its day-to-day business activities for a shorter duration of time. The factors that affect the internal environment include:

- **Vendors or suppliers:** The entities who provide inputs or raw materials to the organisation.



NOTE

The internal environment imposes a greater impact on internal matters of a business, such as the structure and size of a business, policy relating to business, etc.

- **Competitors:** The entities who manufacture or provide the products or services that are similar to those of the organisation and within the same business category.
- **Intermediaries:** These entities are distributors, retailers, wholesalers, etc. The intermediaries form a link between the organisation and the end-customers.
- **Customers:** These are individuals or organisations who buy the products or services of the organisation.
- **Organisation itself:** An organisation itself hosts many factors including shareholders or investors, employees and the board of directors that can significantly affect its functioning.

The analysis of the internal environment plays a vital role in the strategy formulation process. The internal environment analysis helps the organisation determine its capabilities. This enables the organisation to utilise the opportunities in the best possible manner, and maximise its profits. The internal environment consists of resources, competencies, and capabilities that depict the strengths and weaknesses of the organisation. The organisation consists of various departments, such as marketing, finance, human resources, and operations. The organisation should try to know the important internal factors and identify the nature of different departments and their capabilities. Figure 1 shows the major components of the organisation's internal environment:

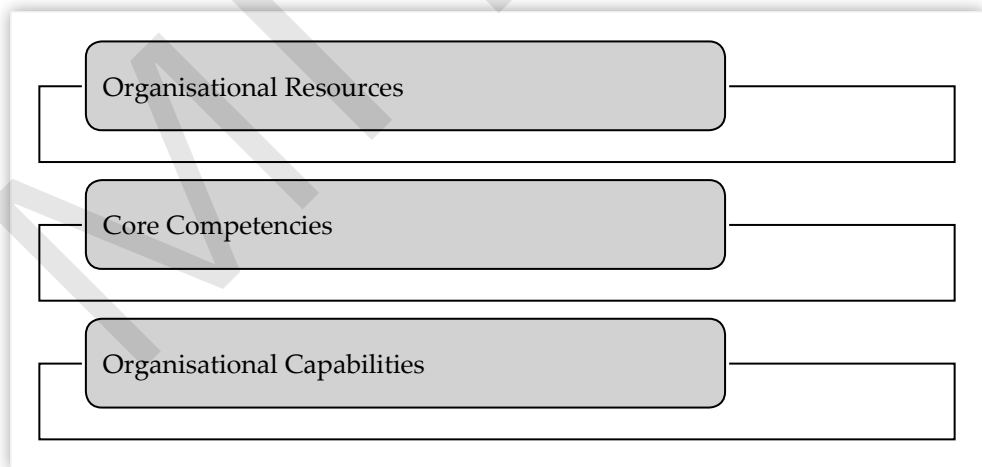


FIGURE 1: Components of the Internal Environment of an Organisation

Let's now discuss the important components of the internal environment of an organisation.

Organisational Resources

Resources help an organisation achieve its goals and objectives. Organisational resources are usually categorised into two types – tangible and intangible.

Tangible resources consist of financial resources, such as cash and long-term investments; physical resources such as plants, equipment, and raw materials; and human resource, such as employees. Intangible resources consist of patents, copyrights, and intellectual property rights.



Quick TIP

Organisational resources are the basis for achieving and sustaining a competitive advantage.

The availability of all the resources is of paramount importance for the organisation's success. The adequacy of resources acts as a strength, whereas the scarcity of resources acts as a weakness for the organisation. Therefore, analysis of organisational resources helps in exploring the strengths and weaknesses of the organisation. The organisational resource analysis also helps the organisation identify the opportunities that exist in the external environment by avoiding threats and attaining a competitive advantage.

The process of identifying and analysing organisational resources, which helps in attaining a competitive advantage, is known as Resource-Based View (RBV) organisational analysis. The RBV organisational analysis helps to identify the core and distinctive competencies of an organisation. It helps to use organisational resources in the best way to attain competitive advantage and determine the sustainability of the competitive advantage.

When an organisation possesses scarce resources, it should use them efficiently for satisfying customer needs and gaining a strategic advantage. Thus, a mere possession of resources is not enough; gaining a strategic advantage depends on the efficiency of resource utilisation. The usage of resources depends upon organisational behaviour.

Organisational behaviour is the manifestation of various influences operating in the internal environment of the organisation that may create or destroy the utility of resources. The forces that affect organisational behaviour are quality of leadership, shared values and culture, quality of work environment, and organisational politics. Since organisational behaviour affects the utilisation of resources, therefore it collectively produces strengths and weaknesses within the internal environment of the organisation.

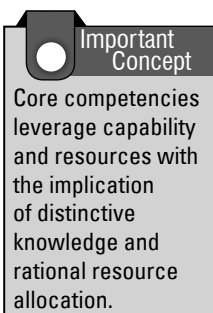
Core Competencies

Core competency refers to the collective learning of an organisation that is gained by coordinating diverse skills of employees and integrating technologies. According to Prahalad and Hamel, core competency should fulfil the following three criteria:

- Provide benefits to consumers
- Make it difficult for competitors to imitate
- Make a significant contribution to a wide variety of markets

Core competency is critical for the organisation to achieve a competitive advantage. For instance, Tesco.com has been successful in capturing leadership in online grocery shopping by designing and delivering a customer interface system that personalises online shopping.

Core competency can be gained by an organisation in either of the two ways – explicit knowledge or tacit knowledge. Explicit knowledge is something that can be easily transmitted or communicated to others. Tacit knowledge either exists in employees' experience or is inherited in the culture of the organisation. Thus, it cannot be transmitted easily to others. It is the tacit knowledge that helps an organisation sustain a competitive advantage in the market, as it is difficult to imitate by its competitors.



Similar to core competency, organisations possess distinctive competencies. Distinctive competency is a specific ability possessed by a particular organisation exclusively or relatively in large measures. It is a strength that allows an organisation to gain a competitive advantage by differentiating its products or minimising costs. For instance, Motorola created a distinctive competency by developing Six Sigma methodologies in its manufacturing process to produce defect-free cell phones. Table 1 shows the difference between core competency and distinctive competency.

TABLE 1: Difference between Core Competency and Distinctive Competency

Core Competency	Distinctive Competency
It is a well-performed internal activity, which is central to the organisation's competitiveness and profitability.	It is a unique competitive activity that helps the organisation perform better than its rivals.
Examples:	Examples:
= Sony: Core competency in miniaturisation of products	= Sharp Corporation: Expertise in flat panel display technology
= McDonald's: Core competency in delivery speed, customer care and cleanliness	= Intel: Expertise in designing and manufacturing powerful microprocessors for PCs
= Federal Express: Core competency in logistics management and customer service	= Walmart: Expertise in low-cost distribution and use of the state-of-the-art retail technology



STUDY HINT

According to Arend and Levesque, and Barney, inimitable resources are resources which are costly to copy and non-substitutable. In other words, there is no alternative to these resources to fulfill the same function immediately.

According to Robert M. Grant, competitors find it difficult to replicate core competency that has the following features:

- **Durability:** This reflects the time span that a resource takes to become obsolete or depreciate. The longer the durability of any product/service/brand name, the tougher it is for competitors to replicate core competency.
- **Transparency:** It reflects the degree of transparency between resources, capabilities and strategies used to develop core competency. The more confused competitors are about what is building core competency, the more difficult it is to copy it. Hence, in order to create core competency, the level of transparency should be low.
- **Transferability:** The lower the level of transferability of factors that build core competency for an organisation, the harder it would be for competitors to replicate core competency. Here, transferability reflects the relocating ability of any resource, capability and strategy that build core competency for an organisation. If these factors can be easily transferred, then competitors could easily follow it. Therefore, for building core competency for an organisation, the level of transferability must be low.
- **Replicability:** It covers the usage of duplicate resources or capabilities by competitors to imitate an organisation's core competency. An organisation should try to build its core competency on factors that have fewer chances of being copied.

Identifying factors that help in building core competency further assist an organisation in determining a sustainable competitive advantage. Building a core

competency that is difficult to replicate gives a fair chance to an organisation to remain ahead of the competition and enjoy the benefits of competitive advantage in the market.



ACTIVITY 1

Take three service organisations and three manufacturing organisations of your choice. List their core competencies in a chart.



NOTE

Organisational capabilities do not change rapidly as they are developed over a long period of time.

Organisational Capabilities

Organisational capabilities refer to the ability of an organisation to attain its objectives, and gain competitive advantage. Organisational capabilities can be achieved/increased by aligning organisational resources and employees' skills to organisational strategies.

Organisational capabilities denote an organisation's strength to use its skills for coordinating its resources and putting them to the best productive use. In other words, organisational capabilities denote the potential of the organisation to utilise its strengths and surmount its weakness to exploit opportunities and face threats in the environment. An organisation can build capabilities through the skills and knowledge of its employees. Employees' skills and knowledge get enhanced when they are provided with learning opportunities.

Organisational capabilities help in gaining strategic advantages; these are rewards in terms of profit, shareholder value, market share or reputation. The absence of capabilities leads to the emergence of strategic disadvantages – financial loss or damage to the market share.

Organisational capabilities help to differentiate an organisation from other organisations as its capabilities are specific and gained over a period. These provide value to the organisation as these are organisation-specific and cannot be transferred and imitated easily. In today's scenario, an organisation focusses on developing its capabilities further to cope with the dynamic and uncertain environment.

Organisational capabilities help to identify the problems with which the organisation deals on a routine basis. These also help in identifying the ways of innovation and development for the organisation. This helps to attain competitive advantage and survive in a highly competitive environment. Organisational capabilities are of two types as explained below:

- **Static capabilities:** Static capabilities help the organisation deal with the problems it faces on a routine basis. Static capabilities enable organisations to sustain in the market.
- **Innovative capabilities:** Innovative capabilities relate to the invention of new abilities, which results in the innovation of new products or services and add value to the organisation. Apple Inc. is an example of an organisation having innovative capabilities. The company is known for researching on ways that could not only help it in bringing new and innovative products, but also in increasing its overall capability.

1.3.2 | EXTERNAL (MACRO) ENVIRONMENT



NOTE

External environmental factors usually affect product demand, consumption and investment patterns.

Other than the immediate surrounding environment of an organisation, there may be factors that influence the overall economy of a particular geographical area or a country. These factors have an impact on the functioning of all organisations operating in that economy. Such type of environment is called external or macro environment.

The external environment is dynamic in nature and is made up of forces that are not under the control of any organisation. However, these forces have a powerful impact on the functioning of organisations. Some of these forces include legislative policies, trade policies, political situation, etc. Figure 2 shows the major components of the external environment:

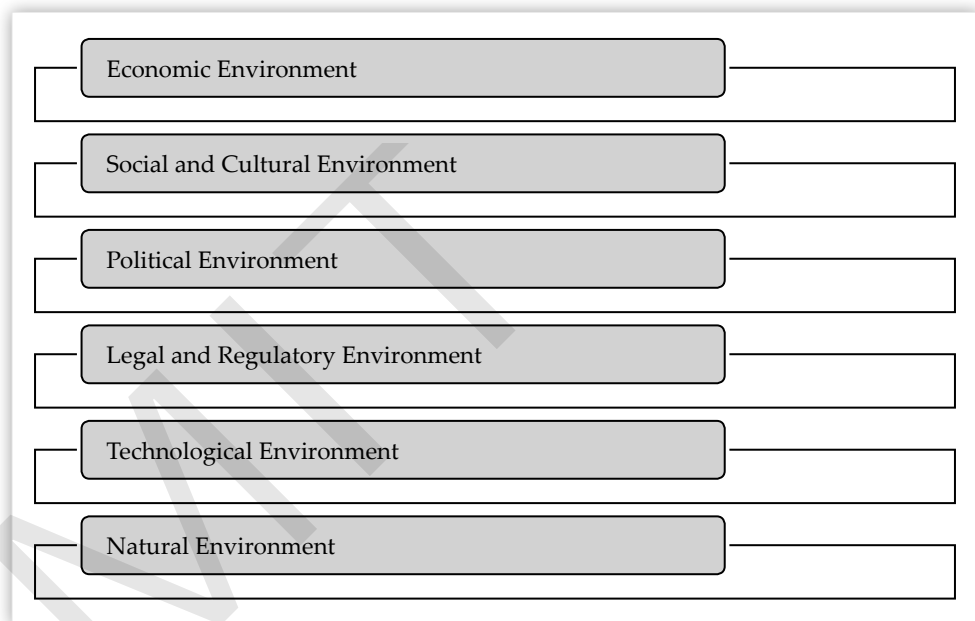


FIGURE 2: Major Components of External Environment

Let's now discuss the important components of the external environment of an organisation in the following sections.

Economic Environment

The economic environment affects an organisation's cost structure and customers' purchasing power. The purchasing power of customers depends on their current income, savings, prices of products and credit availability. The factors affecting the economic environment are:

- **Inflation:** It influences customers' demand for different products. For example, higher petrol prices lead to a fall in demand for cars.
- **Interest rates:** These determine the borrowing activities of the organisation. For example, an increase in interest rates for loans may lead the organisation to cut its important activities.
- **Unemployment:** This leads to a no income state, which affects the purchasing power of an individual.

- **Customer income:** It regulates the buying behaviour of a customer. A change in the customer's income leads to changed spending patterns for products like food and clothing.
- **Monetary and fiscal policy:** Monetary policy stabilises the economy by controlling interest rates and money supply in the economy, whereas fiscal policy regulates the government spending in various areas by collecting revenue from citizens by taxing their income.

Social and Cultural Environment

Every business organisation gets affected by the society in which it operates. The social and cultural environment of a business consists of elements, such as society's basic values, attitudes, perceptions and behaviour. The socio-cultural environment explains the characteristics of the society in which the organisation exists. The analysis of the socio-cultural environment helps the organisation in identifying threats and opportunities for the organisation. For example, as the lifestyles of people changed considerably, they now have lesser time to spend on shopping. This has led to the emergence of shopping malls and supermarkets where they could get everything under one roof to save time.

Political Environment

The political environment consists of factors, such as laws related to public affairs, government policies, fair trade decisions, tax regulations and subsidy policies. The political environment might affect the organisation in both positive and negative ways. Government policies, such as tax incentives or subsidies, impact the business activities positively, whereas strict government regulations or increase in tariffs impact business activities negatively. Some important factors influencing the political environment include the nature of political systems, political ideologies, political stability, and government rules and regulations. For example, the liberal industrial policies of the Gujarat government made Gujarat a leading industrial state in India.

All organisations operate in a particular political environment. Even in the United States, which is considered to be a free market, organisations are not free from the influence of the government. For example, the recession of 2008 substantially increased the unemployment level in the US. In order to create more employment opportunities, the then Obama administration took various measures. It provided tax incentives to organisations which were not outsourcing jobs to other countries. The restrictions on outsourcing increased the operational costs of organisations.

The Tata Nano project in Singur is another case in point. The project was shifted to Gujarat because of political issues between the West Bengal government and the opposition party. Thus, Tata had to bear a huge financial loss because of the political conflict.

The future uncertainties faced by an organisation on account of political factors are known as political risks. In addition to government policies and regulations, political instability also adds to political risk. Different political parties have different ideologies and policies. Therefore, a change in government may affect an organisation significantly. As a result, there is a huge amount of risk involved to carry business operations in politically unstable countries. On the other



STUDY HINT

Businesses and the government have certain duties towards each other, which they must fulfil in order that the businesses can run smoothly. For example, a business has a duty to pay taxes and the government has a duty to provide a favourable environment for the business to conduct its activities.

hand, countries such as India and China are now considered lucrative business destinations because of the political stability in these countries. Political instability also leads to stock market volatility, which affects an organisation in several ways. In addition, tax rates, subsidy policies, foreign investment policies, divestment policies, and other economic policies of the government also affect an organisation.

Legal and Regulatory Environment

The legal and regulatory environment comprises the laws and regulatory framework that directly or indirectly affect an organisation. Every organisation needs to abide by the laws of the country in which it operates. The regulatory framework that affects the organisation varies from one country to another. Some important legislations in India, which have a bearing upon business organisations, are as follows:



NOTE

Forbes, in 2014, published an article according to which most of the CEOs in the USA believed that the regulatory environment of a country has more impact on a business rather than on the economy.

- The Factories Act, 1948
- The Industries (Development and Regulation) Act, 1951
- The Prevention of Food Adulteration Act, 1954
- The Companies Act, 2013
- The Payment of Wages Act, 1936
- The Industrial Disputes Act, 1972
- The Payment of Gratuity Act, 1972
- The Employees Provident Funds and Miscellaneous Provisions Act, 1952
- The Code on Wages, 2019
- The Bureau of Indian Standards Act, 1986
- The Consumer Protection Act, 1986
- The Foreign Exchange Management Act, 1999
- The Trade Marks Act, 1999
- The Patents Act, 1970
- The Competition Act, 2002
- The Information Technology Act, 2000
- The Essential Commodities Act, 2002
- The Central Goods and Services Tax Act, 2017
- The State Goods and Services Tax Act, 2017
- The Integrated Goods and Services Tax Act, 2017



EXHIBIT

THE SHOP AND ESTABLISHMENT ACT

In India, most businesses are subject to the Shop and Establishment Act, which is enacted by every state. The Act is regulated by the Department of Labor and regulates areas such as working hours, rest interval for employees,

opening and closing hours, closed days, national and religious holidays, overtime work, rules for employment of children, annual leave, maternity leave, sickness and casual leave, etc. The Act not only regulates the working of commercial establishments, but also societies, charitable trusts, printing establishments, educational institutions run for gain and premises in which banking, insurance, stock or share brokerage is carried on.

The state specific laws dealing with Shops & Establishments are listed herein below:

1. Andhra Pradesh Shops & Establishments Act, 1988
2. Bihar Shops and Establishments Act, 1953
3. Delhi Shops & Establishments Act, 1954
4. Punjab Shops And Commercial Establishments Act, 1958 [Also applicable in Chandigarh & Haryana]
5. Goa, Daman & Diu Shops and Establishments Act, 1973
6. Bombay Shops & Establishments Act, 1948 [Also applicable in Gujarat]
7. Himachal Pradesh Shops and Commercial Establishments Act, 1969
8. Jharkhand Shops and Establishments Act, 2000
9. Karnataka Shops and Commercial Establishments Acts, 1961
10. Kerala Shops and Commercial Establishments Act, 1960
11. Madhya Pradesh Shops and Establishments Act, 1958
12. Manipur Shops & Establishments Act, 1972
13. Meghalaya Shops & Establishments Act, 2003
14. Nagaland Shops and Establishments Act, 1986
15. Orissa Shops & Commercial Establishments Act, 1956
16. Rajasthan Shops and Commercial Establishments Act, 1958
17. Sikkim Shops and Commercial Establishments Act, 1983
18. Tamil Nadu Shops and Establishments Act, 1947
19. Tamil Nadu Catering Establishments Act, 1958
20. U. P. Dookan aur Vanijay Adhistan Adhiniyan, 1962
21. West Bengal Shops and Establishments Act, 1963

Source: <https://www.citehr.com/438998-total-number-shops-establishment-act-all-states.html>

An organisation can face serious consequences if it does not abide by the laws and regulatory framework of a country. For instance, when KFC entered in India in 1995, it was not aware of the Prevention of Food Adulteration Act, 1954. KFC chicken contained three times more monosodium glutamate (an ingredient used to enhance flavour) than allowed by the Act. Therefore, an organisation should analyse the various aspects of the laws and regulatory framework before entering in any country.

Technological Environment

The technological environment includes new inventions for improving the business processes of an organisation. These processes include the production process, the communication process and the distribution process. Technological innovations influence the decisions of organisations and determine how they compete and thrive in the marketplace.



Quick TIP

The technological environment of an organisation mostly affects customers, employees, operating costs and security. For instance, social media and the Internet have made it easier for organisations to develop their outreach programmes.

Today, technology contributes to the economic growth of a country. It has become an indispensable part of our lives. Organisations that fail to track ongoing technological changes find it difficult to survive in today's competitive environment. Technology acts as a rapidly changing force, which creates new opportunities for organisations to acquire the market share. Therefore, organisations need to observe changing trends in technology. Technological trends that affect an organisation's environment are as follows:

- **Pace of technological change:** It may lead to product obsolescence. If the pace of technological change is rapid, then organisations need to modify their products as and when required, lest their products should become obsolete at a rapid pace.
- **Research and development:** It helps in increasing growth opportunities for an organisation. Today, many organisations have developed a separate team for R&D to bring innovation in their products/services.
- **Increased regulation:** It refers to government guidelines to ban unsafe products. Organisations should be aware of these regulations to prevent their violation.

Natural Environment

The natural or ecological environment consists of natural resources, which are needed by an organisation to manufacture products. Natural factors that affect the activities of an organisation include:

- **Natural resources:** These resources serve as raw materials for manufacturing various products. Organisations are realising the problem of depletion of natural resources and are trying to use these resources judiciously. Thus, some organisations have begun de-marketing their products. For example, Indian Oil Corporation (IOC) tries to reduce the demand for its products by promoting advertisements such as 'Save Oil, Save India'.
- **Weather:** This leads to opportunities or threats for organisations. For example, in summers, the demand for water coolers, air conditioners, cotton clothes and water increases, while in winters, the demand for woollen clothes and room heaters rises. The organisational environment is greatly influenced by the weather conditions of a country.
- **Pollution:** It includes air, water and noise pollution, which lead to environmental degradation. Nowadays organisations tend to promote environment-friendly products through their marketing activities. For example, organisations promote the usage of jute and paper bags instead of plastic bags.

Thus, an organisation needs to be concerned about the natural environment and make continuous efforts to minimise the environmental damage. In other words, the organisation can create a better brand image by being more environment-conscious. Therefore, the natural environment plays a vital role in the long term success of the organisation.



EXHIBIT

DIFFERENCES BETWEEN INTERNAL AND EXTERNAL ENVIRONMENT

Characteristic	Internal Environment	External Environment
Definition	It is the immediate environment in which the organisation operates.	It is the general environment, specific to a larger geographical area, like a country or a state which affects all business entities.
Factors or elements	Competitors, vendors and suppliers, intermediaries, customers, etc.	Geographical characteristics, economy, social and cultural determinants, technological factors, regulatory and political factors
Nature of elements	Specific to an organisation/ business category	Generally affect all organisations operating in an economy
Extent of control	Limited control possible	No control of business
Impact	Direct and regular	Indirect and irregular



**SELF
ASSESSMENT
QUESTIONS**

4. The nearby environment under which an organisation operates is called _____ environment.
5. The internal or micro-environment factors represent the strengths and weaknesses of an organisation, whereas the external or macro factors represent the opportunities for and threats to an organisation. (True/ False)
6. Which of the following factors affect the internal environment of an organisation?
 - a. Competitors
 - b. Intermediaries
 - c. Customers
 - d. All of these
7. The process of identifying and analysing organisational resources, which helps attain a competitive advantage, is known as _____ organisational analysis.
8. _____ refers to a collective learning of an organisation that is gained by coordinating diverse skills of employees and integrating technologies.

9. Which of the following components of the external environment affects an organisation's cost structure and customers' purchasing power?
 - a. Natural environment
 - b. Political environment
 - c. Economic environment
 - d. Social and cultural environment
10. The future uncertainties faced by an organisation on account of political factors are known as _____.



ACTIVITY 2

Using the Internet, find out why analysing environment is important for brand competitors like Coke and Pepsi, which engaged in the so-called cola wars for decades.

1.4 SUMMARY



- The business environment can be defined as the sum total of all individuals, institutions and other forces that are beyond the control of an organisation, but the organisation still depends upon them as they affect the overall performance and sustainability of the organisation.
- A clear understanding of the business environment can have the following effects on the business:
 - Identification of existing and potential opportunities and threats
 - Creation of a culture of continuous learning
 - Image-building
 - Ability to combat competition
 - Carry out SWOT analysis
- The business environment can be broadly classified into internal (micro) and external (macro) environment.
- The nearby environment, under which an organisation operates, is called the internal environment. On the other hand, the general environment that affects the working of all organisations is called the external environment.
- The major components of the internal environment are:
 - Organisational resources
 - Core competencies
 - Organisational capabilities
- The major components of the external environment are:
 - Economic environment
 - Social and cultural environment
 - Political environment
 - Legal and regulatory environment
 - Technological environment

1.5 KEY WORDS



- **Competitive advantage:** Specific advantage of an organisation over its competitors that helps increase its profit margins and retain the maximum number of customers
- **Core competency:** Collective learning of an organisation, gained by coordinating diverse skills of employees and integrating technologies
- **Distinctive competencies:** Unique and superior competencies of an organisation that add value in various organisational processes
- **Inflation:** The increase in the price level of goods and services in an economy in a specified time period
- **Market:** A place where organisational activities are carried out
- **Resource-Based View (RBV):** A process of identifying and analysing organisational resources, which aid in attaining competitive advantage

1.6 CASE STUDY: QATAR AIRWAYS FLYING HIGH WITH WINGS OF COMPETITIVE ADVANTAGE



Source: www.qatarairways.com

Qatar Airways, the national airlines of the State of Qatar, began its operations in 1994 and was re-launched in 1997 by The Emir, Sheikh Hamad bin Khalifa Al Thani, who aspired to turn Qatar Airways into a leading international airlines.

Appointed as the CEO of the airlines in 1996, Akbar Al Baker led the airlines to become a high-quality carrier and displayed an amazing growth in fleet size and passengers' numbers. It was awarded the Airline of the Year award in 2011 at the annual Skytrax World Airline Awards. The company took delivery of its 100th aircraft in 2011. Qatar Airways was awarded the title of being the "World's Top Airline" in the final Global Airline Rankings of the World Airline Awards for the year 2012. The airline has now reached over 100 destinations globally in alliance with its code-share partners.

With its consistent growth, the airlines now comprises the following organisations under the Qatar Airways Group:

- Qatar Aircraft Catering Company
- Qatar Aviation Services

- Qatar Distribution Company
- Doha International Airport
- Qatar Executive
- Qatar Airways Cargo
- Qatar Duty Free

The tremendous growth of Qatar Airways and its achievements are evidence of a valuable combination of resources and capabilities. Some of which are:

- **Availability of financial resources and capabilities:** The airline has a strong financial position due to its stronghold on petrodollars. The airlines has adequate funds for its smooth functioning. In addition, it also has an internal capacity to generate funds through internal and external sources as required.
- **Availability of physical resources and capabilities:** The physical resources of the airlines include offices, plants and equipment. The geographic locations of its establishments and access to raw materials and distribution channels add to the airlines' capabilities. Qatar Airways has achieved phenomenal growth in its fleet size and number of customers.
- **Availability of technological resources and capabilities:** Qatar Airways has technical skills and resources that give it a competitive edge, supported by trademarks, patents, copyrights, etc. The Airways has a fleet size of over 100 aircraft carriers, and has recently added Airbus A330 carrier in its fleet. In 2012, the airlines also got into an agreement with Wipro Infotech to develop its technological strength.
- **Availability of organisational resources and capabilities:** The airlines under the leadership of its CEO Akbar Al Baker has managed to elevate its standards with an exceptional alignment of its organisational resource allocation strategy with the internal environment.
- **Availability of organisational human resources and capabilities:** Qatar Airways could not have achieved its success without the availability of well-trained and experienced staff.



Source: www.qatarairways.com

- **Innovation resources and capabilities:** The airline has established a global network of over 100 destinations. In Doha, the capital city of Qatar, the airlines has established a hub from where it covers destinations like Europe, Middle East, Africa, South Asia, Asia Pacific, North America and South America, and brings Qatar on the global travel map. The airlines has a modern fleet of over 110 passenger and cargo aircraft. In 2009, with a flying time of 16 hours, the airlines launched the longest non-stop flight in the world from Doha to Houston. Qatar Airways launched its executive subsidiary Qatar Executive in 2009 to operate corporate jets.

Continuing with its commitment to innovate, the airlines has built and operates the international premium terminal at the Doha International Airport. This terminal is specifically meant for its premium passengers and is only one of its kind in the world.

- **Corporate social responsibility and safety norms:** In 2003, the airlines achieved 100% compliance in the International Air Transport Association Operational Safety Audit, the first of its kind to do so. The group is also involved in social work and research activities to fulfil its corporate social responsibility. The airline engages in activities pertaining to the welfare of the local and global community. The organisation leads in the research and production of new generation fuel, made from natural gas. The airline boasts of the world's first commercial passenger flight run on a fuel made from natural gas.

Conclusion

Having a competitive edge enabled Qatar Airways to not only offer value services to its passengers but also increase its profits. The airline adequately and efficiently uses its resources to achieve a competitive advantage that results in superior value creation. Every airline across the world has resources and established work processes but only a few of them are able to strategically use their resources and capabilities.

The above analysis emphasises that core competencies are crucial for gaining and sustaining competitive advantage. The strategy of Qatar Airways was to acquire new resources and generate new capabilities and competencies since its inception to turn its weaknesses into strengths. Technology is an important factor in competitive advantage. Qatar Airways can further reduce costs to sustain competitive advantage by strategizing the development of new aviation technology, innovating its marketing activities, and further improving its customer relationship management techniques.

Human resources, even though expensive, also form the most important constituent of a competitive advantage. A skilled workforce can provide credibility to a business and long-term success. Qatar Airlines should continue and even improvise wherever possible its recruitment and selection, training and development, and rewards and remuneration programmes.

Qatar Airways is an apt example of how gaining and sustaining a competitive edge through strategy can help increase revenues. To translate a strategy into a competitive advantage, an organisation must possess core competencies and capabilities.

QUESTIONS

1. Explain the growth story of Qatar Airways.
(**Hint:** Qatar Airways, the national airlines of the State of Qatar, began its operations in 1994 and was re-launched in 1997 by The Emir, Sheikh Hamad bin Khalifa Al Thani, who aspired to turn Qatar Airways into a leading international airlines.)
2. Write a short note on the factors that gave Qatar Airways a competitive edge.
(**Hint:** The tremendous growth of Qatar Airways and its achievements are evidence of a valuable combination of resources and capabilities.)

1.7 SHORT ANSWER QUESTIONS



1. _____ can be defined as the sum total of all individuals, institutions and other forces that are beyond the control of an organisation, but the organisation still depending upon them as they affect its overall performance and sustainability.
2. Understanding the business environment helps an organisation retain its market position and gain _____.
3. _____ competency is a specific ability possessed by a particular organisation that allows to gain a competitive advantage by differentiating its products or minimising costs.
4. _____ is the general environment, specific to a larger geographical area, like a country or a state which affects all business entities.
5. A core competency can be gained by an organisation in either of the two ways – explicit knowledge and _____ knowledge.
6. _____ capabilities help an organisation deal with the problems it faces on a routine basis.
7. The full form of RBV in organisational analysis is Resource-Based View. (True/False)
8. Explicit knowledge either exists in employees' experience or is inherited in the culture of the organisation. (True/False)
9. Business environment is dynamic in nature. (True/False)
10. Political environment is affected by various factors, such as inflation, interest rates, unemployment, monetary and fiscal policy. (True/False)
11. Which of the following types of business environment is specific to an organisation or business category?
 - a. External environment
 - b. Internal environment
 - c. Both a. and b.
 - d. None of these
12. Which of the following is not an element of external environment?
 - a. Geographical characteristics
 - b. Social and cultural determinants

- c. Technological factors
 - d. Suppliers
13. Which of the following factors affects the internal environment?
- a. Vendors or suppliers
 - b. Competitors
 - c. Intermediaries
 - d. All of these
14. Which of the following features is possessed by core competency so that competitors find it difficult to replicate it?
- a. Durability
 - b. Transparency
 - c. Transferability
 - d. All of these
15. Which of the following is not a natural factor that affects the activities of an organisation?
- a. Natural resources
 - b. Weather
 - c. Pollution
 - d. Unemployment
16. Which of the following is defined as a type of organisational capabilities that relates to the invention of new abilities, which result in the innovation of new products or services and add value to the organisation?
- a. Static capabilities
 - b. Innovative capabilities
 - c. Both a. and b.
 - d. None of these
17. Which of the following is an external environmental factor that an organisation needs to abide by the laws of the country in which it operates?
- a. Legal and regulatory environment
 - b. Economic environment
 - c. Technological environment
 - d. None of these
18. Which of the following options is a technological trend that affects an organisation's environment?
- a. Pace of technological change
 - b. Research and Development (R&D)
 - c. Increases regulation
 - d. All of these
19. Government policies and regulation is an important component of which of the following external environments?
- a. Political environment
 - b. Social and cultural environment
 - c. Economic environment
 - d. None of these

20. Which of the following is not a characteristic of the organisation's environment?
- a. Complexity
 - b. Vibrancy
 - c. Versatility
 - d. Static
21. Society's basic values, attitudes, perception and behaviour are the main components of which of the following external environments?
- a. Political environment
 - b. Social and cultural environment
 - c. Economic environment
 - d. None of these
22. Which of the following options is not an advantage of organisational capabilities?
- a. Rewards in terms of profit
 - b. Increase in a shareholder's value
 - c. Increase in the market share
 - d. None of these
23. Which of the following options is a well-performed internal activity, which is central to the organisation's competitiveness and profitability?
- a. Core competency
 - b. Distinctive competency
 - c. Explicit knowledge
 - d. None of these
24. Which of the following organisational resources consists of financial resources, such as cash and long-term investments or physical resources, such as plant and machinery, etc.?
- a. Tangible resources
 - b. Intangible resources
 - c. Organisational capabilities
 - d. None of these
25. Which of the following is an advantage of understanding and analysing business environment?
- a. Image-building
 - b. Competitive advantage
 - c. Continuous learning
 - d. All of these

1.8 DESCRIPTIVE QUESTIONS



1. Explain the concept and scope of the business environment.
2. Briefly describe the difference between the internal and external environments.
3. Explain various components of the internal environment.
4. What are the various components of the external environment? Discuss in brief.

1.9 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Business Environment	1.	Business environment
	2.	True
	3.	False
Types of Business Environment	4.	internal
	5.	True
	6.	d. All of these
	7.	Resource-Based View (RBV)
	8.	Core competency
	9.	c. Economic environment
	10.	political risks

B. SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	Business environment
2.	competitive advantage
3.	Distinctive
4.	External environment
5.	tacit
6.	Static
7.	True
8.	False
9.	True
10.	False
11.	b. Internal environment
12.	d. Suppliers
13.	d. All of these
14.	d. All of these
15.	d. Unemployment
16.	b. Innovative capabilities
17.	a. Legal and regulatory environment
18.	d. All of these

Q. No.	Answer
19.	a. Political environment
20.	d. Static
21.	b. Social and cultural environment
22.	d. None of these
23.	a. Core competency
24.	a. Tangible resources
25.	d. All of these

1.10 SUGGESTED BOOKS AND E-REFERENCES



SUGGESTED BOOKS

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A. Self Assessment Questions

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2.11 Suggested Books and e-References



LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Explain business environment analysis
- ▶▶ Discuss globalisation and its impact on businesses
- ▶▶ Explain the role of ethics in the business environment
- ▶▶ Describe how to create ethical environment in organisations

2.1 INTRODUCTION

Read Pre-read Connect

The previous chapter has explained various factors, such as political factors, social factors, cultural factors and economic factors, that affect business strategies and decisions of an organisation.

The success of a business today largely depends on its ability to analyse environmental changes and internal and external environmental factors effectively. The widely used technique for analysing the business environment is SWOT analysis, which analyses the strengths, weaknesses, opportunities and threats in an organisation.

Apart from analysing the internal and external environment, it is also important to understand that with the advent of globalisation, businesses have begun expanding globally. This has led businesses to cater to the global needs by operating in multiple countries. Therefore, it is important for organisations to understand the repercussions of globalisation, irrespective of what kind of businesses they are into.

In order to perform effectively in such a dynamic and global business environment, an organisation also requires focusing on business ethics. Ethics are concerned with setting moral standards and norms of human behaviour. In an organisation, employees are expected to possess highly defined ethics. This is a strong ethical base of employees that ensures high productivity of both employees and the organisation. Thus, it is important for an organisation and its employees to have a deep insight into organisational ethics.

This chapter focuses on how to analyse these business environmental factors to create effective business strategies. Moreover, the chapter focuses on factors such as globalisation and ethics and discusses how these factors affect the business environment of any organisation.

2.2 BUSINESS ENVIRONMENT ANALYSIS



NOTE

Business environment analysis facilitates strategic thinking within the organisation.


Business environment analysis refers to identifying internal strengths and weaknesses, and external opportunities and threats of an organisation. It analyses the means to leverage external opportunities and manage internal weaknesses and external threats. Therefore, business environment analysis is an important prerequisite for creating business strategies. The two most widely used techniques for conducting business environment analysis are:

- PESTLE analysis
- SWOT analysis

Let us discuss these two techniques in detail.

2.2.1 | PESTLE ANALYSIS

PESTLE analysis is a tool that organisations use for analysing and monitoring macro-environmental factors having prominent effect on organisational activities.

 **STUDY HINT**

PESTLE analysis is used by organisations before launching a new venture or before entering into a new industry.

These macro-environmental factors encompass the external business environment of an organisation. PESTLE stands for:

- P – Political
- E – Economic
- S – Socio-cultural
- T – Technological
- L – Legal
- E – Environmental

Analysis of each of the above macro-environmental factors provides organisations with deep insight into potential threats and weaknesses to business. Such information on threats and weaknesses is used for performing SWOT analysis. A detailed explanation on SWOT analysis is given in the next section.

Figure 1 shows macro-environmental factors:

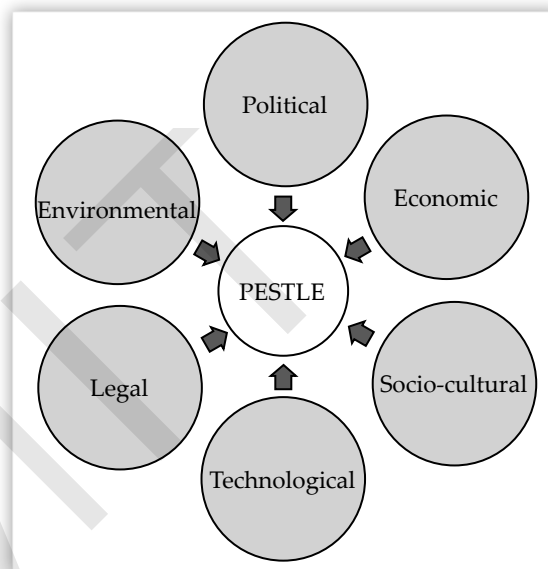


FIGURE 1: Factors in PESTLE Analysis

Let us discuss impact of each of the factors on business activities of an organisation.

- **Political factors:** These factors estimate the extent to which the government can intervene in an organisation's business activities. Such intervention can happen when the government formulate certain rules and regulations and businesses are bound to act accordingly. These rules and regulations are given by the government in the form of different policies, such as foreign trade policy, tax policy, labour law, environmental law, trade restrictions and so on. Political stability or instability of overseas markets also affects business practices of organisations.
- **Economic factors:** These factors affect the growth and profitability of organisations to a large extent. Economic factors include economic growth of a country, rates of interest, exchange rates, inflation, disposable income of consumers and businesses, demand and supply patterns in different markets, etc.
- **Socio-cultural factors:** They constitute shared beliefs and attitudes of people in a country. Traditions, cultural aspects, ethical values, family demographics, food habits and education levels of people form the socio-

cultural environment of a country. These factors may have serious impact on an organisation's business practices. For example, an apparel manufacturer dealing in Western clothing cannot think of extending its business in Gulf countries. Thus, adapting to socio-cultural factors of a country is a key to success for organisations.



NOTE

PESTLE and SWOT both are used as strategic planning tools.

- **Technological factors:** These factors include changes in methods of manufacturing and distribution, automation, research and development, intellectual property regulations, competitor's technology, etc.
- **Legal factors:** These include present and future legal and regulatory requirements that have serious impact on businesses. Legal factors may include laws related to consumer protection, labour, health and safety, protection of intellectual property, tax and discrimination; international and domestic trade regulations/restrictions, advertising standards, product labelling and safety standards, etc.
- **Environmental factors:** They are related to the surrounding environment that may get affected by an organisation's business practices. These factors include weather, climate change, carbon footprint, environmental regulations, pollution laws, recycling and waste management policies, laws for renewable energy, and so on. With the growing awareness of Corporate Sustainability Responsibility (CSR) initiatives, considering environmental factors has become of prime importance for businesses.

2.2.2 | SWOT ANALYSIS

SWOT stands for Strengths, Weaknesses, Opportunities and Threats. SWOT analysis helps in formulating effective strategies for a business. It aims to match the strengths and weaknesses of the organisation, with opportunities and threats faced by the organisation. An organisation always tries to leverage opportunities with the help of its strengths; In addition, the organisation also needs to protect itself from external threats by minimising its weaknesses. While performing a SWOT analysis, the organisation needs to answer the following questions:



Quick TIP

Strengths and weaknesses come under the purview of the internal environment, whereas threats and opportunities come under the purview of the external environment.

- How is the organisation better than its competitors?
- What unique skills or resources does it possess?
- How are the competitors better than the organisation?
- What unique skills or resources do the competitors possess?
- What are the market opportunities that remain unutilised?
- What are the changes in the external environment that pose a threat to the organisation?

SWOT has the following four components:

- **Strengths:** Strengths help a firm in gaining a strategic advantage over its competitors. Some examples of organisational strengths are brand name, expertise, strong distribution network, diversified products and cost advantage. For instance, a strong brand image and a wide distribution channel are the strengths of Coca-Cola.

- **Weaknesses:** Weaknesses refer to organisational constraints which lead to strategic disadvantages. Organisational weaknesses include a lack of product diversity, high attrition rate and low awareness among consumers about the brand. For example, weakness of Tesco is an over-dependence on the UK market for its revenue.
- **Opportunities:** Opportunities signify the presence of favourable conditions in the external environment of an organisation. Opportunities can be capitalised by properly utilising the strengths of the organisation. Economic boom, unfulfilled needs of customers, technological developments and change in customers' tastes and preferences of customers are some examples of opportunities. For instance, economic de-regulation created a huge opportunity for many international organisations to enter India and capitalise on its huge market.
- **Threats:** Threats are the presence of unfavourable conditions in the external environment of an organisation. Threats add to the risk faced by the organisation. Threats have the potential to weaken an organisation, either financially or otherwise. Economic recession, shift in consumers' tastes and preferences, unfavourable regulations, political instability and easy entry of new players are some of the typical threats faced by different organisations. For example, entry of retail giant Walmart posed a serious threat to Indian retailers such as Big Bazaar. This is because Walmart has greater resources and more expertise than Big Bazaar.

SWOT analysis is usually done on a four-cell matrix, in which the four cells represent four components of SWOT. An example of the SWOT matrix of a hypothetical organisation XYZ is shown in Figure 2:

NOTE
SWOT analysis is used to create a unique selling proposition (USP) for products and services.

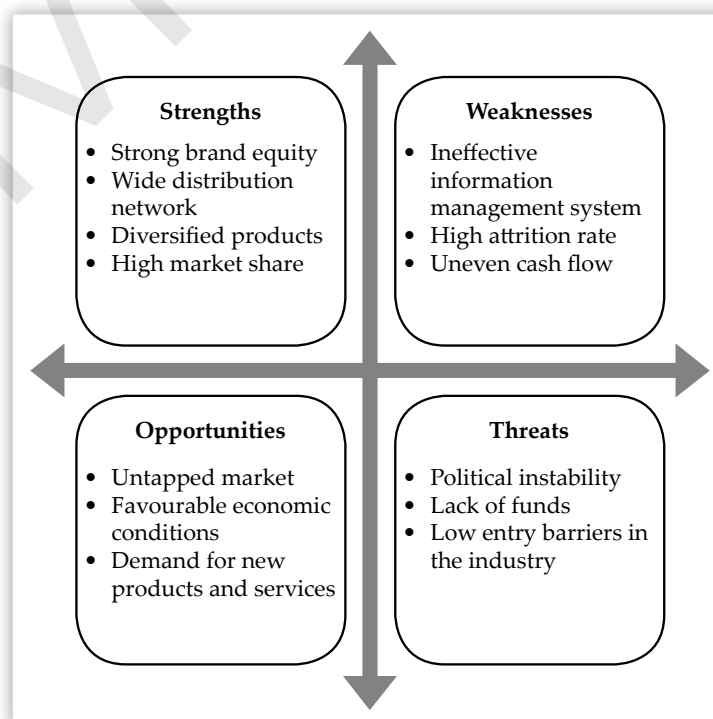


FIGURE 2: SWOT Analysis—The Four-Cell Matrix

Therefore, SWOT analysis provides a detailed understanding of the strengths and weaknesses in comparison to the threats and opportunities of an organisation. A survey conducted by Competitive Intelligence Professionals revealed that SWOT analysis was used by more than 82% of the respondents. The main reasons for its wide popularity are simplicity in terms of usage, flexibility, clarity and goal orientation. However, SWOT analysis has a few pitfalls as well. These include an over-simplification of the complex market scenario and generation of a lengthy list of four components.



SELF ASSESSMENT QUESTIONS

1. Which of the following is not an environmental threat?
 - a. Political and legislative changes
 - b. Environmental effects
 - c. Development in information technology
 - d. Weakness of the competitor
2. Shift in consumers' tastes is a type of threat faced by an organisation. (True/False)
3. _____ is the presence of unfavourable conditions in the external environment of an organisation.

2.3 GLOBALISATION AND ITS IMPACT ON BUSINESSES

There has been a frequent shift in national cultures, organisational structure and trade patterns with the changing world economy. Earlier, countries were confined to their national boundaries only and restricted trade to cross-border territories. Now, the scenario has changed as an open economy and relaxation in trade barriers has led to free flow of capital, goods, services, human resources and technologies across nations.

Different economies have integrated into an international economy through the exchange of trade and foreign direct investments (which are investments made to acquire long-term interest in an organisation at a global level). This cross-border integration and interconnection can be social, economic, cultural or political. This integration is attributed to the emergence of the concept of globalisation.

Concept and Definition of Globalisation

Globalisation can be defined as an assimilation of different countries through the exchange of ideas, financial resources, information, goods and resources. It has made a significant contribution to the Indian economy by generating abundant employment opportunities with the expansion of markets. Globalisation has both positive and negative impact on the economy of a country. Following are some popular definitions of globalisation:

The **United Nations ESCWA** defines globalisation in *an economic context*. *Globalisation is the reduction and removal of barriers between national borders in order to facilitate the flow of goods, capital, services and labour, although considerable barriers remain to the flow of labour. Globalisation is not a new phenomenon. It began in the late*

Important Concept

As per **Karadagli**, globalisation is the integration of trade, finance, social-cultural, and technological processes that connect people across continents.

nineteenth century, but its spread slowed during the period from the start of the First World War until the third quarter of the twentieth century. This slowdown can be attributed to the inward-looking policies pursued by a number of countries in order to protect their respective industries, however, the pace of globalisation picked up rapidly during the fourth quarter of the twentieth century.

Tom G. Palmer of the Cato Institute states that *globalisation is the diminution or elimination of state-enforced restrictions on exchanges across borders and the increasingly integrated and complex global system of production and exchange that has emerged as a result.*

Thomas L. Friedman has analysed the impact of the flattening of the world, and argues that globalised trade, outsourcing, supply chain and political forces have changed the world permanently, both for better and for worse. He also argues that the pace of globalisation is rapid and will continue to make an impact on business organisations and practice.

Noam Chomsky argues that the word 'globalisation' is used in a doctrinal sense to describe the neoliberal form of economic globalisation. Therefore, on the basis of the aforementioned definitions, globalisation is the interdependence and integration of the global economy to enhance the worldwide exchange of capital, goods and services. A particular product may not necessarily be designed, manufactured and sold in one country alone. For example, Daimler Chrysler car is designed in Germany and assembled in Mexico from the components made in the United States and Japan. The interiors of cars are made from Malaysian rubber and Korean steel. Another example can be Nokia cell phone, which is designed in Finland and made in China or Korea using chip sets produced in Taiwan and designed by an Indian software engineer working there. All this integration is possible due to globalisation.



NOTE

Globalisation has been instrumental in shaping the Indian industry and has been made possible by ensuring major shifts in the economic and political policies.

Globalisation, when seen through the perspectives of market, means the merging of separate, distinct and isolated national markets into a large global marketplace. Relaxation in trade barriers and adaptation to cultures across nations has made it possible for organisations to maintain a standard quality and sell their products in other countries. For example, consumer products like Citibank credit cards, soft drinks by Pepsi Co., Play Station and video games by Sony, Apple iPod, and McDonald's burgers have maintained the same quality and standards throughout the world.

However, the production perspective of globalisation refers to the sourcing of raw materials, parts and components and services from different countries. This is advantageous to the organisations in terms of national differences in costs of labour, energy, land and capital. For example, IBM ThinkPad X31 Laptop is designed by efficient IBM engineers in the United States. A computer case, keyboard and hard drive are manufactured in Thailand; the display screen and memory were contributed by South Korea; Malaysia provides the built-in wireless card; whereas the United States manufactures the microprocessor.

Finally, the laptop is assembled in Mexico and shipped for further sale. This whole process segregates the manufacturing process of countries where specific jobs can be done in the most cost-effective manner (with cheap labour and raw materials) and ultimately uses the expertise of the best nations to assemble final products.

Another very common example of globalisation can be seen in Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO) that have been used to advantage national differences in production costs.

Impact of Globalisation on Business Organisations

Let us now discuss how globalisation impacts a business.

Globalisation is driven by advancement and changes in the world economy. Generally, organisations go global for a reason for expanding their markets and increasing their sales and profits. One of the major forces leading to globalisation is the expansion of communication systems. In present times, it has become easier and convenient to distribute information to any part of the world through the Internet. Globalisation has affected business organisations in several ways. Some of these are:

- **Advancement of technologies:** It is one of the crucial factors of globalisation. Enhancement in Information Technology (IT), telecommunications and an improved communication network has made a remarkable improvement since the 1990s in the way information is accessed. The advancement in technology has led organisations to easy exchange of goods and services, resources and ideas, irrespective of geographical location of a place.
- **Reduction in cross-trade barriers:** It is another critical force of globalisation, which has affected business organisations to a large extent. Every country restricts the movement of goods and services across its border by imposing tariffs and quotas on goods and services imported. These random restrictions and regulations create chaos in a global business environment. Such practices impose limits on international business activities. However, due to globalisation, trade restrictions imposed by several countries have been relaxed to a great extent. In the export-import of goods, the tariff and non-tariff barriers and subsidies were reduced by different countries to allow a free movement of goods across the borders.
- **Increase in consumer demand:** With an increase in the average family income and standard of living, the demand of consumers for a variety of products has also increased. Consumers nowadays are well aware of products and services available in other countries through the use of the Internet, phone and television. This fact has impelled many organisations to work in association with foreign players for catering to the needs of the local market.
- **High competition:** An organisation generally strives hard to gain a competitive edge in the market. A frequent increase in competition in the domestic market compels organisations to go global. Thus, organisations enter other countries (for selling goods and services) to expand their market share. They export goods to foreign lands where they receive a relatively higher price for their goods and services. Many organisations strive to achieve even larger global market shares through mergers and acquisitions, strategic alliances and joint ventures.
- **Financial integration:** Financial integration is one of the most crucial positive impacts of globalisation on businesses. Financial integration is defined as a phenomenon in which global economies are closely linked. It is a process of closely assimilating different financial markets and economies, thus leading

to a free flow of capital and financial resources within nations. Technologies, such as electronic data transfer and electronic fund transfer, have contributed significantly to the development of globalisation. The inflow of FDI, portfolio investment and bank credit rose dramatically since the late 1990s.

- **Employment opportunities:** Due to globalisation, many organisations have shown their interest in investing capital in different countries and have expanded their reach globally by establishing new branches and subsidiaries in different countries. Of late, there is tremendous growth in segments, such as IT, personal and beauty care, etc. This has led to a remarkable increase in employment opportunities, especially in developing countries. Due to an increase in better employment opportunities, individuals move from one country to another and in return bring back foreign currency, which adds to the national income of the country they belong to.



**SELF
ASSESSMENT
QUESTIONS**

4. _____ can be defined as an assimilation of different countries through the exchange of ideas, financial resources, information, goods and resources.
5. Globalisation is driven by advancement and changes in the world economy. (True/False)
6. A frequent increase in competition in the domestic market compels organisations to go global. (True/False)

2.4 CORPORATE GOVERNANCE, SOCIAL RESPONSIBILITY AND BUSINESS ETHICS

Before developing a relationship between the three terms 'corporate governance', 'social responsibility' and business ethics, let us first understand the meaning of these three terms one by one.

Corporate governance is a set of systems, principles and processes employed in an organisation with an aim to enforce accountability and maintain transparency. In other words, corporate governance provides guidelines regarding how the organisation can be directed or controlled so that it can meet its goals and objectives in a way that it can create value and is also beneficial for all stakeholders in the long term. Nowadays, almost every organisation strives to operate at a global level. Therefore, organisations are more accountable than in the past. Consequently, regulatory bodies like the Organisation for Economic Co-operation and Development (OECD) have started demanding that business organisations must adopt corporate governance principles.

Social responsibility is a self-regulating business practice that enables organisations to be socially accountable to itself, its stakeholders and the public. Key areas of social responsibility include eco-efficiency, responsible sourcing, stakeholder engagement, labour standards and working conditions, employee and community relations, social equity, gender balance, human rights, good governance and anticorruption measures. Social responsibility basically involves voluntary efforts

of organisations to ensure that the negative impact of their business activities on stakeholders are eliminated or reduced.



STUDY HINT

The 3Cs of business ethics are Compliance, Contribution and Consequences.

Ethics can be defined as a set of principles that helps in segregating fair from unfair. In other words, it is a branch of philosophy that deals with standards for right and wrong behaviour of individuals. When a code of conduct is followed in business, it is called business ethics. A business has several stakeholders, such as consumers, financial institutions, government, employees and suppliers. Ethical business practices help in delivering values to its stakeholders, which, in turn, develops loyalty quotient for business.



EXHIBIT

SIGNIFICANCE OF BUSINESS ETHICS

The importance of business ethics is explained in the following points:

- **Creating a good image:** A business firm following a code of conduct (ethics) is able to create a good image of the business in the minds of its customers. A good public image helps business firms to lead the market.
- **Stopping business malpractices:** Business ethics examines various ethical problems, such as insider trading, corporate governance, bribery, discrimination, corporate social responsibility and fiduciary responsibilities.
- **Improving customers' confidence:** Once customers are aware of the ethical values of a concerned organisation, they start building trust towards that organisation. Moreover, an organisation with customer loyalty is always able to emerge as a brand.
- **Safeguarding consumers' rights:** As per the Consumer Protection Act, 1986, a consumer has a right to safety, right to be informed, right to choose, right to be heard and right to redress. Business ethics ensure that the concerned business organisation is respecting all these rights of its consumers.
- **Protecting other stakeholders:** It is not only the consumer segment that should be treated well by organisations, but there are also many other stakeholders as well that require fair treatment by organisations. For example, an organisation that treats its employees fairly is able to get loyalty quotient from employees in return.
- **Competing with a healthy approach:** Competition is inevitable, but a healthy approach towards competitors helps in building a cordial atmosphere. Business firms should try to provide equal opportunities to small-scale businesses, such as taking raw materials from small-scale suppliers. They must ignore the formation of monopolies as it degrades consumer sovereignty.
- **Developing good relations:** An organisation maintaining a code of conduct is able to earn respect in return, thereby developing good and friendly relations between the organisation and society. This would help businesses in earning profits, which would lead to the growth of the economy.

By considering the above definitions of the three terms, it can be said that 'corporate governance', 'social responsibility' and 'business ethics' are interrelated concepts. Corporate governance stresses that organisations should be transparent and accountable; social responsibility emphasises that business activities of organisations must support society; and business ethics explains moral norms for employees. In a nutshell, it can be said that business ethics enables managers to be more accountable and transparent. Similarly, when corporate governance principles are adopted by an organisation, it becomes mandatory for the organisation to meet the expectations of its stakeholders. Thus, corporate governance principles include principles related to business ethics and social responsibility.



EXHIBIT

STEPS IN CREATING AN ETHICAL ENVIRONMENT IN ORGANISATIONS

For creating an ethical environment in an organisation, it should be ensured that the ethics of the organisation are embedded in its culture. An organisation that has ethics embedded in its culture can ensure the ethical behaviour of its employees. There are certain steps that an organisation must follow to make the organisation an ethical one. These steps are:

1. **Getting commitment from top management:** The top management of an organisation includes all individuals that have the power to make strategic decisions. Any action taken at the top level trickles down to the bottom. Therefore, an ethical environment can be created in the organisation if the top management takes an initiative towards adopting ethical practices.
2. **Setting a code of ethics:** To build and ensure an ethical and moral behaviour in an organisation, formal codes must be developed. These codes can be altered from time to time as per business and human resource requirements. Such codes of conduct state the norms and behaviour expected by the organisation in an explicit manner. However, implicit norms also exist in the organisation, that are not stated anywhere, but are followed throughout the organisation.
3. **Communicating ethics:** After the codes of ethics are created, it is important that they are communicated across in detail. Successful implementation of any code depends on how well it is communicated to people. In this regard, it is advisable that the top management should hold meetings with employees on a regular basis to inform them about existing or upcoming codes of ethics.
4. **Providing training on ethics:** Communicating the codes of ethics is important for an organisation. However, assuming that employees will be able to fully practise these codes is an overstatement. Employees may think that they are well informed about the code of ethics, but in reality, it may not be so. Therefore, it is in the interest of the employees to attend and imbibe ethical training sessions conducted by the organisation.
5. **Designating an ethics officer:** An ethics officer guides employees in imparting ethical conduct and the right decision making. He/she is the permanent employee of an organisation and a part of the top management.

Important Concept

According to Cater Mcnamara, business ethics is generally coming to know what is right or wrong in the workplace and doing what is right—this is in regard to effects of products/services and in relationship with stakeholders.

If employees get to know about any wrong practices being carried out in their organisation, they can inform the ethics officer about it. The ethics officer guides about what constitutes moral behaviour and moral choice making. In some cases, there is a whole panel that is dedicated to ethics. The activities that are performed by the ethics panel include the following:

- Organising regular meetings to discuss ethical issues
 - Detecting areas where ethical codes are violated
 - Communicating the codes of conduct to all members of the organisation
 - Recognising employees who show ethical behaviour and punishing those who violate the stated codes.
6. **Checking response and ensuring enforcement:** For an organisation, enforcing the codes of ethics throughout the organisation is a major issue, which is also a difficult move. The positive response of employees must be rewarded, while the unethical and violating behaviour of employees must be curbed.
 7. **Performing audits, revisions and refinement:** To ensure that the code of ethics is being implemented and administered successfully, reviews and audits are conducted. Such audits include an itemised examination of any potential infringement of laws/regulations.



SELF ASSESSMENT QUESTIONS

7. _____ is a branch of philosophy that deals with standards for right and wrong behaviour of individuals.
8. When a code of conduct is followed in business, it is called _____.
9. Social responsibility is a self-regulating business practice that enables organisations to be socially accountable to itself, its stakeholders and the public. (True/False)
10. Regulatory bodies like the _____ have started demanding that business organisations must adopt corporate governance principles.



ACTIVITY 1

With the help of the Internet, find and present information on how business ethics helped TCS in boosting its market image.

2.5 SUMMARY



- Business environment analysis refers to identifying internal strengths and weaknesses, and external opportunities and threats of the organisation.
- The most widely used technique for conducting business environment analysis is the SWOT analysis.

- SWOT stands for Strengths, Weaknesses, Opportunities and Threats.
- Globalisation can be defined as assimilation of different countries through the exchange of ideas, financial resources, information, goods and resources.
- Globalisation has affected business organisations in several ways. Some of these are:
 - Advancement of technologies
 - Reduction in cross-trade barriers
 - Increase in consumer demand
 - High competition
 - Financial integration
 - Employment opportunities
- Corporate governance is a set of systems, principles and processes employed in an organisation with an aim to enforce accountability and maintain transparency.
- Social responsibility is a self-regulating business practice that enables organisations to be socially accountable to itself, its stakeholders and the public.
- Ethics can be defined as a set of principles that helps in segregating fair from unfair. In other words, it is a branch of philosophy that deals with standards for right and wrong behaviour of individuals. When a code of conduct is followed in business, it is called business ethics.

2.6 KEY WORDS



- **Audit:** Inspection of an organisation's accounts
- **Corporate governance:** A mechanism of controlling and directing an organisation and protecting the interests of stakeholders
- **Social responsibility:** A business practice of participating in social initiatives that benefit both the society and the organisation
- **Foreign Direct Investment (FDI):** An investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company
- **Globalisation:** The reduction and removal of barriers between national borders in order to facilitate the free flow of goods, capital, services and labour
- **Gross Domestic Product (GDP):** The monetary value of all the finished goods and services produced within a country's borders in a specific time period

2.7 CASE STUDY: SWOT ANALYSIS OF MAYO CLINIC



Based out of Rochester, Mayo Clinic was started as a temporary hospital in 1883 by Dr. William and his two sons, William J. and Charles H. Mayo when a tornado struck the city. Today Mayo Clinic is one of the most reputed healthcare providers in the world. The organisation has established three clinics and four hospitals spanning across three states. The hospital now employs more than 40K physicians, medical scientists, nursing and paramedical professionals. Further, Mayo Clinic Health System comprised nearly 70 hospitals and clinics spread across Minnesota, Iowa, and Wisconsin is also owned and operated by Mayo Clinic. In addition to this, three colleges for medical training, namely Mayo School of Graduate Medical Education, Mayo School of Health Sciences and Mayo Medical School are also owned and operated by Mayo Clinic. Around a million people from all 50 states and around 150 countries seek medical treatment at Mayo each year.

Despite its tremendous growth, Mayo Clinic adheres to its guiding principle that 'the best interest of the patient is the only interest to be considered'.



Source: www.mayoclinic.org

MAYO's MISSION STATEMENT

As stated on the website of Mayo Clinic (2018), its mission statement is:

"To inspire hope and contribute to health and well-being by providing the best care to every patient through integrated clinical practice, education and research."

Their primary value states that "The needs of the patient come first". Therefore, we can say that Mayo Clinic is a patient-focussed organisation.

SWOT ANALYSIS OF THE ORGANISATION

Strengths

Some of the strengths of the organisation are:

- **Availability of highly skilled physicians and staff, culture of innovation and research capabilities:** Mayo Clinic is a highly research- and education-oriented institute. The healthcare teams at Mayo are engaged in multidisciplinary research projects that make it a pioneer in the invention of new treatment and prevention techniques.

- **Focus on quality:** Quality of healthcare services is one of the flagship services that provide a competitive edge to the organisation. Mayo makes focused efforts towards the achievement of excellence in knowledge, medical expertise and quality of medical care, empathetic and compassionate staff and latest technology. The organisation makes use of clinical indicators like mortality rate, post-surgical infections and, number of correct diagnoses. In addition administrative quality indicators like time for initial assessment, treating patients with respect and dignity, patient satisfaction scores, etc., are also monitored and evaluated continuously.
- **Integrated medical record system and team work:** Mayo makes use of the state-of-art healthcare technology like patient scheduling system that facilitates process flows in the hospital by assigning patients to physicians, organising the patient's time at clinic, etc. In addition, the electronic medical record captures vital information about patients like laboratory tests, notes of doctors and the entire treatment record. The previous history of the patient can be accessed by physician at any point in time.

Weaknesses

- Despite its high standards and quality of care, there are still areas where the organisation can make conscious efforts to make improvements.
- It was reported in 2016 by the affiliated regional medical groups that the ambulatory care services of the Mayo Health System were ranked below regional average of 12.
- The consistency of services across multiple hospitals and clinics of Mayo was assessed to be varying by the Dartmouth Researchers. The patients being provided end-of-life intensity at different Mayo Foundation Hospitals showed the inconsistency of care. This is an indication for Mayo to improve this service area.

Opportunities

- The extension of research findings into practice is an opportunity for Mayo Clinic to increase the scope of its services in new treatments and diagnosis.
- Mayo Clinic focusses on affiliations for increasing its footprint in newer geographical locations and building a larger network.

Threats

- The organisation has traditionally followed a salary-based compensation system. This is known to have increased the fixed cost of the hospital.
- It is relatively difficult to acquire and retain highly qualified medical practitioners in America.
- Mayo can likely face criticism on researches and innovation by its competitors and other medical authorities.

The current success of Mayo Clinic rests on three pillars, namely:

- Salary-based compensation for doctors and multidisciplinary practices; patient care gets enhanced in a group practice approach

- A well-integrated technological infrastructure, and research and innovation
- Patient-oriented policies

Some strategies that Mayo Clinic can consider as per SWOT analysis include:

- Expansion of services to geriatric, i.e., aging population as the baby boomers become senior citizens, they are likely to suffer from chronic diseases and diseases of the old.
- In the past, Mayo Clinic has faced denial of funding for on-going research activities. This poses a threat to its current strengths, which may prove to be a deterrent to its research and innovation culture.
- Quality initiatives of the organisation can also adopt techniques like Lean Operations and Six Sigma for improving its ambulatory care experience and for bringing consistency of care and processes across all of its locations.

QUESTIONS

1. Explain the growth story of Mayo Clinic.

(**Hint:** Based out of Rochester, Mayo Clinic was started as a temporary hospital in 1883. Today, Mayo Clinic is one of the most reputed healthcare providers in the world.)

2. Based on the SWOT analysis of Mayo Clinic, discuss its major strengths.

(**Hint:** Some of the strengths of the organisation are the availability of highly skilled physicians and staff, culture of innovation and research capabilities. Mayo Clinic is a highly research- and education-oriented institute.)

2.8 SHORT ANSWER QUESTIONS



1. The widely adopted technique for analysing the business environment is the _____ analysis.
2. _____ are concerned with setting moral standards and norms of human behaviour.
3. _____ analysis refers to identifying internal strengths and weaknesses, and external opportunities and threats of the organisation.
4. _____ signifies the presence of favourable conditions in the external environment of an organisation.
5. Free flow of capital, goods, services, human resources and technologies across nations is a feature of _____.
6. As per the _____, a consumer has a right to safety, right to be informed, right to choose, right to be heard and right to redress.
7. Business environment analysis is an important prerequisite for creating business strategies. (True/False)
8. Threats refer to the organisational constraints which lead to strategic disadvantages. (True/False)

9. Expansion of modern communication systems is one of the major forces which lead to globalisation. (True/False)
10. When a code of conduct is followed in business, it is called business ethics. (True/False)
11. Which of the following is not a component of SWOT analysis?
 - a. Strengths
 - b. Weaknesses
 - c. Opportunities
 - d. Trade
12. SWOT analysis is widely adopted because of which of the following reasons?
 - a. Simplicity
 - b. Flexibility
 - c. Clarity
 - d. All of these
13. Which one of the following is not an impact of globalisation?
 - a. Technological advancements
 - b. Reduction in trade barriers
 - c. Low competition
 - d. Employment opportunities
14. Which of the following options delineates as the importance of business ethics?
 - a. Protecting other stakeholders
 - b. Safeguarding consumer's rights
 - c. Improving customer's confidence
 - d. All of these
15. Which of the following is the first step of creating an ethical environment in organisations?
 - a. Setting a code of conduct
 - b. Getting commitment from the top management
 - c. Communicating ethics
 - d. Designating an ethics officer
16. Which of the following is the last step of creating an ethical environment in organisations?
 - a. Setting a code of conduct
 - b. Getting commitment from top management
 - c. Communicating ethics
 - d. Performing audits, revisions and refinement

17. Which of the following activities is performed by the ethics panel?
 - a. Organising regular meetings to discuss ethical issues
 - b. Detecting areas where ethical codes are violated
 - c. Communicating the codes of conduct to all members of the organisation
 - d. All of these
18. Which of the following is not an advantage of fostering business ethics in an organisation?
 - a. Customer loyalty
 - b. Satisfaction of employees
 - c. Congenial work environment
 - d. None of these
19. Which of the following is not an advantage of globalisation?
 - a. Cost advantage
 - b. Quality improvement
 - c. Larger market share
 - d. Low employment
20. The cross-border integration and interconnection can be:
 - a. social and cultural
 - b. economic
 - c. political
 - d. All of these
21. As per the survey conducted by the Competitive Intelligence Professionals, it has been revealed that the SWOT analysis was used by more than ____ % of the respondents.
 - a. 50
 - b. 82
 - c. 80
 - d. 30
22. Which of the following is an example of weakness as per SWOT analysis?
 - a. Strong brand equity
 - b. Ineffective information
 - c. Lack of funds
 - d. Untapped market
23. Which of the following is an example of opportunities as per SWOT analysis?
 - a. Strong brand equity
 - b. Demand of new products and services

- c. Diversified products
 - d. None of these
24. Which of the following is an example of threat as per SWOT analysis?
- a. Strong brand equity
 - b. Demand for new products and services
 - c. Political instability
 - d. None of these
25. Which of the following is an example of strength as per SWOT analysis?
- a. Strong brand equity
 - b. Demand of new products and services
 - c. Political instability
 - d. None of these

2.9 DESCRIPTIVE QUESTIONS



1. Briefly describe SWOT analysis.
2. What do you understand by the term globalisation?
3. Write a short note on business ethics.
4. Establish a relationship between 'corporate governance', 'social responsibility' and 'business ethics'.

2.10 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Business Environment Analysis	1.	d. Weakness of the competitor
	2.	True
	3.	Threat
Globalisation and its Impact on Businesses	4.	Globalisation
	5.	True
	6.	True
Corporate Governance, Social Responsibility and Business Ethics	7.	Ethics
	8.	business ethics
	9.	True
	10.	Organisation for Economic Co-operation and Development (OECD)

B. | SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	SWOT
2.	Ethics
3.	Business environment
4.	Opportunity
5.	globalisation
6.	Consumer Protection Act, 1986
7.	True
8.	False
9.	True
10.	True
11.	d. Trade
12.	d. All of these
13.	c. Low competition
14.	d. All of these
15.	b. Getting commitment from the top management
16.	d. Performing audits, revisions and refinement
17.	d. All of these
18.	d. None of these
19.	d. Low employment
20.	d. All of these
21.	b. 82
22.	b. Ineffective information
23.	b. Demand of new products and services
24.	c. Political instability
25.	a. Strong brand equity

2.11 SUGGESTED BOOKS AND E-REFERENCES**SUGGESTED BOOKS**

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LEGAL ENVIRONMENT

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Discuss the legal aspects of business
- ▶▶ Explain various types of business laws
- ▶▶ Describe various constituents of the Indian Legal System
- ▶▶ List various sources of law
- ▶▶ State the impact of the legal system in business decision making

3.1 INTRODUCTION

 **Read**
Pre-read Connect

In the last two chapters, you have learned about the general business environment surrounding companies. From this chapter onwards, we shall study the legal environment of businesses in India.

The chapter provides an overview of the legal environment surrounding businesses in India. In subsequent chapters, we shall study some major laws which are essential for the orderly conduct of businesses.

3.2 LEGAL ASPECTS OF BUSINESS



NOTE

According to **Blackstone**, law is defined as a rule of civil conduct, prescribed by the supreme power of a state, commanding what is right and prohibiting what is wrong.

The legal environment refers to laws and regulations that are established in a country for the orderly conduct of business. It is important for managers to understand the legal environment of a country as they reflect the policy framework and the mind-set of the governmental structure of the country. It would enable them to function as per the statutory framework of the country.

The main function of laws is to provide stability, predictability and continuity so that people can determine what is legally right and wrong and the rights, obligations and privileges of citizens are clearly and formally demarcated. The society consists of both individuals and businesses. The legal system also treats businesses as legal entities. Hence, laws are framed not only for individuals of the society but also for the orderly conduct of businesses in the society. Hence, we can say that the laws of any country consist of enforceable rules that govern relationships between individuals, businesses and the society. The laws can differ between different countries. This is because the laws establish rights, duties and privileges that are consistent with the cultural values and beliefs of the respective societies which are different in different countries based on the evolution of their society.

As the laws concern individuals, society and businesses of a country, it implies that there are different types of laws depending on the entities, and their rights and duties. For example, civil laws deal with the violation of the rights of individuals. The criminal law is meant for governing relationships between individuals and the society. Any wrong-doing by an individual against the society is handled by the criminal law. Similarly, business laws deal with the orderly conduct of businesses and their relationships with other constituents of the society.

A business person can be an individual, a sole proprietor, a partnership or a company. The scope of business laws covers the almost entire gamut of operations of businesses starting from the incorporation of the business entity to day-to-day functioning to bankruptcy proceedings if any.

Laws can also be classified in terms of substantive laws and procedural laws. The substantive laws give rights and responsibilities while procedural laws govern the administration of those laws in terms of procedures involved.

The administrative law and procedures constitute a dominant element in the regulatory environment of business. For example, while laws governing financial securities are governed by securities contracts passed by the parliament,

administrative bodies like the Securities and Exchange Board of India (SEBI) established by the government for the purpose of formulating the regulations to enforce the Securities Contract Act.



STUDY HINT

Today, the organisations must also focus on data security and privacy laws.

The most important law which regulates all aspects relating to a company in India is the Companies Act, 2013. It contains provisions relating to the formation of a company, powers, and responsibilities of managers, raising capital, holding meetings, etc. In the subsequent section, we shall discuss important legislation governing businesses in India.

Figure 1 shows various laws that affect business operations:

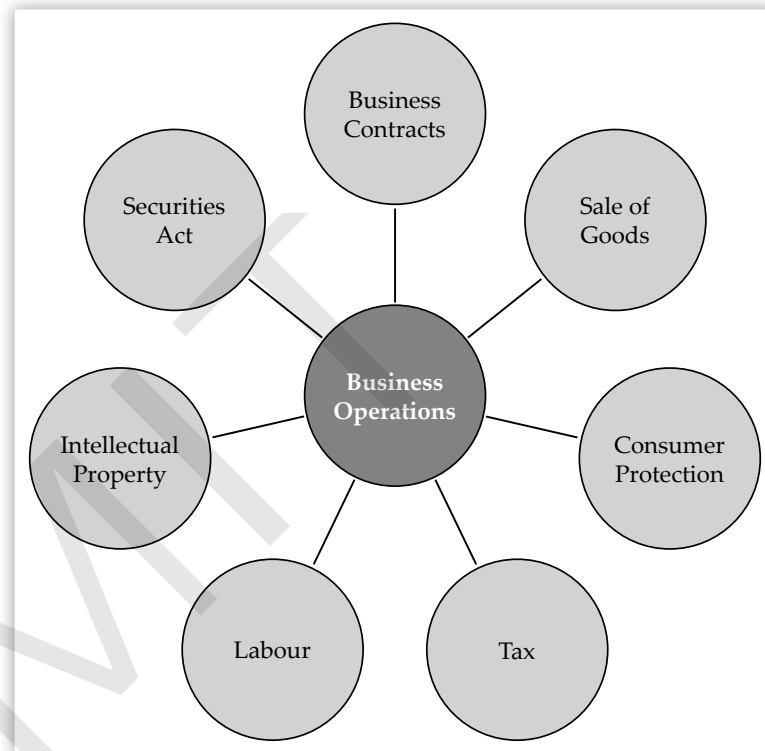


FIGURE 1: Laws that Affect Business Operations



SELF ASSESSMENT QUESTIONS

1. The legal aspects of the business are governed by which of the following?

a. Business laws	b. Criminal laws
c. Administrative laws	d. Both a. and c.
2. Civil laws deal with the violation of the rights of individuals. (True/False)

3.3 INTRODUCTION TO BUSINESS LAWS



STUDY HINT

Business law is also known as commercial law.

Business law is the body of rules, whether by convention, agreement or national or international legislation, governing the dealings between persons in commercial matters. Business laws regulate both the incorporation to winding up of business entities (Companies Act) and their various types of business transactions and

operations (Contracts Act, etc.). Business laws, for example, regulate various business operations, like corporate contracts, employee hiring practices, manufacture of goods and marketing and sales of goods.

 **Quick TIP**

The collection of all the business laws establishes a framework within which an organisation must carry out all its business activities.

The objectives of business laws are to:

- Provide a framework of rules, regulations and procedures, in terms of various central and state government laws within which business activities can be carried out ensuring the orderly conduct of business.
- Establish a framework of judicial and quasi-judicial authorities and related regulations to whom business persons can resort to when there are violations of legal rights.
- Prevent the concentration of economic power.
- Protect the interests of consumers and ensure environment protection.

Given below is a brief description of various important business laws:

- **Indian Contract Act, 1972:** The Contracts Act governs the definition, formation and performance of contracts. The law is essential in order to facilitate legally enforceable agreements between people and conduct business operations with confidence. As per this Act, any agreement is a legally enforceable contract under law, if it has the following elements:
 1. Offer by a contracting party
 2. Acceptance by the other party (both of whom are competent to enter into an agreement and the agreement is made with free consent) and
 3. A lawful consideration. In the case of the breach of contract, the injured party can claim damages and seek an injunction. The Act also governs the agency relationship between the principal and agent, and their rights and duties.

The contract act also governs several important types of contracts like the contract of indemnity and guarantee, contract of bailment and pledge and contract of agency.

- **Indian Sale of Goods Act, 1930:** This Act defines a special type of contract – the Contract of Sale (which was earlier governed by the Contracts Act itself). A contract of sale is a contract whereby a seller transfers or agrees to transfer the property in goods to a buyer for a price. It is subject to the general principles of the Contracts Act. However, it deals with the additional features of purchase and sale such as transfer of ownership of goods, delivery of goods, rights and duties of buyer and seller, remedies for breach of sale, conditions and warranties implied under the contract, etc.
- **Contract of Partnership Act, 1932:** This Act governs another special type of contract – the Contract of Partnership. The Act defines partnership as the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. The individual persons of the partnership are called “partners” and the partnership is termed as “a firm”. The act governs various features of the partnership like definitions, duties of partners, the conduct of business, mutual right and liabilities, profits earned

by partners, implied authority of the partner as an agent of the firm, the liability of a partner for the acts of the firm, dissolution of partnership, etc.

- **Negotiable Instruments Act, 1881:** This Act governs the laws relating to negotiable instruments. A negotiable instrument is a 'document transferable by delivery'. The document (e.g. bank cheque) is a written contract evidencing a right to receive money and it may be transferred by negotiation which could be by delivery or by endorsement. Examples of negotiable instruments are bank cheques payable either to order or bearer, promissory notes and bill of exchanges. The Act governs the definition of terms involved, liabilities of parties to the instrument, rules regarding negotiation, presentment, payment, interest and discharge of liabilities. It also describes the methods of notice of dishonour, noting and protest, penalties in the case of dishonour, etc.
- **Companies Act, 2013:** This Act regulates the incorporation, conduct and dissolution of listed and unlisted companies. It contains provisions about the definition of a company, types of companies, registration of companies, important documents like memorandum and articles of association of companies, directors and their responsibilities, concepts regarding separation of ownership and management, the liability of the company and shareholders, transferability of shares, etc. The Act came into force across India on 12th September 2013 and has a few amendments to the Companies Act 1956. It has also introduced new concepts like a One Person Company.
- **Patents Act, 1970:** This Act governs industrial patents that are protectable under the law. It defines what constitute a patent, provides requirements for patentability, details the procedures for patenting and describes the protection available under the Act and penalties applicable in the case of infringement of patents.
- **Consumer Protection Act, 2019:** This Act is meant for protecting consumer interests. The Act guarantees six specific rights for consumers and provides for the establishment of consumer councils to protect these rights, and three-tier quasi-judicial agencies for the redressal of consumer grievances.



NOTE

CSR Rules have been defined under Companies Act, 2013 and these rules specify the set of activities for companies to undertake in order to meet their obligations.

Other important business laws are Workmen Compensation Act, Payment of Bonus Act, Payment of Gratuity Act, Minimum Wages Act, Competition Act and Right to Information Act, etc.

3.3.1 BUSINESS MANAGEMENT AND JURISPRUDENCE



STUDY HINT

Business law is derived from customary law, judicial decisions, common law and Indian statutes.

Business laws are enacted by legislative bodies like parliament and state assemblies. The role of the executive is to implement the provisions of the Act. The role of the judiciary is to interpret the Act for the given case. Even though the laws are written in a precise manner so that there is no possibility of ambiguity, it is still possible for courts to have conflicting interpretations. Since acts are written in a given context if the context changes over a period of time, the interpretations can also change with the context. In this way, courts play a significant role in defining what the law is.

Though judges are not free to decide cases solely on the basis of their personal opinions, how judges apply the law to specific cases of business disputes depends in part on their philosophical approaches to law. Judges have some flexibility in interpreting and applying the law. The philosophical approach to the study of

law is termed as “jurisprudence” and there are different schools of jurisprudential thought which can lead to different kinds of interpretation of laws in a particular context.



SELF ASSESSMENT QUESTIONS

3. Which of the following is true with regard to business laws?
 - a. The Companies Act provides various business laws required to regulate businesses.
 - b. Business laws affect almost every aspect of businesses.
 - c. Business laws focus on the incorporation of a company and the raising of capital.
 - d. Business laws are based on commonly accepted rules, conventions and traditions and there is no particular act enacted for the purpose.
4. Which of the following is not an objective of business laws?
 - a. Orderly conduct of business
 - b. Establish a framework of judicial and quasi-judicial authorities related to regulations
 - c. To allow growth of big and powerful corporates with economic power
 - d. To protect interests of consumers
5. When dealing with business disputes, the judges:
 - a. Have to strictly judge the case based on statutes
 - b. Have flexibility in interpreting the laws depending on the context
 - c. Have the power to enact new laws
 - d. None of these



ACTIVITY 1

Consider any recent major business case adjudged in a court of India where judges have given a verdict based on their interpretations of the law concerned. Comment on which of the schools of jurisprudence that particular interpretation can be classified into.

3.4 INDIAN LEGAL SYSTEM

The legal system followed by most countries can be classified into two types namely, common law and civil law traditions.

Common law system is generally uncodified. This means there is no comprehensive compilation of legal rules and statutes. Common law is developed through the doctrine of *stare decisis*, which means “to abide by decided cases”. Once a court resolves a particular issue, other courts in the same jurisdiction addressing a similar legal problem will generally follow that court’s decision.



Quick TIP

Business law is the part of civil law.

The legal decisions of courts are largely based on precedents which are judicial decisions that have already made in similar cases in the past. These precedents are maintained over time through the records of the courts as well as historically documented in collections of case law known as yearbooks and reports. This implies that judges have an enormous role in shaping the laws.

The civil law system is a codified system with a comprehensive, continuously updated legal code that specifies all matters capable of being brought before a court, the applicable procedure, and the appropriate punishment for each offense. Such codes distinguish between substantive and procedural laws. In a civil law system, the judge's role is to establish the facts of the case and to apply the provisions of the applicable code. He is required to work within a framework established by a comprehensive, codified set of laws. The role of the judge is less crucial as compared to decisions of legislators and legal scholars in the civil system.

India inherited the common law system when the British East India Company came to India. Coding of law began with the formation of the first Law Commission and the Indian Penal Code was drafted, enacted and brought into force in 1860. The Code of Criminal Procedure was drafted by the same Commission. After Independence, the Constitution of India was formulated as the guiding light in all matters executive, legislative and judicial, in the country. India follows a hybrid legal system with a mix of common law and civil law.

3.4.1 | LEGAL STRUCTURE



NOTE

The Indian legal system is established from the British common law, passed judicial decisions, i.e., precedence and legislatures.

The subject of law and justice is handled by the Cabinet Ministry of Law and Justice comprising the Legislative Department and Department of Legal Affairs. The Department of Legal Affairs is concerned with advising various ministries of the Central Government while the Legislative Department is concerned with drafting principal legislation for the Central Government. The Department of Justice is also a part of the Ministry of Law and Justice whose functions include the appointment, resignation, and removal of the Chief Justice of India, judges of the Supreme Court of India, Chief Justices and judges of High Courts and their service matters.

In the Indian legal structure, the Judiciary is independent rather than federal in structure. The highest appellate court of the judiciary is the Supreme Court of India, which can decide legislative powers demarcated by the Constitution for union and states. There are high courts in each state and a hierarchy of subordinate courts under the high courts.

3.4.2 | GOVERNMENT ROLES AFFECTING BUSINESS

Apart from the legislative role of making business laws, government plays other roles which can affect businesses. The four important roles played by the government in an economy are:

- **Planning role:** The planning role of government involves promoting rapid economic growth on the basis of national priorities through the optimum use of national resources. The planning role of government can significantly affect the business prospects of companies, especially in the case of socialistic or mixed economies. Even in India, where liberalisation has taken place with

a move away from the socialistic economy to a mixed economy to a free market economy, the government's planning role can significantly affect businesses. In India, the Planning Commission, established in 1950, used to formulate India's five-year plans. This has been replaced now with NITI Aayog, also called the National Institution for Transforming India, a policy think tank of the government established with the aim to achieve sustainable development goals and enhance cooperative federalism by fostering the involvement of state governments in the economic policy-making process using a bottom-up approach. It is meant to provide both directional and policy inputs and design strategic and long-term policies and programmes for the Government of India.

- **Regulatory role:** The government regulations may be based on direct or indirect controls. Direct controls involve administrative controls, like pricing of goods, licensing of industry, regulating foreign direct investments, conducting open market operations of the central bank, etc. Indirect controls may be exercised through fiscal and monetary initiatives like changes in credit policy and fiscal policy. Various ways of government regulations that can affect businesses in a country are given below:
 - The government has the power to determine conditions under which companies can enter into certain lines of business in terms of granting of a charter, a franchise, a license, or permit any person to use public facilities or resources.
 - The government may regulate or promote the conduct of economic ventures based on national policies aimed at achieving economic goals.
 - The government may enact rules and regulations regarding issues of national importance which may affect businesses, like foreign exchange, import and export, repatriation of profits, the ceiling on dividends, limitation of public utility profits, etc.
 - Government regulations may control the relationship between various segments of the economy towards the peaceful business environment and ensure the concentration of economic power.
 - The government may establish legally constituted regulatory bodies (e.g., Quasi-judicial agencies meant for consumer protection, IPR protection, etc.) to protect the interests of consumers, investors, etc.
- **Promotional role:** This refers to government intervention to promote economic growth and industrial development. This includes providing proper infrastructure for businesses to operate, promoting entrepreneurship, assisting priority and rural sectors, promoting private and foreign investments, providing trade incentives for exports and foreign trade, etc.
- **Entrepreneurial role:** The government may also take on an entrepreneurial role by participating in business activities through ownership and management of industrial and management undertakings. The objective is to promote industries where private ownership is difficult or not conducive to the public good, secure balanced growth of the economy, promote capital-intensive industries that may require huge investments and yield low returns in the short run.



NOTE

In India, the government regulates the organisations by means of licensing, capital issues, price controls, distribution mechanism, preventing monopolies and restrictive practices.



**SELF
ASSESSMENT
QUESTIONS**

6. Legal systems followed in different countries can be classified into _____ and _____ traditions.
7. Which of the following statements is true?
 - a. Indian legal system is based on civil law tradition.
 - b. Common law tradition is generally uncodified.
 - c. Civil law is developed through the doctrine of *stare decisis*.
 - d. All of these
8. The four important roles played by the government that can have a significant impact on businesses in a country are _____, _____, _____ and _____.



ACTIVITY 2

Identify a country where civil law tradition is followed. Compare and contrast its legal system with that of India.

3.5 SOURCES OF LAW

Primary sources that establish the laws governing businesses include the following:

- **The Indian Constitution:** The “Constitution” of any country is its supreme law. The Constitution provides the framework for the separation of power between legislative, executive and judiciary authorities who derive their powers directly or indirectly from it. The Constitution of India, which came into force on January 26, 1950, contains 395 articles originally (and now 468 articles) divided into 22 parts and 12 schedules.
- **The Statute Law:** The statutory laws are made by the Parliament of the country, also termed as “Statutes” or “Acts”. The law-making process involves the following steps:
 1. The process starts when a Member of the Parliament (Lok Sabha or Rajya Sabha) introduces a bill. A bill is a draft form of law. The bill is taken up for discussion and the merits and demerits of the bill are discussed by the members of the parliament of the country. After the discussion, the bill may be accepted, rejected or referred to a ‘Standing Committee’ for further recommendations.
 2. If the bill is passed in the Lok Sabha or Rajya sabha, it is sent to the other house of the Parliament. It may again be discussed in the other house which can accept, reject or accept with modifications. If the bill is modified, it is sent to the other house again for acceptance.
 3. At the end of the above process, if the bill is accepted by both the houses of the Parliament, it is sent to the President for his assent.
 4. If the President gives assent, the Bill becomes an Act. The Act could be a new one or an amendment to existing law and whatever be the case, a new law comes into being.



NOTE

Companies Act, 2013; Competition Act, 2002; Copyright Act, 1957; etc., are some of the important statute laws associated with organisations in India.

- **Regulations created by administrative agencies:** The next source of business laws is the administrative law consisting of rules, orders and decisions of administrative agencies. These agencies could be central, state or local government agencies established to perform a specific function. Administrative laws consist of a vast body of laws, also known as subordinate legislation, in the form of rules, regulations as well as bye-laws made by these authorities. This subordinate legislation is made under the authority conferred or delegated either by Parliament or State or Union Territory legislature concerned.

An example is the quasi-judicial agencies established by the Consumer Protection Act. Similarly, the SEBI establishes rules and regulations for the orderly functioning of the capital market which is critical for companies raising finance from capital markets. The administrative laws and procedures constitute a dominant element in the regulatory environment of the business.

- **Judicial precedents and case laws:** The next major source of law is the rules of law announced in court decisions which are based on interpretations of constitutional provisions, statutes enacted by legislatures, and of regulations created by administrative agencies. Judicial decisions of superior courts like Supreme Court and high courts have become important sources of law.

This body of judicial precedents or past history of judicial pronouncements is referred to as case laws. Case laws are doctrines and principles announced in various cases. The common law doctrines and principles govern only areas not covered by the statutory or administrative law.

Apart from the above, local customs and conventions which are not against the statute, morality, etc., are also recognised and taken into account by courts while administering justice in some cases.



NOTE

Judicial precedents are based on the principle of *stare decisis* which means standing by the decision that has already been made.



SELF ASSESSMENT QUESTIONS

- Which of the following is a source of business laws?
 - Constitution
 - Statute laws
 - Judicial precedents
 - All of these
- With regard to business laws, identify the correct statement:
 - A law in India can be enacted once it is approved by any of the Parliament houses.
 - Regulations which are administrative laws require passing of a bill in Lok Sabha and approval by President.
 - In the legal system prevailing in India, judicial precedents and case laws are an important source of business laws.
 - Both (a) and (c)



ACTIVITY 3

Identify a recent business dispute settled in court where the decision was based on judicial precedent. Discuss why the same could not be derived directly based on the statute.

3.6 WHY MANAGERS NEED TO UNDERSTAND LEGAL SYSTEM?

Business laws are meant to regulate and guide the conduct of businesses. It is important for business persons to be aware of these important laws as a lack of knowledge of the existence of laws is not an admissible excuse under the court of law. Business operations should be conducted within the framework of business laws of the country. Business laws, thus, form the basic foundation for the regulation of all business operations and managerial decision making.

Table 1 shows how every operation of a business is governed by certain laws. Let us take up the basic functions of a business and how they are governed by business laws:

TABLE 1: Business Operations and Concerned Business Laws

S. No.	Business Operation	Business Law	Purpose
1.	Formation of business entity	Companies Act, Partnership Act, Limited Liability Partnership Act	Governs the nature of formation/incorporation of the legal entity. Different laws or regulations govern different types of entities like proprietorship, LLPs partnership or companies
2.	Raising capital	Companies Act, Securities and Exchange Board of India (SEBI) Act, SEBI Regulations	Protects investors and ensures a stable financial market
3.	Employment of workers and executives	Labour Welfare Laws, Minimum Wages Act, Trade Union Act, the Apprentices' Act, Employees Compensation Act	Stipulates laws governing the welfare of workers and working conditions
4.	Purchase of raw material from suppliers	Contracts Act, Sale of Goods Act	Helps create business contracts that are legally enforceable in the court of law
5.	Import of goods	Laws governing export/import, letters of credit, foreign exchange management	Regulates export/import and usage of foreign currencies
6.	Payment to suppliers	Negotiable Instruments Act, Banking laws	Governs the usage of cheques, promissory notes, and bills of exchange used for payment
7.	Design and development of products	Patent, Copyright and Trade Mark laws	Laws pertaining to ownership and rights of inventions, copyrights, trademarks, etc.



STUDY HINT

Contract Act is a general law which deals with all business transactions.

S. No.	Business Operation	Business Law	Purpose
8.	Manufacturing of products	Factories Act, Industrial Disputes Act, Essential Commodities Act, Prevention of Adulteration of Food Act, Competition Act, Environment Protection Act,	Governs the nature of products that can be manufactured, product quality and safety standards, prevention of monopoly, promotion of competition
9.	Marketing, advertising, and distribution of products	Laws Governing Media, Consumer Protection Act, Emblems and Names (Prevention of Improper Use) Act, Food Safety and Standards Act	To ensure fair trade practices and consumer protection
10.	Sale of goods to consumers	Consumer Protection Act, Standard of Weights and Measures (Packaged Commodities) Rules	For protecting consumer interests
11.	Payment of taxes	Direct and Indirect Tax Acts including the Income Tax Act	Stipulates various types of taxes to be paid to government authorities
12.	Publishing financial statements for investors	Companies Act, SEBI Regulations	Protects investor safety and orderly conduct of capital markets

You will be studying some of the major laws mentioned above separately in the subsequent chapters.

A good knowledge of the legal environment is an essential attribute of successful managers. Given below are some advantages of possessing appropriate legal knowledge by managers. A good legal knowledge:

- Helps managers negotiate contract effectively and efficiently
- Protects and enhances the value of organisational resources
- Creates a multitude of options through legal tools
- Converts regulatory constraints into opportunities

Managers should not view the legal environment as a constraining factor in their managerial decision-making exercise. They should be able to appreciate the rationale behind various laws and should show respect for the law. They should realise that organisations are part of the social ecosystem and they should be able to meet social and government expectations by fulfilling their organisation's role. They should take responsibility for managing the legal dimensions of their business decisions and be able to clearly differentiate between the role of managers and their legal counsel. It is the job of the manager to take appropriate risks subject to legal requirements and they should not leave important decisions in the hands of the lawyers.



NOTE

A basic understanding of business law is in order to manage legal risk.

Managers should also be proactive in their approach to considering the legal aspects of their business operations. They should deploy legal counsel at early stages of their strategy development and implementation exercise, and should not wait for the final moment which could turn out to be very costly. This also requires a keen mind with regard to the impact of the legal environment on various business issues. Hiring legal counsel after a deal has been struck or after a problem has arisen could lead to various complications ultimately affecting business opportunities.

Managers should be able to make an informed judgement as many practical legal situations can be ambiguous. They should not allow lawyers to dominate their decision-making exercise. They should be able to appreciate the fact that every legal dispute is a business problem requiring a business solution that may even throw up new opportunities rather than handing over the problem to the lawyers.



**SELF
ASSESSMENT
QUESTIONS**

11. A good knowledge of the legal environment is necessary for a manager because:
- Lack of knowledge is not an excuse in the court of law
 - To proactively manage business deals
 - Convert regulatory constraints into opportunities
 - All of these



ACTIVITY 4

Based on your desk research on recent court cases on business disputes, identify a case where the manager could have avoided the situation by proactively managing the issue. Clearly describe which of the business law is involved and what action should the manager have taken to prevent the court case.

3.7 SUMMARY



- The legal environment is one of the important factors that shapes and guides businesses in any country.
- Law is meant to provide stability, predictability, and continuity so that people can determine what is legally right and wrong. Apart from laws, there are also regulations which govern the conduct of businesses.
- Civil laws deal with the behaviour that constitutes an injury to an individual or a private party whereas criminal laws deal with the offense against the society or state.
- Laws can also be differentiated between common law tradition and civil law tradition and substantive vs. procedural laws.
- The scope of business laws covers almost the entire gamut of the operations of businesses.
- Business laws have several important objectives including objectives like preventing the concentration of economic power.

- Some of the important business laws are Indian Contract Act, Sale of Goods Act, Companies Act, Partnership Act, Negotiable Instruments Act and Consumer Protection Act.
- Business laws are enacted by legislative bodies, implemented by the executive and interpreted and administered by the judiciary.
- Indian legal system inherited the common law system from the British, and currently follows a hybrid system of common law tradition and civil law. The common law system is uncodified while civil law system is a codified system with comprehensive, continuously updated legal codes that specify all matters capable of being brought to courts.
- Government plays four important roles that have significance for the conduct of business in the country, viz., planning role, regulatory role, promotional role and entrepreneurial role.
- The four important sources of law are the constitution, statute law, regulations, and judicial precedents.
- Legal environment affects almost every aspect of the conduct of business and managerial decision making. Managers should appreciate the importance of the legal environment and be legally knowledgeable, proactive and be able to convert regulatory constraints into opportunities.

3.8 KEY WORDS



- **Case law:** The law established in previous court decisions and also known as legal precedents
- **Common law:** The legal system which relies on the articulation of legal principles in a historical succession of judicial decisions. Common law principles can be changed by legislation
- **Court:** Government entity authorised to resolve legal disputes
- **Injunction:** A court order preventing one or more named parties from taking some action
- **Jurisprudence:** The study of law and the structure of the legal system
- **Statute:** A law passed by a legislature
- **The doctrine of *stare decisis*:** The principle that similar cases with similar facts under similar circumstances should have similar outcomes

3.9 CASE STUDY: COMMON LAW AND CIVIL LAW TRADITIONS – FEATURES OF CONTRACT LAW



India's legal system is rooted in the common law tradition inherited from the British rule as is the case with most of the commonwealth countries. At present, the Indian legal system is a hybrid system of common law, civil law and religious custom-based traditions, though it had established itself with a strong constitution with codified laws. As compared to India, there are several other countries, even

in Asia, that follow the Civil Law Tradition. For example, the legal system of Indonesia is inherited from the Dutch which had a civil law system.

One of the important pillars of business laws is the Contract Law. The nature of Contract Law and its application differs between two legal traditions. In this case study, the common law and civil law traditions are analysed from the perspective of Contract Law.

International Trade and Legal Systems

International trade involves business contracts between companies from different countries. Each of these countries has its own sources of law, with greater weight placed on some sources than others. Most of the countries follow either Common Law or Civil Law systems. The rationale and principles underlying each of these systems are different.

The common law system is followed in the United States and most of the former British colonies. Important features of a common law system are:

- Common law system is less prescriptive than civil law system.
- There is not always much emphasis on establishing a written constitution or a system of codified laws.
- Judicial decisions can be overturned only by the same or higher court or through legislation.

The civil law system is followed in the case of former French, Dutch, German, Spanish and Portuguese colonies and much of Central and South America. The important features are:

- Civil law system is a highly prescriptive codified system of law and there is generally a written constitution based on specific codes enshrining basic rights and duties
- Only legislative enactments are considered binding for all.
- There is not much scope for the judge-made law or judicial precedents
- Courts are specific to underlying legal codes

Contract Law in Civil and Common Law Traditions

There are several important differences in legal frameworks governing contract laws between Civil Law and Common Law Traditions. In the common law system, contracting parties are deemed to have the ability to assess possible risks relating to transactions, and provide sufficient terms in a contract to regulate their relationships and allocation of risk. In contrast, a contract under civil law tradition is made not only on the terms agreed upon by the parties but is also subject to certain principles and governing provisions of the contract law enacted in the country. Courts in countries following civil law tradition may employ doctrines and applicable codified rules to interpret, integrate or even rectify the contract so as to ensure justice for the contracting parties.

Some important and basic differences are listed below:

- A contract under common law requires three important elements, viz., an offer, an acceptance and a consideration. In comparison, the essential features of a contract in the civil law tradition are consent, capacity and object forming the subject matter and a lawful cause.
- In common law systems, contract law provides extensive freedom for contracting. Contract law provisions are not restrictive. In the case of the civil law system, usually, there are several provisions implied in the contracts.
- In contract law of countries with civil law tradition, less importance is placed on setting out all the terms governing the relationship between the parties to a contract in the contract itself.
- Any inadequacies and ambiguities in contracts framed under civil law tradition are remedied or resolved by the operation of law.

Owing to the above reasons, the contracts framed under civil law tradition tend to be a shorter one in length than those framed in a common law country owing to the above reasons. Contracts under civil law tradition may give the contracting authority (especially governments) the ability to unilaterally change the contract standards. For example, in countries like France, the law makes void any attempt to override the contracting authority's ability to unilaterally cancel a contract. In some civil law countries, the civil law codes contain mandatory notice periods before termination for the breach of contract that cannot be avoided or overridden. Other rights of contracting authority that may override contractual provisions are right of unilateral modification, right of unilateral cancellation and right to continuity of service.

All the above differences imply an important difference that has major implication for business contracts – a contract executed under civil law is subject to interference by the governing contract law of the country while a common law contract excludes any such interference. Common law judges tend not to interfere with the contracting parties agreed on terms and their role is only to enforce what the parties have agreed on, instead of creating justice on a different basis.

Contract Negotiation Phase

Between the two systems, there is a fundamental divergence in their approach to the conclusion of a definite contract. The common law emphasises on 'when' a contract starts to have legal effects by establishing what point in time a valid contract was born. Hence, the acceptance of an offer for valid consideration becomes an essential feature for the conclusion of a legal contract. In contrast, the civil law tradition stresses the presence of the contracting parties' free will by addressing elements like capacity, lawful cause and the object forming the subject matter.

In any business contract, before an agreement is reached, there is always a period of negotiation. This could involve a protracted negotiation period for large-scale complex contracts. Both the parties may invest a considerable amount of time, efforts, and resources that might involve expert guidance, legal counsels, feasibility studies, preliminary sub-contracting effort etc. This phase is recognised

as a 'quasi-contract' and the liability arising during this period is usually regarded as a 'pre-contractual liability'. Under civil law tradition, though a quasi-contract is still not a contract, it is considered as an obligation that the law creates in the absence of any contract.

In comparison, freedom of negotiation is a tenet embodied in common law under which the contracting parties are free to negotiate contractual terms without facing the risk of pre-contractual liability. It is based on the notion that the party to the negotiation should bear the risk of loss in the event of breaking off of negotiations by the other party. In other words, each party is at liberty, no matter how capricious his reason, to break off negotiations at any time and there will be no incidence of pre-contractual liability in the case of contracting under the common law system.

The civil law system recognises a doctrine termed "Culpa in Contrahendo ('fault in negotiation')" which has its roots in the German Civil Law tradition and which is widely adopted in many of the civil law countries. In accordance with this doctrine, contracting parties had the obligation to act in bona fide during negotiations and, hence, if a party who acted in bad faith by preventing from concluding a contract was liable to an injured party. The doctrine of Culpa in Contrahendo has already been adopted by the Private International Law of European Union in Article 12 of EC Regulations of the European Parliament.

International Business Contracts

Globalisation has resulted in the rapid growth of cross-border transactions and warrants a harmonised and unified legal system with regard to business contracts. There are several international legal instruments that are used for cross-border trade. Some examples are the United Nations Convention on Contracts for International Sale of Goods (CISG), the UNIDROIT Principles of International Commercial Contracts (PICC) and Principles of European Contract Law and the United States Uniform Commercial Code (UCC). These instruments aim to harmonise and promote uniformity in contractual practice in order to enhance legal certainty and predictability. In practice, it has proved to be extremely difficult to achieve as the legal instruments tend to be interpreted differently in different countries owing to differences between civil and common law traditions. For example, the CISG convention does not include pre-contractual liability. However, some experts opine that the general principles of CISG require "duty of good faith" between contracting parties which implies that the parties can be held to pre-contractual liability. In the case of PICC, there are certain explicit provisions that allow pre-contractual liability.

QUESTIONS

1. Assume that you are negotiating a major business contract with your supplier who belongs to a country that follows civil law tradition. In contrast to a supplier belonging to a common law country, do you think more or less legal expertise will be required in concluding the contract?

(Hint: Common law systems expect parties to be knowledgeable and foresee risk allocation issues prior hand before concluding the contract but excludes

them out of the purview of the law itself. But contracts under civil law tradition require every contract term to be clearly specified and be brought within the legal provisions of the contract law. Hence, more legal expertise, along with usual business expertise, would be required to conclude a contract under civil law tradition.)

2. How does pre-contractual liability handled in contracts frame under the common law legal system?

(**Hint:** Common law system expects individual parties to take care of such liabilities. The negotiation phase does not come under the purview of a contract in common law system in comparison to the civil law system.)

3.10 SHORT ANSWER QUESTIONS



1. The _____ environment refers to the laws and regulations that are established in a country for the orderly conduct of business.
2. The Constitution of India, which came into force on January 26, 1950, contains _____ articles.
3. _____ law deals with the violation of rights of individuals.
4. In India, _____ regulates all aspects relating to a company.
5. India follows a hybrid legal system with a mix of civil law and _____ law.
6. The government may take a/an _____ role by participating in business activities through ownership and management of industrial and management undertakings.
7. In the regulatory business environment, a dominant element is constituted by the administrative law and procedures. (True/False)
8. The philosophical approach to the study of law is termed as “jurisprudence”. (True/False)
9. The common law system refers to a codified system which includes a comprehensive and updated legal code that specifies all matters capable of being brought before a court, the applicable procedure, and the appropriate punishment for each offense. (True/False)
10. The Constitution is the supreme law of India. The Constitution of India, which came into force on January 26, 1950, contains 365 articles divided into 22 parts and 9 schedules. (True/False)
11. Which of the following roles is being played by the government that impose greater impact on the business?
 - a. Planning
 - b. Regulatory
 - c. Promotional
 - d. All of these

12. Which of the following options is defined as the rules of law announced in court decisions which are based on interpretations of constitutional provisions, statutes enacted by legislatures and of regulations created by administrative agencies?
 - a. Judicial precedence or case laws
 - b. The statute law
 - c. Common law
 - d. None of these
13. The Companies Act, Securities and Exchange Board of India (SEBI) Act, and SEBI Regulations are formulated for which of the following?
 - a. Protecting investors and ensuring a stable financial market
 - b. Governing the nature of formation/incorporation of the legal entity
 - c. Regulating the export/import and usage of foreign currencies
 - d. None of these
14. Which of the following statements is an advantage of having a good legal knowledge?
 - a. It protects and enhances the value of organisational resources.
 - b. It creates a multitude of options through legal tools.
 - c. It converts regulatory constraints into opportunities.
 - d. All of these
15. Which role of the government involves promoting rapid economic growth on the basis of national priorities through the optimum use of national resources?
 - a. Promotional
 - b. Planning
 - c. Regulatory
 - d. None of these
16. Which of the following laws pertains to ownership and rights of inventions, copyrights, trademarks, etc.?
 - a. Companies Act
 - b. Contract Act
 - c. Patents, copyrights and trade mark laws
 - d. Factories Act
17. Which of the following laws governs the usage of cheques, promissory notes and bills of exchange used for payment?
 - a. Companies Act
 - b. Contract Act
 - c. Patents, copyrights and trade mark laws
 - d. Negotiable Instruments Act

18. Which of the following is an objective of business law?
 - a. Protecting the interest of consumers
 - b. Preventing the concentration of economic power
 - c. Establishing a framework of judicial and quasi-judicial authorities
 - d. All of these
19. Which of the following Acts is established to protect the consumer interests?
 - a. Companies Act
 - b. Factories Act
 - c. Consumer Protection Act
 - d. SEBI regulations
20. Which of the following Acts addresses the creation of business contracts that are legally enforceable in the court of law?
 - a. Companies Act
 - b. Factories Act
 - c. Consumer Protection Act
 - d. Contract Act
21. Which of the following forms the basic foundation for the regulation of all business operations and managerial decision making?
 - a. Companies Act
 - b. Factories Act
 - c. Consumer Protection Act
 - d. Business Law
22. Which of the following laws is defined as the doctrines and principles announced in cases?
 - a. Case laws
 - b. Statute law
 - c. Common law
 - d. None of these
23. Which of the following laws consists of a vast body of laws, also known as subordinate legislation, in the form of rules, regulations as well as bye-laws made by administrative agencies?
 - a. Administrative law
 - b. Common law
 - c. Case law
 - d. Statute law
24. Which of the following establishes the rules and regulations for the orderly functioning of the capital market which is critical for companies raising finance from capital markets?
 - a. SEBI
 - b. RBI
 - c. Statute laws
 - d. None of these
25. Which of the following is not the main function of law?
 - a. Stability
 - b. Predictability
 - c. Continuity
 - d. None of these

3.11 DESCRIPTIVE QUESTIONS



1. What are various objectives of business laws? Give examples of some major business laws and their purpose.
2. Discuss various schools of jurisprudence thought.

3. Write a brief note on the nature of the Indian legal system. What are various ways of government regulations that can affect businesses?
4. What are various sources of law? Explain each of them.
5. Explain with examples how various aspects of basic business operations are regulated by laws. What are the important qualities of a legally astute manager?

3.12 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Legal Aspects of Business	1.	d. Both (a) and (c)
	2.	True
Introduction to Business Laws	3.	b. Business laws affect almost every aspect of businesses.
	4.	c. To allow growth of big and powerful corporates with economic power
	5.	b. Have flexibility in interpreting the laws depending on the context
Indian Legal System	6.	Common Law and Civil Law
	7.	b. Common law tradition is generally uncodified
	8.	regulatory, planning, entrepreneurial, promotional
Sources of Law	9.	d. All of these
	10.	c. In the legal system prevailing in India, judicial precedents and case laws are an important source of business laws
Why Managers Need to Understand Legal System?	11.	d. All of these

B. SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	legal
2.	365
3.	Civil
4.	Companies Act, 2013
5.	common
6.	entrepreneurial

Q. No.	Answer
7.	True
8.	True
9.	False
10.	True
11.	d. All of these
12.	a. Judicial precedence or case laws
13.	a. Protecting investors and ensuring a stable financial market
14.	d. All of these
15.	b. Planning
16.	c. Patents, copyrights and trade mark laws
17.	d. Negotiable Instruments Act
18.	d. All of these
19.	c. Consumer Protection Act
20.	d. Contract Act
21.	d. Business law
22.	a. Case laws
23.	a. Administrative law
24.	a. SEBI
25.	d. None of these

3.13 SUGGESTED BOOKS AND E-REFERENCES



SUGGESTED BOOKS

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Explain various elements of a valid contract
- ▶▶ List various types of contracts
- ▶▶ Describe the features of different types of contracts
- ▶▶ Explain the scope and provisions of the Indian Contract Act, 1872

4.1 INTRODUCTION

Read Pre-read Connect

In the last three chapters, you have studied about the legal and business environment surrounding businesses in India. From this chapter onwards, we shall study various important laws that govern businesses in India.

Among the business laws, the most important is the law of contract. The contract law of a country forms the basic foundation for businesses as it facilitates the conduct of business operations in a stable and predictable manner.

The word 'contract' is derived from the Latin term *contractum*, which means drawing together. According to **Section 2(h) of the Contract Act**, *an agreement enforceable by law is a Contract*.

As per **Sir William Anson**, *a contract is an agreement enforceable by law made between two or more persons, by which rights are acquired by one or more to acts or forbearances on the part of the other or others*.

Explaining the object of the law of contract, **Sir William Anson** observes, *the law of contract determines the circumstances in which promises made by the parties to a contract shall be legally binding on them. It is intended to ensure that what a man has been led to expect shall come to pass, and that what has been promised to him shall be performed*.

A mutual understanding is required between two individuals for any activity. This understanding is sometimes made in writing. A formal writing is known as a contract if it meets certain criteria. Contracts are often carried out in an informal manner, but sometimes due to legal obligations and responsibilities, they are made in a formal manner.

The agreements that fulfil the conditions of a contract have been codified by the Indian Contract Act, 1872. The Act identifies the basic terms and conditions that are mandatory to make a valid contract. It identifies the key ingredients of a contract along with certain special types of contracts.

In this and the next few chapters, we shall focus our study on the laws regarding different types of contracts.

4.2 WHAT IS A CONTRACT?



NOTE

Contracts are made only for legal businesses and not for illegal businesses, such as smuggling and trafficking.

To understand the significance and importance of laws governing contracts, consider a very basic situation involving any agreement between you and your friend. Any agreement between two parties would involve rights and obligations for both the parties. You enter into an agreement with your friend expecting that he would respect the terms and conditions and fulfil his part of the obligations. But suppose your friend fails to fulfil his promise, breaching the terms and conditions of the agreement. This might involve a loss for you as the breach of the agreement could affect your other plans. You take up the issue with your friend and he refuses to abide by the terms. Now, what are the means by which you can ensure that your friend fulfils his part of the obligations? Suppose you say you would take up the issue to courts for a legal remedy. But your friend says that the agreement is meant to be a personal arrangement and it is not a valid legal contract. This would make you frustrated and cautious about entering into any agreement with others in the future.

If you now talk to your advocate, he would tell you that every agreement cannot be a valid contract enforceable in a court of law. He would also enlighten you about the basic and mandatory elements of a valid legal contract which are legislated by the government authorities through the “Contract Law” of the country. However, you would be able to enforce your agreement with your friend as a legal contract if it satisfies the requirements of a valid contract, which are basic things like free consent on the part of your friend, a lawful object for the agreement, valid consideration, etc.

The concept of a contract need not necessarily be the type of example mentioned above. Even basic daily and routine transactions like travel by bus (contract of carriage), purchase of goods (contract of sale of goods), a haircut or taking a meal at a restaurant (contract of service), etc. are all legally valid contracts which we undertake on a daily basis.

Important Concept

To interpret a contract, a court looks at the clear language of the contract from the viewpoint of an objective and reasonable person. In case the contract is not clear, the court may consider outside evidence, such as statements given outside, behaviour of the parties, etc.

In contrast to the above basic routine transactions, the contract law, however, becomes necessary, and important in the case of commercial and business transactions. Consider now business transactions between companies. Every business transaction of a company, whether with its employees, shareholders, suppliers, customers or business partners, would involve some kind of agreement regarding the rights and obligations of the company with the other party. The company has to trust that every such agreement with other entities would be respected in terms of ‘duty and good faith’ and fulfilled in the course of business operations. If the company has to worry about the validity of such implicit or explicit agreement with other parties, it can never conduct its business in a stable and predictable manner. Moreover, when a dispute arises, the company should be able to enforce the agreement in a court of law and get a remedy for any breach of the agreement.

Companies cannot rely on ‘duty and good faith’ alone when they enter into any arrangement with other parties and naively believe that the other parties would fulfil their part of the duties and obligations. Companies have to be sure that their business agreements would be legally respected and fulfilled and any failure of the other party can be remedied through a court of law. In order to ensure this, they should draft their agreements in such a way that they are valid legal contracts which can be enforced in a court of law. Entering into business agreements should give confidence to the concerned parties that the expectations created by a promise of future performance would be fulfilled, and in case of any breach of contract terms, legal remedies are available.

To facilitate the orderly conduct of business and improve the efficiency of the market economy with the least friction, governments make laws that can be enforced in courts. In this regard, the Contract Act is the most important one that specifies legal provisions regarding a valid legal contract. The Contract Act is, thus, a basic foundational business law that is essential for the smooth and efficient conduct of business in any country.

Following are some important functions of a legal business contract:

- To allow companies to enter into agreements with other entities with confidence that the expectations created by such agreements would be fulfilled.

- To ensure that any breach of terms and conditions of an agreement can be remedied in a court of law.
- To enable businesses to plan forward as their contracts with other entities provide certainty with regard to future business transactions in terms of price, performance, obligations, and rights involved.
- To establish the respective responsibilities of parties to a contract and the standard of performance expected of them.
- To allocate the business and economic risks involved in the transaction between the parties.
- To proactively provide for future uncertainties and any failures on the part of any party.

**Quick TIP**

There are several remedies that a party might ask a court to impose for a breach of contract. The most common is compensatory damages.

Unlike what you might think, the concept of contract is a very complex one and it is easy for any party to breach a contract without any legal obligations on him unless the contract is properly drafted taking into consideration the legal definitions and provisions, and is properly understood by both the parties. To that extent, the law governing contracts, though might look simple, is also a complex one. In order to understand the importance of the above statement, consider the following issues as a manager of your company and arrive at your own answers to the questions posed:

- As a procurement manager, you have received a catalogue from a supplier with prices of various parts listed. Based on the catalogue, you order some spare parts in a particular quantity. You receive the spare parts but the price mentioned in the invoice is around 20% higher. Can you sue the supplier for pricing the parts higher than the price specified in the catalogue he had sent just a day before?
- As a procurement manager, you enquire with your supplier about the price of certain raw material. You receive a quotation which also contains terms and conditions under which the price is quoted. Now, you order a certain quantity and your purchase order contains its own terms and conditions under which the product is normally supplied. If there is any dispute with the supplier regarding supply, which terms and conditions would be applicable—those on the supplier's quotation or those on your purchase order?
- Suppose you are a software product manufacturer and a major customer has floated a tender for the development of a new software product specifying the requirements and other terms and conditions. You do some preliminary research and prototype development and send a quote to the customer. By spending money and other resources in the feasibility study, you are able to arrive at a solution for the lowest cost. However, the customer rejects your offer. In this case, can you claim that the customer made an offer which was accepted by you with exact terms and conditions being fulfilled and, hence, the customer cannot go back on his offer? What legal provisions of contract law would govern this transaction?
- Suppose you receive an offer from your customer to purchase machinery at a particular price. The offer is valid for one month. You ask your manufacturing and commercial team to work on the possibility of selling the machine at that price. But after two weeks, you receive a communication from the customer



NOTE

The practice of contract law includes identifying emerging issues and advocating for changes and extensions of law in order to allow the client to conduct business in a convenient and favourable way.

that he is no more interested in purchasing the machine. Since you have spent resources on the project, can sue the customer for unilaterally cancelling his offer?

- You have offered to sell costly machinery to a particular customer. The customer had decided to accept the offer at that price along with the terms and conditions and communicates you his acceptance by post. But before the acceptance is received by you (or known to you), you get an interest from another customer who is ready to purchase the machinery at a 25% higher price. You decide to sell the equipment to the second customer at a higher price. Can the first customer sue you for going back on your promise?

The above business situations are only sample cases meant to explain the complexity involved in dealing with day-to-day business contracts. In the real world, the above situations would be automatically taken care of by conducting businesses through formal and systematic business processes. For example, purchase, invoicing and payment processes are standard processes that are formalised through standard contracts between business entities. However, these business processes should also take into account the 'legal business contracts' involved in business operations, and how and whether they abide by the Contract Act.

The Contract Act defines what is a legal contract and its various elements. The Contract Act, especially that enacted under Common Law countries, does not specify what should be the content of any contract or any mandatory provisions required under the Act. A contract is an agreement between two entities, and the law generally does not interfere with its content. The subject matter of a contract and the considerations involved pertain to the desires and interest of the entities involved and they are free to contract, on any subject matter, which they are interested in. The Contract Act will only define a legal contract that can be enforced in a court of law.



ACTIVITY 1

Find out the essentials of a contract and describe them in brief. Also, try to create a contract with your partner and consult the technical issues related to the contract.



STUDY HINT

'Insure' and 'ensure' sound similar, but they are different. 'Insure' simply means to safeguard against loss or damage using an insurance policy.

4.2.1 | AGREEMENTS AND CONTRACTS

Before you understand what a contract is, let us understand the concept of agreement. In the earlier example, we referred to an agreement you made with your friend which we said need not necessarily form a legal contract. In general, we use the terms 'agreement' and 'contract' synonymously. However, an agreement need not necessarily be a valid legal contract. Any agreement between two parties that can be legally enforced in a court of law is termed as a 'contract'. The difference will be explained shortly.

There are several other terms and phrases pertaining to contracts that have specific meanings in a court of law. The terminologies and definitions of various terms pertaining to a contract are important as they facilitate a clear and precise understanding between parties involved in a contract which is very important in business transactions.

We shall now study some important and basic terminologies regarding contracts as defined in the Indian Contract Act, 1872. This would help us understand the concept of contracts and the legal provisions pertaining to them.

First, let us define the term 'agreement'. As per the **Indian Contract Act, 1872**, *every promise and every set of promises, forming the consideration for each other, is an agreement*. This definition involves other specialised terms like 'promise' and 'consideration'. The term 'promise' means a 'proposal' that has been 'accepted'. A 'proposal' is defined as follows: *When one person signifies to another person his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal*.



CASE LAW

Balfour vs. Balfour (King's Bench-1919)

Rule of Law: Where parties to the contract do not intend to create a binding agreement, the agreement cannot be enforced.

The case of Balfour vs. Balfour is a well-known illustration of a domestic agreement. In this case, Mr. Balfour was working in Ceylon. He and his wife (Mrs. Balfour) went to England on furlough. When Mr. Balfour was to return to Ceylon, his wife was advised to remain in England due to ill health. Mr. Balfour agreed to send a sum of £30 per month for the probable expense of maintenance. For some time, he sent the amount, but afterwards differences arose between them, which resulted in their separation and the allowance fell into arrears. Mrs. Balfour's claim for recovery was dismissed by Lord Justice Atkin on the ground that parties did not intend that it will be attended by legal consequences.

If the other person to whom the proposal is made signifies his assent, the proposal is said to be 'accepted'. The person who makes the proposal is called the 'promisor' and the person accepting the proposal is the 'promisee'. When the promisee, at the desire of the promisor, has done or abstained from doing something, such an act is called a 'consideration' for the promise. Table 1 shows the various terminologies and their explanations:

TABLE 1: Terminologies and their Explanations

S. No.	Term	Explanation
1.	Proposal	When one person (promisor) signifies his willingness to do something to another person seeking his assent
2.	Acceptance	When the person to whom the proposal is made (promisee) signifies his assent to the proposal
3.	Promise	A proposal, when accepted, becomes a promise (agreement)
4.	Consideration	Whatever the promisee does or promises to do (or abstains from doing as the case may be) as per the proposal made
5.	Agreement	Every promise and every set of promises forming the consideration for each other is an agreement



NOTE

A valid contract requires each party to give something in return for some other thing. That is called consideration.

Let us now use these terms in an example. Suppose your friend agrees to sell his car to you for ₹ 5 lakhs. He tells you that once you give him a cheque for ₹ 5 lakhs,

he would deliver his car at your doorstep. This is “an agreement” between you and your friend. Your friend has made a “proposal” to sell his car at ₹ 5 lakhs. He, thus, ‘promises’ to deliver the car if you pay a ‘consideration’ of ₹ 5 lakhs. You decide to purchase the car from your friend at that price. Your communication with regard to your willingness to purchase the car forms the “acceptance of the proposal”. In this example, your friend is the promisor, you are the promisee, and the consideration is ₹ 5 lakhs. Your acceptance to give ₹ 5 lakhs is also termed as the ‘reciprocal promise’. Since the example involves promises between two parties forming consideration for each other, it amounts to “an agreement”.

There are also some important requirements and features regarding a valid agreement. These are as given below:

- A communication of a proposal is said to be complete when it comes to the knowledge of the person to whom it is made. For example, suppose your friend made the offer to sell the car through post. The communication of the proposal is complete once the mail reaches you.
- With regard to acceptance, the completion of communication (of the acceptance) can happen at different point of time for the promisor and promisee. For the proposer, the communication of acceptance is said to be complete once it is put in a course of transmission to him, i.e., the moment it is out of the power of the acceptor. In the example, suppose you send the acceptance by post. As far as you are concerned, the acceptance would be complete only when the communication would reach your friend. But, for your friend, the communication of acceptance is said to be complete at the moment it is posted by you. This means if the post is lost in transmission, it has different significances for the two parties. For example, after you post the letter communicating the acceptance, the acceptance is complete only when it comes to the knowledge of the proposer. Before that, you cannot be sure of having accepted the proposal. But, for the proposer, the acceptance is complete the moment it is posted by you. This means when it is in transmission, the proposer cannot revoke the proposal.
- There are also requirements with regard to acceptance. As per law, the acceptance should be ‘absolute’ and ‘unqualified’. It should be expressed in some usual and reasonable manner unless the proposal prescribes the exact manner in which it should be communicated. For example, in your reply to your friend accepting his proposal to sell the car, you mention that the price of ₹ 5 lakhs is fine with you provided the car gives a mileage of 20 km/litre. Any assumption on your part that the car would definitely give at least 20 km/litre and, hence, your acceptance is complete is not valid under the law. This is because you have qualified the acceptance by stating that ‘subject to car giving particular mileage’. Since this is not considered as an acceptance, there is no agreement involved, and your friend is free to sell the car to somebody else at the same price.

Important Concept
Some of the common examples of agreements include: partnership agreements, non-disclosure agreements, lease agreements, etc.

The above example only illustrates the concept and elements of “an agreement”. An agreement may or may not be “a legal contract”.

Any agreement that is legally enforceable by law is defined as a contract. If an agreement has to become legal, it should satisfy the relevant provisions of the Contract Act.

Some important points with regard to “agreements” and “contracts” are given below:

- An agreement may or may not be legally enforceable.
- An agreement that is not legally enforceable is called a void agreement.
- An agreement that is legally enforceable by law is defined as a contract.
- A legally enforceable agreement can also become voidable agreement for specified reasons.

Figure 1 shows the concepts involved in agreements and contracts:

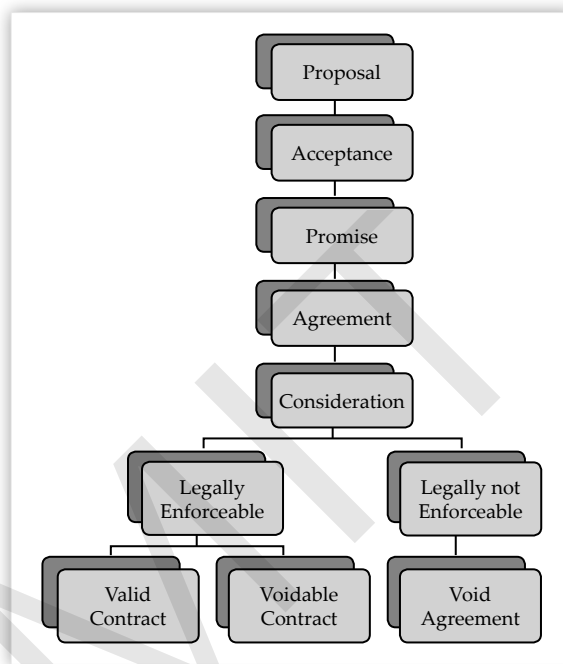


FIGURE 1: Concepts Involved in Agreements and Contracts

4.2.2 | LEGALLY NOT ENFORCEABLE AGREEMENTS



STUDY HINT

Section 2 deals with the issue of amending and cancelling the contract.

All agreements may or may not be legally enforceable. The Indian Contract Act, 1872 specifies cases where agreements cannot be enforceable by law. Such agreements are termed as ‘void agreements’. These are listed below:

An agreement is considered void if:

1. The consideration and objects are unlawful in part (Section 24).
2. The agreement is without any consideration (unless it is in writing and registered and satisfies the nature of contract specified) (Section 25).
3. The agreement is in restraint of marriage (Section 26).
4. The agreement is in restraint of trade (Section 27).
5. The agreement is in restraint of legal proceedings (Section 28).
6. The meaning of the agreement is not certain or not capable of being made (Section 29).

7. The agreement is by way of betting (wager) (Section 30).
8. The agreement is contingent on an impossible event (Section 31).
9. The agreement is impossible to act upon [Section 56 (1)].
10. The agreement is one where both parties are under mistake as to the matter of fact (Section 20).
11. The agreement is with a minor or a person of unsound mind.

4.2.3 | LEGALLY ENFORCEABLE AGREEMENTS

Legally enforceable agreements can result in a valid legal contract or a voidable contract.

Valid Legal Contract

To test whether an agreement can be a legal contract, we need to understand the basic requirements of a valid contract. As per the Indian Contract Act, 1872, *all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not expressly declared as void by the act.*

In the above definition of contract in the Indian Contract Act, 1872, there are a number of important terms that define the mandatory requirements of a legally valid contract. These are:

- A valid “agreement” between two parties
- “Free consent” of parties with regard to the agreement
- “Competency” of parties to contract
- A “lawful consideration” for the promises met
- A “lawful object” being the subject matter of the agreement
- Such an agreement is not expressly declared as void in the Indian Contract Act, 1872

Note that out of the six requirements, we have already defined the requirement of a valid “agreement”. The valid agreement involves a promisor making a proposal, which is also termed “Offer” for valid consideration and which is “Accepted” by the promisee. Hence, the term agreement also includes the requirement of “Offer” and “Acceptance”. Thus, there are seven elements of a valid contract, viz., Offer, Acceptance, Free Consent, Competent parties, Lawful consideration, Lawful object and the agreement not expressly declared as void by the Indian Contract Act, 1872.

A typical business contract can pass through several stages beginning with the state of negotiation during which the parties discuss and negotiate proposals and counter-proposals as also the considerations involved, resulting finally in acceptance of the proposal by the promisee. At this stage, the agreement is reduced to writing, and a formal document is executed on which the parties affix their authorised signatures so as to be bound by the terms of the agreement set out in the document.



NOTE

Earlier, a contract for the sale of goods was part of the Contract Act. Later, owing to its significance, it was removed from the Contract Act, and a separate Act, the Sale of Goods Act, was enacted which now governs the sale of goods. However, the definition of any contract and related general provisions come under the Contract Act only. The example of sale of a car between friends is taken to easily explain the concept.

**Important
Concept**

“Void” means the contract is not currently valid, and the parties are not held to its terms, whereas “Voidable” contract is still valid but may be “Void” in case the non-breaching party decides to do that.

Voidable Contracts

A legally enforceable agreement can also lead to a voidable contract. This is explained in the section on the type of contracts.

Formal and Informal Contracts

Though business contracts tend to be written into a formal document, it is not necessary under the law that every contract must be in writing. Unless the law requires that the agreement has to be in writing, even an oral agreement can lead to a valid contract under the Indian Contract Act, 1872.

Even though the law does not mandate that contracts should be made in writing in cases where a contract is concluded by the word of mouth or conduct, there will arise difficulties in establishing the proof of agreement when disputes arise between parties later.



**SELF
ASSESSMENT
QUESTIONS**

1. Suppose you decide to sell your car to your friend for ₹ 5 lakhs. You send your proposal by email to your friend asking him to reply within a week. The communication of the proposal is complete:
 - a. Once you have sent the email.
 - b. When your friend reads the email.
 - c. When your friend replies to the email.
 - d. When you read the reply.
2. In the above case, suppose your friend sends a reply communicating that he is willing to buy the car and accepts the terms and conditions. The acceptance of the proposal is complete from the perspective of your friend:
 - a. Once your friend sends the email accepting the proposal.
 - b. Once the email is received in your inbox.
 - c. Only after you read the email communicating the acceptance.
 - d. When you reply back confirming the sale.
3. In the above case, the acceptance of the proposal is complete from your perspective:
 - a. Once your friend sends the email accepting the proposal.
 - b. Once the email is received in your inbox.
 - c. Only after you read the email communicating the acceptance.
 - d. When you reply back confirming the sale.
4. What constitutes promise in the above proposal?
 - a. Promises made in the proposal sent by you
 - b. The accepted proposal

- c. Your friend's promise to pay ₹ 5 lakhs
 - d. None of these
5. What constitutes "consideration for the promise" in the above proposal?
- a. Your promise to deliver the car
 - b. Your friend's promise to pay ₹ 5 lakhs for the car
 - c. Both the car and ₹ 5 lakhs
 - d. None of these
6. Suppose if the above agreement involves a smuggled car from another country and your friend also knows about this fact, then the agreement is termed as:
- a. Void contract
 - b. Voidable contract
 - c. Void agreement
 - d. None of these

4.3 TYPES OF CONTRACTS

Contracts can be of different types. Following are some examples of different types of contracts:

- As the procurement manager of a company, you enter into an agreement with your supplier to supply raw material for a period of one year at stipulated price conditions. This is a business contract between your company and the supplier.
- A biscuit-manufacturing company advertises that whoever sends a specified number of coupons collected from the packaging material of biscuits sold by it will be awarded a prize. You collect the specified number of coupons and send it to the company and demand the prize. Once you send the specified coupons as per the procedure, a contract has been formed between you and the company. This is a unilateral contract where the company has made an offer which you have accepted by performing the required conditions.
- You enter into an agreement with a civil engineer to redesign and build your home. You promise that if he completes his renovation work as per the approved design and within the stipulated time, you will pay the amount stated in the agreement. This is a performance contract between you and the civil engineer.
- You enter into a salon and sit for hair-cut. After the hair-cut is complete, you are required to pay the service fee for it. There is an implied contract when you sit for a hair-cut that after the completion of the hair-cut, you will pay the usual service fee.
- You want to open a savings account with a bank. You request the bank's customer service representative to open the account and he gives an account



NOTE

In contracts, the terms of the contract must be certain.

opening form to be filled. On completion of the form and other formalities, you have entered into a contract with the bank. This is an example of a standard and formal contract.

- You order an electronic item from the online marketplace at a much discounted price. Later, you come to know that the low price is applicable only for used items which are not mentioned as part of the terms and conditions. The contract you have with the company is voidable at your choice.
- You agree to transport some package for your friend while on your personal travel in a train destined to your friend’s location. When the agreement runs into dispute for some reasons, you find that the package contains material which is prohibited from transporting through train, e.g., fireworks. This is an unenforceable contract.

The contracts can be classified as shown in Figure 2:

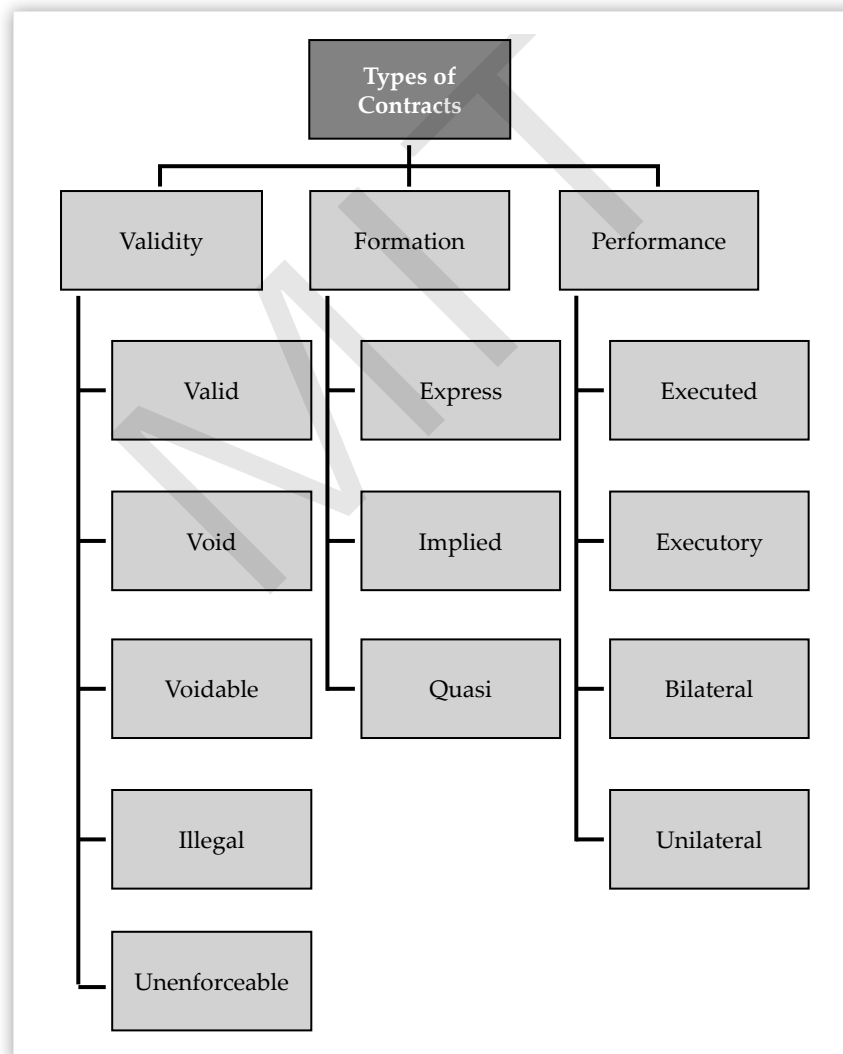


FIGURE 2: Types of Contracts

Let us discuss different types of contracts in the next sections.

4.3.1 | ON THE BASIS OF VALIDITY

We can name contract types based on their legal validity. In general, all contracts created in accordance with the definitions and provisions of the Indian Contract Act, 1872 are legally valid contracts and can be enforced in courts of law. However, the Indian Contract Act, 1872 also defines when the contract's validity can be questioned. Hence, in terms of the validity of contracts, we can classify contracts into following types:

- **Valid contract:** A contract that satisfies the requirements of Section 10 of the Indian Contract Act, 1872 is known as a valid contract.
- **Void contract:** A contract which ceases to be enforceable by law becomes a void contract (Section 2(j)). A void contract is initially valid but before the due date of performance, it becomes void due to the happening of an event which the parties had neither anticipated nor in a position to control the event such as a house agreed to be sold.
- **Voidable contract:** As mentioned in the earlier section, a legally enforceable agreement can also lead to a voidable contract. A voidable contract is a legally enforceable agreement but obtained without free consent. When the consent to the agreement is caused by coercion, fraud, misrepresentation, the agreement becomes voidable at the option of the party whose consent was wrongly caused.

While a legally valid contract can be enforced by either of the parties to the contract, a voidable contract can be enforceable only by the affected party at his option but not the other party. Such contracts are termed as voidable contracts by the Indian Contract Act, 1872 as they can be made void at the instance of the affected party.

- **Illegal agreement:** Agreements where the subject matter or consideration is unlawful, they are termed illegal contracts. The object of the agreement or consideration might be forbidden by law, against provisions of any law, fraudulent, might involve injury to a person or property of another person, or immoral and against public policy.

For example, if you enter into a contract with an employment agency to get you a job in a government department by bribing the officials which forms part of the consideration of the agreement, the contract becomes illegal.

- **Unenforceable contract:** A contract which cannot be enforced because of non-compliance with some legal formalities is termed as an unenforceable contract. The contract is not unenforceable due to the contract not satisfying the mandatory requirements of a valid contract such as stamping, registration, etc.



NOTE

If Mr. P agrees to sell 1000 kg of sugarcane to Mr. Q for ₹ 20,000/-, but Mr. P fails to do so due to an earthquake, then the contract becomes unenforceable.

4.3.2 | ON THE BASIS OF FORMATION

On the basis of formation of contracts, they can be classified into following three types:

- **Expressed contract:** A contract need not be put in writing for it to become a legally valid contract. As you would have noticed, out of the seven requirements for a valid contract, there is no requirement that the contract

should be made in writing. A verbal agreement that satisfies the seven requirements is also a valid contract. However, as mentioned before, all business contracts are made in writing. Any such contract during the creation of which the proposal or acceptance of any promise is made in words, the contract is said to be an expressed contract.

- **Implied contract:** If the terms of a contract can be inferred from the conduct of the parties or from the circumstances of the case, the contract is termed an implied contract.

The example of the hair-cut service mentioned earlier is an implied contract between the salon owner and the customer. Similarly, when you take food at a restaurant, there is an implied contract that you should pay the bill as per the menu card prices for the food consumed by you.

- **Quasi-contract:** A quasi-contract is a contract implied in law. A contract between two parties might arise, even when there is no agreement, but due to obligations created by law. The obligations may be imposed on a party and an action is allowed to be brought by another party. Such obligations are termed as quasi-contracts. Quasi-contracts are neither implied nor expressed, but are created by law on the ground of equity, justice and good conscience to prevent unjust enrichment by a party at the cost of another. The Indian Contract Act, 1872 specifies various types of quasi-contracts in terms of Sections 68-72 as follows:

- **Section 68:** Necessities supplied to persons incapable of contracting.

Example: A minor is not competent to enter into a contract. Suppose you take care of the necessities of a minor in terms of handling his/her properties and personal needs. You are entitled to be reimbursed from the wealth/income of the minor.

- **Section 69:** Reimbursement by a person who pays money due to another in payment of which he is interested.

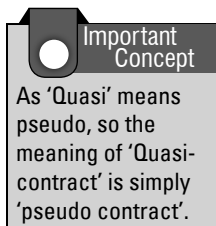
Example: Suppose you receive a notice from revenue authorities about house tax arrears with regard to a property you have rented. The landlord of the house you have rented is not in India and could not be communicated. If you pay the fees on behalf of the owner, you are entitled to be reimbursed by the landlord.

- **Section 70:** Obligation of persons enjoying the benefit of a non-gratuitous act.

Example: If a person does anything for another person lawfully without intending to do so out of gratitude, he is entitled to compensation by the person who enjoyed the benefits. Suppose some expensive goods have been wrongly delivered to your address. You consume the goods as if they belong to you. Then, a quasi-contract arises wherein you are bound to reimburse the legal owner of the goods.

- **Section 71:** Responsibilities of the finder of lost goods.

Example: If a person finds goods belonging to another and takes them into his own custody, he is subject to the same responsibility as a bailee.



- **Section 72:** Liability of persons to whom money is paid or a thing delivered by mistake or under coercion.

Example: If a person has been paid money or anything delivered to him wrongly or under coercion, he must repay the money or return the goods. Suppose you and your friend jointly owe money to another person. You make the full payment to the person not knowing that your friend has already paid his part of the obligation. Since excess payment has been made, the contracted person is liable to repay the amount to your friend.

4.3.3 | ON THE BASIS OF PERFORMANCE

Contracts can be classified on the basis of performance as follows:



STUDY HINT

The main difference between a unilateral and a bilateral contract is just the number of parties promising for an action.

- **Executed contracts:** These are contracts where both the parties have completely performed their respective obligations under the contract. Any contract which is completed in accordance with the terms of the contract agreement is termed an executed contract. For example, a cash sale is a completed contract. The buyer has paid the consideration in terms of the price of the goods while the seller has fulfilled the promise in terms of delivering the goods to the buyer. Thus, any cash sale is an executed contract.
- **Executory contracts:** These are unfulfilled contracts where performance remains unfinished to some extent by either of the parties or by both the parties. If the sale involves “an agreement for sale” wherein the seller has agreed to sell goods for which the buyer has to make a payment, it is termed as an executory contract till the sale is complete in all respects.
- **Bilateral contracts:** In these types of contracts, there is an outstanding obligation on both sides when the contract is concluded. In an agreement, a promisor makes a promise in return for the promisee doing some act or promising to do some act, as a consideration for the promise made. If the consideration that passes from the promisee to the promisor is a reciprocal promise, then it is called a bilateral contract. In these contracts, the offer is accepted by giving a reciprocal promise, thereby creating an outstanding obligation on both sides.

For example, you enter into a contract with a plumber to do some maintenance work at your home. You make an offer that if he is able to complete the work successfully within a week, you will pay a fixed amount as remuneration on completion of the work. The plumber accepts the offer which means that he promises to complete the work within the stipulated time. When the contract is concluded, both you and the plumber have outstanding obligations remaining and, hence, it is termed as a bilateral contract. For example, if the above contract involves full upfront payment to the plumber in advance before he can undertake the work, the contract becomes executed from your side once you make the full advance payment while it remains executory from the perspective of the plumber.

- **Unilateral contracts:** These contracts involve “offer of a promise for an act”. The performance of the act by the promisee as specified by the promisor is

considered as acceptance for the offer. The acceptance is conveyed by the performance of the act desired by the promisor.

Example: A young boy ran away from his father's home at Baheri on the 9th of June, 1924. The father issued a pamphlet offering a reward of ₹ 500 for those who find or trace the boy and bring him home. On 19th July, the boy was located by a person in the dharmashala of Bareilly railway station, who promptly took him to the railway police station and had a telegram sent to the boy's father. Though the boy was not brought to the home of the father, the court decreed in favour of the person who found the boy and declared that he was eligible for the reward. This is a unilateral contract, which can be enforced in the court of law, wherein there is an initial obligation on only one side – only with the promisor. The acceptance of this offer was conveyed when the person found the boy and informed his father. At this stage, the contract is complete and the boy's father was bound to pay the reward [Har Bhajan Lal vs Har Charanlal (1925)]



**SELF
ASSESSMENT
QUESTIONS**

7. You enter into a contract with your friend but later find that he has misrepresented some fact deliberately to increase the consideration to be paid by you. Choose the right statement with regard to this contract.
 - a. Contract is voidable at the hands of either party.
 - b. Contract is voidable at your option.
 - c. Contract is enforceable at your option.
 - d. Both b. and c.
8. You enter into an agreement with your friend, who is poor, to take care of his boarding and lodging expenses out of love and friendship. In lieu of this, your friend has not made any alternate arrangements. Later, when you go back on your promise, your friend decides to sue you based on the agreement. Choose the right statement with regard to this agreement.
 - a. This is a valid contract that can be enforced in courts by your friend.
 - b. This is not a valid contract since there is no consideration from your friend.
 - c. This is an enforceable contract if the agreement is written and registered with authorities under any applicable legal provisions.
 - d. None of these
9. Which of the following is an implied contract?
 - a. Any verbal and unwritten contract
 - b. A contract whose terms can be inferred from the conduct of the parties
 - c. Both the above
 - d. None of these

10. The contracts for necessities supplied to a minor are called:
 - a. Implied contracts
 - b. Quasi-contracts
 - c. Unilateral contracts
 - d. Bilateral contracts
11. In the case of unilateral contracts:
 - a. There is no express acceptance of an offer by the promisee.
 - b. The acceptance is the act performed in lieu of the promise made.
 - c. There is an obligation only on the side of the promisor.
 - d. All of these

4.4 INDIAN CONTRACT ACT, 1872

The Indian Contract Act, 1872 was enacted on 25th April, 1872 and came into force on the first day of September 1872. The Act was modelled on the English Common Law which was the primary source of the principles enunciated in the Indian Contract Act. The Indian Contract Act, 1872 also allows applicability of accepted trade customs and usages as long as they are consistent with the provisions of the Act.

4.4.1 | STRUCTURE OF THE INDIAN CONTRACT ACT, 1872

The Indian Contract Act, 1872 contains in total 11 chapters and 266 sections (without excluding repealed sections). The Act originally covered the principles governing the following types of contracts:

1. General principles governing all types of contracts
2. Contracts of sale of goods
3. Contracts of indemnity and guarantee
4. Contracts regarding bailment and pledge
5. Agency contracts
6. Partnership contracts

Owing to the importance and usage, the contracts for the sale of goods and partnership contracts have been repealed by this Act, and two separate Acts have been enacted for them.



SELF ASSESSMENT QUESTIONS

12. The Indian Contract Act allows trade customs and usage, if they are consistent with the provisions of the Act. (True/False)

4.5 SUMMARY



- Contracts are essential for the orderly conduct of business in a market economy.
- Contracts provide stability and predictability to business operations and allow forward planning and allocation of economic risks.
- To ensure the above functions of contracts, it should be possible to enforce them in courts of law and seek remedy for any breach of their conditions. The contract laws provide the legal framework for achieving this objective.
- An agreement between two entities does not automatically become a contract. All agreements are not contracts. But all contracts are some form of agreement between two or more parties.
- An agreement is an arrangement between two parties wherein the first party makes a proposal (offer) which is accepted by the second party for a consideration. An accepted proposal is termed as a promise in the Indian Contract Act. A set of promises forming part of the consideration for each other is the legal definition of an agreement.
- An agreement should satisfy the mandatory requirements specified in the contract laws of the country in order to become a valid legal contract. These include a valid agreement, free consent, competency of parties, lawful consideration, and lawful object and not prohibited by law.
- An agreement, depending on whether it satisfies the conditions mentioned above, may or may not be legally enforceable. Legally unenforceable agreements are called void agreements. Legally enforceable agreements can be either valid contracts or voidable contracts which are defined in the Indian Contract Act, 1872.
- The Indian Contract Act, 1872 does not say that contracts should be in writing. Hence, contracts can be oral or written agreements. However, all business transactions are based on formal written contracts.
- There are different types of contracts. It is a general practice to classify them in accordance with these three characteristics, viz., validity, formation and performance. Different types of contracts under each category are explained with examples in the chapter.
- Quasi-contracts are special types of contracts which are not made between two parties but are implied in law. Law may impose obligations on parties leading to quasi-contractual obligations based on specific events where undue enrichment of one party at the cost of other party happens. Such instances where quasi-contracts are applicable are listed in the Indian Contract Act, 1872.
- In India, the Indian Contract Act, 1872 governs contracts. It contains provisions that state the general principles governing all types of contracts. It has 11 chapters and 266 sections. Of these, chapters regarding the Sale of Goods Act and Partnership Act have been removed and enacted as separate laws.

4.6 KEY WORDS



- **Breach:** A failure to do what is promised. When one party to the contract alleges that the other party has not adhered to any of the terms or conditions of the contract
- **Condition:** An essential or fundamental requirement in a contract
- **Consideration:** Something of value that is bargained for and given in exchange for the promise made in a proposal
- **Misrepresentation:** A false statement of fact, which may be innocently, negligently or fraudulently made
- **Offer:** A promise to carry out the terms of a proposed transaction in exchange for a consideration. The term 'proposal' is used in the Indian Contract Act to refer to an offer

4.7 CASE STUDY: DIFFERENCE BETWEEN OFFER AND INVITATION TO OFFER – VOLUNTARY RETIREMENT SCHEME



This case study illustrates the difference between an offer and invitation to offer based on a real-world case adjudged in the Supreme Court of India.

The Concept of Invitation to Offer and the Indian Contract Act, 1872

The concept of invitation to offer is part of the common law principles governing contract laws. There is no reference to the concept of invitation to offer in the Indian Contract Act, 1872. Though a valid offer can be differentiated from others through the definition of an offer given in the Act, the concept of invitation to offer is arguably a complex one and could lead to different interpretations in real-life circumstances. Given this fact, it is necessary to understand the implications of invitation to offer and differentiate it properly with valid offers as defined under the Act.

Background of the Case

In 2000, it was observed that the Indian nationalised banks were overstaffed to the extent of 25% surplus manpower. As part of the strategies to reduce excess manpower in the banking sector, the Government of India decided to introduce the voluntary retirement scheme in 2000. In pursuant to the government policy, the State Bank of India and other nationalised banks adopted separately, but an almost identical scheme for voluntary retirement. The scheme was applicable for employees who on the date of application had completed 15 years of service or 40 years of age. The scheme was kept open for a specified period of time (for example, one month in the case of Punjab National Bank) during which the employees were required to make an application. The employees seeking voluntary retirement under the scheme were entitled to the ex-gratia amount of 60 days of salary or salary for the number of months of service left along with related benefits as appropriate.

Conditions for Applying to VRS Scheme

The VRS scheme contained the various eligibility criteria and the banks reserved the right to withdraw the scheme at any time it thought fit. As per the conditions, a mere request of an employee seeking voluntary retirement under the scheme would not take effect until and unless it was accepted in writing by the competent authority. It would not be open for an employee to withdraw the request made for the voluntary retirement after having exercised the option. The competent authority had the absolute discretion either to accept or reject the request of an employee seeking VRS depending on the requirement of the banks. The bank was to communicate the applicants the acceptance or otherwise of the application, giving reasons in writing in the case of rejection of requests.

Procedure for Application

An employee should make a request on the prescribed application enclosed with the scheme as annexure through proper channel addressed to the competent authority of the bank before the last date prescribed. The application form seeking voluntary retirement was titled as “Application for Offer to seek voluntary retirement from the service of the Bank” with the content that started as follows: “I hereby offer to seek voluntary requirement from the services of the Bank in accordance with the terms and conditions stipulated in the VRS scheme...” The application also required employees to declare that they accept the terms and conditions unconditionally and irrevocably. There was a window of one month for giving application and a subsequent 15 days’ period being applicable for withdrawal of offers.

Issue of Withdrawal of Applications

A large number of employees submitted their applications out of whom around 2% withdrew their offer. However, in spite of the withdrawal, their offers were also accepted. Employees who withdrew their offers filed cases in court questioning the action on the part of the banks in accepting their applications despite their withdrawal. There were also issues raised by the employees about the validity of the scheme from the perspective of the Banking Companies Act, 1949. The Punjab & Haryana High Court held that the scheme itself is bad and that even assuming the scheme is validly framed, it would be open to an employee to withdraw his option before the same has been accepted and effectively enforced.

When the issue came again before the Supreme Court, it was argued from the banks’ side that the scheme was an Offer and not an Invitation to Offer and in terms thereof enforceable rights and duties had been conferred upon both the employer and the employee that would be enforceable. It was contended that though some employees withdrew their application before the communication of the decision, they did not exercise their option before the specified deadline for withdrawal. It was rebutted by the counsel from the employees’ side that the scheme was merely an invitation to offer and the option pursuant thereto on the part of an employee would constitute an offer. Also, as per Section 5 of the Indian Contract Act, 1872, the employees had an absolute right to withdraw their offer before a concluded contract is arrived at. It was contended that the clause of the scheme in this regard was in violation of Section 5 of the Indian Contract Act, 1872. It was further argued

that a mere declaration given by an offeror that he would not withdraw or cancel the offer would not destroy his locus.

Legal Issues

The Supreme Court considered the following legal issues in the above case:

- Whether an application by an employee to secure voluntary retirement under the VRS can be withdrawn by such an employee before the same is accepted by the competent authority though the scheme contained an express stipulation that an application made thereunder is irrevocable and the employee will have no right to withdraw the application once submitted?
- Whether, upon making an application under VRS, the employer bank secures the authority to unilaterally determine one way or the other the jural relationship of master and servant between the parties?
- Whether the VRS scheme is an Offer/Proposal or merely an Invitation to Offer? In other words, whether the banks intended to make an offer or merely issued an invitation to treat?

The Judgement

The Supreme Court held that the employment contracts of any company fall under the Indian Contract Act and that the procedure laid down for VRS suggested that the application of the employee would be an Offer which could be considered by the bank in terms of the procedure laid down therefor. There was no assurance that such an application would be accepted without any consideration. The clause requiring the bank to communicate its acceptance or rejection in writing was considered crucial in this regard. It could be deduced that the banks treated the application from employees as an Offer which could be accepted or rejected. The procedure laid down for the scheme provided unfettered and unguided right to deal with the jural relationship between the banks and their employees.

The court held that the scheme would merely constitute an invitation to treat and not an offer. Quoting the Indian Contract Act, that a proposal is one that is made when one person signifies to another his willingness to do or obtain from doing anything with a view to obtaining the assent of the other to such act or abstinence (Section 2(a) of the Indian Contract Act, 1872), the Court held that the banks by the reason for the scheme, or otherwise, have not expressed their willingness to do or abstain from doing anything with a view to obtaining the assent of the employees to such an act.

The Court held that the scheme is not an offer which, if treated so, would automatically lead to a concluded contract between the bank and the employee once the scheme is accepted by the employee. However, since it is only an invitation to offer, an employee application would not amount to acceptance of an offer of voluntary retirement, but only a proposal from the side of the employee offering voluntary retirement. The proposal would constitute a promise only after acceptance by the bank within the meaning of Section 2(b) of the Indian Contract Act, 1872 and would become enforceable contract only after that. It was also held that in terms of the said scheme, no consideration passed so as to constitute an

agreement. Even after acceptance, no consideration passed far less amounting to any reciprocal promise from the employee.

The Supreme Court concluded, with regard to the acceptance of the offers by banks which were revoked already by the employees, that the voluntary retirement scheme was not a proposal or an offer but merely an invitation to treat and the applications filed by the employees constituted the offer. Hence, after the offer is made and before it is accepted by the bank, the employees have the rights to revoke the offer. Hence, it upheld the High Court verdict earlier that the employees had rights to revoke their offers and the banks were liable to reinstate them in service with all consequential benefits.

(Source: “Bank of India and Others Vs. O.P.Swaranakar etc.”, www.legalcrysal.com. <https://www.legalcrysal.com/case/669928/bank-india-ors-vs-o-p-swaranakar-etc>)

QUESTIONS

1. The banks contended that the VRS was an offer to their employees to take up voluntary retirement. However, the Court held that the VRS was only an invitation to offer. What elements of a valid offer were not present in the VRS as per the Indian Contract Act?

(**Hint:** A proposal is one that is made when one person signifies to another his willingness to do or abstain from doing anything with a view to obtaining the assent of the other to such act or abstinence (Section 2(a) of the Indian Contract Act, 1872). In this case, the VRS was designed in such a way that it invited employees who are willing to retire voluntarily in lieu of voluntary retirement benefits. However, it retained the right to decide who will be allowed to take the offer. The scheme “did not offer” to employees to voluntarily retire but “offered them to apply for” voluntary retirement. It was up to the bank to decide or accept the application subject to procedures laid down. Hence, the bank did not signify its willingness to do something or abstain from doing anything. The scheme actually required employees to signify their willingness to retire voluntarily. Hence, it is only an invitation to offer.)

2. What would be the impact if the scheme is considered an offer?

(**Hint:** An accepted offer becomes a promise leading to a valid legal contract. Banks were not actually willing to retire everybody who applies for the scheme. If the scheme is an offer, then everybody who applies would necessarily need to be given voluntary retirement. Since banks retained rights and had laid down the procedure to decide who are eligible and how many are eligible, they cannot make an offer to everybody to voluntarily retire. Hence, if at all, it is only an offer to apply for the scheme. The application is, however, an offer for voluntary retirement which banks had the right to accept or not.)

4.8 SHORT ANSWER QUESTIONS



1. Which one of the following is not important for a contract?
 - a. Competency of parties
 - b. Necessary terms and conditions

- c. Free consent
 - d. Lawful consideration
2. The agreement between two parties becomes a contract if:
- a. Parties are competent
 - b. It is enforceable by the law
 - c. It is by free consent of the parties
 - d. None of these
3. Which of the following statements is incorrect?
- a. Minor's agreement is void.
 - b. Contract without consideration is void.
 - c. Agreement caused by mutual mistake is void.
 - d. Wagering agreement is void.
4. Which of the following the Contract Acts does not specify?
- a. Legal contract
 - b. Elements of legal contracts
 - c. Content of the contract
 - d. None of these
5. While making a contract, which one of the following options will be the right sequence?
- a. Offer, acceptance, considerations, agreement
 - b. Agreement, considerations, offer, acceptance
 - c. Offer, considerations, acceptance, agreement
 - d. None of these
6. Which of the following statements is not true with regard to agreements and contracts?
- a. An agreement may or may not be legally enforceable.
 - b. An agreement which is not legally enforceable is a void agreement.
 - c. An agreement which is legally enforceable by law is a contract.
 - d. A legally enforceable agreement cannot become a voidable agreement.
7. An agreement will be considered void under which of the following situations?
- a. Consideration and objects are lawful in part
 - b. The agreement is not in restraint of trade
 - c. The agreement is not in restraint of legal proceedings
 - d. The agreement is in restraint of marriage

8. An agreement made without free consent will be considered:
 - a. Voidable
 - b. Always void
 - c. Unlawful
 - d. None of these
9. Which one of the following sections refers to “Agreement by way of betting (Wager)”?
 - a. Section 20
 - b. Section 56(1)
 - c. Section 31
 - d. Section 30
10. Which of the following statements is an incorrect statement?
 - a. If the party is minor, the agreement becomes void.
 - b. If the object of an agreement is unlawful, the agreement becomes void.
 - c. If the consideration of an agreement is unlawful, the agreement becomes void.
 - d. If the consent takes place as a result of coercion, the agreement becomes void.
11. Which of the following options does not represent a benefit of business laws for an organisation?
 - a. Forward planning
 - b. Stability
 - c. Predictability
 - d. Continuity
12. Which of the following is not a function of a legal business contract?
 - a. Enable business to plan forward
 - b. Establish the responsibilities of parties
 - c. Ensure that any breach of terms and conditions of an agreement can be remedied
 - d. Does not allocate the business and economic risks in transactions
13. In _____ contracts, there is an outstanding obligation on both sides when the contract is concluded.
 - a. executed
 - b. executory
 - c. bilateral
 - d. unilateral
14. Which one of the following sections refers to “Responsibilities of the finder of lost goods”?
 - a. Section 72
 - b. Section 71
 - c. Section 69
 - d. Section 68
15. Which one of the following is a quasi-contract?
 - a. Verbal and non-written contract
 - b. If terms inferred from the conduct of the parties
 - c. Contracts implied in law
 - d. None of these

16. A contract which satisfies the requirements of Section 10 is known as a _____.
17. A voidable contract is a legally enforceable agreement obtained without _____.
18. The Indian Contract Act, 1872 was enacted on _____.
19. All business transactions are based on _____.
20. The agreements where considerations are unlawful are known as _____.
21. The Contract Act helps in defining _____.
22. Every business contract must be in writing. (True/False)
23. A legally enforceable agreement does not lead to a voidable contract. (True/False)
24. Section 72 covers liability of persons to whom money is paid or a thing delivered by mistake. (True/False)
25. Contracts do not provide stability and predictability to business operations. (True/False)

4.9 DESCRIPTIVE QUESTIONS



1. Explain the functions of a contract. Differentiate between a contract and an agreement.
2. Explain the elements of a valid contract under the Contract Act.
3. What are various types of agreements and contracts that an agreement can lead to? List the conditions at which an agreement will become void agreement as per the Contract Act.
4. What are different types of contracts? Explain with examples different types of contracts based on performance.
5. Explain the difference between bilateral and unilateral contracts.

4.10 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
What is a Contract?	1.	b. When your friend reads the email.
	2.	c. Only after you read the email communicating the acceptance.
	3.	a. Once your friend sends the email accepting the proposal.
	4.	b. The accepted proposal
	5.	b. Your friend's promise to pay ₹ 5 lakhs for the car

Topic	Q. No.	Answer
Types of Contracts	6.	c. Void agreement
	7.	d. Both (b) and (c)
	8.	b. This is not a valid contract since there is no consideration from your friend.
	9.	b. A contract whose terms can be inferred from the conduct of the parties.
Indian Contract Act, 1872	10.	b. Quasi-contracts
	11.	d. All of these
	12.	True

B. | SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	b. Necessary terms and conditions
2.	b. It is enforceable by the law
3.	c. Agreement caused by mutual mistake is void.
4.	c. Content of the contract
5.	a. Offer, acceptance, considerations, agreement
6.	d. A legally enforceable agreement cannot become a voidable agreement.
7.	d. The agreement is in restraint of marriage
8.	a. Voidable
9.	d. Section 30
10.	d. If the consent takes place as a result of coercion, the agreement becomes void
11.	a. Forward planning
12.	d. Does not allocate the business and economic risks in transactions
13.	c. bilateral
14.	b. Section 71
15.	c. Contracts implied in law
16.	valid contract
17.	free consent
18.	April 25, 1872
19.	formal written contracts
20.	illegal contracts
21.	a legal contract
22.	False
23.	False
24.	True
25.	False

4.11 SUGGESTED BOOKS AND E-REFERENCES



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CONTRACT LAW – II

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Discuss important common law principles regarding contracts
- ▶▶ List and explain various mandatory elements of a valid contract under the Indian Contract Act, 1872
- ▶▶ Describe the concept of discharge of contracts and explain various modes by which contracts are discharged
- ▶▶ Explain the implications of a breach of contract as per the Indian Contract Act, 1872

5.1 INTRODUCTION



In the last chapter, you have studied some basic concepts regarding contracts and different types of contracts. As mentioned in the last chapter, the Indian Contract Act, 1872 has nine chapters consisting of 190 sections (excluding the repealed sections). Out of these 190 sections, the first six chapters consisting of 75 sections deal with the general principles governing all types of contracts. The remaining three chapters deal with some special types of contracts, viz., indemnity and guarantees, bailment & pledges and agency contracts. These three types of contracts will be discussed in the next chapter. The subsequent chapters will deal with other types of contracts like the Sale of Goods Act, Partnership Act, etc.

In Chapter 4, out of the first six chapters of the Indian Contract Act, 1872, which govern general principles of all contracts, we only studied about some basic foundational concepts of contracts forming part the first nine sections of Chapter I.

In this chapter, you will study the remaining four chapters comprising 66 sections that contain provisions regarding the formation of contracts, the performance of contracts, discharge of contracts, breach of contracts and quasi-contracts. You will study the provisions regarding the essential elements of valid legal contracts including definitions and requirements forming part of Chapter II and Chapter III of the Indian Contract Act, 1872 ("Act"). Next, the chapter deals with discharge of contracts and various modes by which contracts are normally discharged and cover important provisions of Chapter IV that deal with the performance of contracts in terms of rights and obligations of contracts. Chapter V which deals with quasi-contracts and provisions regarding breach of contract forming part of Chapter VI is also covered in this chapter.

5.2 FORMATION OF CONTRACTS

Our objective in the last chapter was to introduce the basic concepts as defined in the Indian Contract Act, 1872. In this chapter, while discussing elaborately the concepts delineated in the remaining 66 sections of the Indian Contract Act, 1872, we shall also consider the related English Common Law principles pertaining to contracts.

As we discussed different types of legal systems in the chapter on the legal environment, the judicial and legal systems of the countries that follow the common law system depend less on the codified laws and more on the common law. The contribution and impact of the common law are especially very important and significant in the case of contract laws. Therefore, to understand contract law, it won't be sufficient if you are thorough only with the provisions of the Indian Contract Act, 1872, but you also need to be well versed with the common law principles related to the Indian Contract Act, 1872, which may not have been codified.

It may be possible to derive some of the common law principles from the existing provisions of the Indian Contract Act, 1872, but in other cases, these principles may either be derived as common sense or may purely depend on judicial precedents.

In the last chapter, we studied the concept of contract and the functions of a contract. We discussed the difference between an agreement and a contract and the importance of enforceability of contracts in courts. We also studied the possible remedies in case of breach of contracts in order to ensure orderly conduct of business. It is important to note that contract laws only define what legal contracts are and are meant only to enforce what has been agreed between two parties. The Indian Contract Act, 1872 does not say anything about the terms that should or should not be included in a contract. The terms and conditions that form part of any contract fall in the domain of the interests of the parties concerned, and the purpose of the legal system is to only implement or enforce what has been agreed upon by the parties in the court of law. The Indian Contract Act, 1872 only describes the general principles which the parties are expected to adhere to while creating rights and duties for themselves.

**Quick TIP**

If the scope of a contract is very huge and has certain risks associated with it, then it is advisable to seek the help of a corporate lawyer.

In other words, parties to a contract are free to set their own terms and conditions for themselves and law will not interfere in their freedom. For example, if you enter into a contract with your friend to sell your car worth ₹ 25 lakhs for just ₹ 5 lakhs on your free consent, it is a valid legal contract even though the consideration is inadequate. The contract law only insists that there should be some lawful consideration to make a meaningful agreement but does not delve into an analysis whether the consideration is just or not. So, in the above car deal, after the contract is concluded, you cannot breach the contract by saying that you have unjustly sold your car for ₹ 5 lakhs even though it is worth ₹ 25 lakhs as long as your friend can prove that the agreement was made without any coercion, etc., but with your free consent.



**SELF
ASSESSMENT
QUESTIONS**

1. The Indian Contract Act, 1872 only describes the general principles which the parties are expected to adhere to while creating rights and duties under a contract. (True/False)

5.3 RULES OF OFFER, ACCEPTANCE AND CONSIDERATION

In this section, we shall study some important common law principles related to the concept of contract before we get into the detailed discussion about various provisions given in different sections of the Indian Contract Act, 1872.

Remember that in the **Indian Contract Act, 1872**, the term “agreement” is defined as *every promise forming the consideration for each other* where a promise is defined as an accepted proposal. Note that the Indian Contract Act, 1872 uses the term “proposal” instead of the more frequently used term “offer”. Acceptance of the proposal by signifying assent of the person to whom the proposal is made is termed as “acceptance” while an accepted proposal is termed as “promise”.

Some common law principles are:

1. **Intention to create legal relations:** In the last chapter, when we discussed the basic elements of an enforceable agreement, we assumed that agreements would always be formed with ‘an intention to create legal relations’ between the parties. However, this is generally true only in the case of business and commercial agreements.

As per common law principles, even if an agreement has all valid elements like offer, acceptance, and consideration, it won't be considered a legal contract and cannot be legally enforceable in courts, if it can be proved that there was no intention between the parties to create legal relations. For example, most of the informal agreements we make with our near and dear ones in the family, and in the social context, are generally done without any intention to create legal relations. Hence, these are not considered as legal contracts in the court of law.

In this regard, the English Common Law states the following rules which are important:

A. Social/domestic agreements do not involve "intention to create legal relations".

For example, if you have told your friend that you will visit his party tomorrow without fail and if he makes some special arrangements for you and undergoes loss due to your absence, it would only be considered as a social/domestic agreement formed without legal intentions. There is an important case law in this regard, viz., *Spellman vs. Spellman*, 1961. Mr. and Mrs. Spellman, who were undergoing a bad patch in their marriage relations, concluded that if Mr. Spellman purchased a new car, their relationship would improve. Mr. Spellman purchased a new car and registered it in his wife's name. But within weeks, they fell apart again and Mr. Spellman took the car with him. His wife sued him claiming the car belonged to her. The court decreed that the agreement was in the nature of a domestic agreement and there was no intention to create a legal relation on the part of Mr. Spellman and, hence, there was no legal contract in existence. The burden of proving the intention to create legal relations lies on the party alleging the same.

B. In contrast to social and domestic agreements, commercial agreements are considered to have the intention to create legal relations.

Unless there is contrary evidence that the agreement was not formed with an intention to create legal obligations, all commercial and business agreements, by default, are considered to be formed with an intention to create legal obligations and will be considered legally valid contracts (provided they satisfy the other mandatory requirements of a valid contract given in the Contract Act).

2. **An offer for a contract can be made to an individual, or a group of persons, or to the world at large:** Suppose you are in need of a particular artefact or an old and rare edition of a book. You issue an advertisement in the newspaper that the first person who gets you that artefact or book will be rewarded with a significant stated amount of money. In this case, the advertisement might look as if you are making a contract with the entire world. Though you are making an offer to the entire world, in reality, your contract will be only with the people who finally perform the condition stated in the offer.
3. **Invitation to treat vs. offer:** An offer is different from an invitation to treat (or invitation for offer). Suppose you issue an advertisement seeking tenders for a building contract. The contractors would submit their quotes in accordance with the conditions and requirements you have given in the

Important Concept

In the context of social and domestic agreements, the law generally holds that the parties to the agreement do not intend to create legal obligations. This presumption may be rebutted by evidence to the contrary.

request for tender. In this case, your advertisement seeking tenders is only “an invitation to treat” while the tenders submitted by the contractors are the actual “offers”. When you accept the tender of a particular contractor, your acceptance would lead to a contract between you and that contractor.

The more ubiquitous examples are grocery stores and supermarket stores. Supermarket stores display various grocery items with price tags. A sale contract is concluded only when you make “an offer” to purchase by giving money as consideration to the cashier and the cashier “accepts” your offer for purchase. The display of items with the announcement “for sale” with the price tag is only an “invitation to offer”. To differentiate between the two, consider a situation wherein you take an item to the cashier for purchase. You cannot insist that an offer for sale is made by the display which you have accepted by selecting the item and the cashier is bound to sell the item to you. Since the display is only an invitation to treat, when you want to purchase, you are making only an offer to purchase which becomes a contract only if the cashier accepts your offer. Your offer can also be rejected by the cashier for whatever reason.

Some examples of an invitation to offer are the issue of a prospectus by a company, sale by auction, government tenders, request for proposals, VRS announced by companies, etc.

4. **An offer must be definite and not uncertain, and acceptance has no effect till communicated:** You cannot make an offer that says if the other party does not respond within a week, the offer is considered to have been accepted automatically. Similarly, even if the other party has really accepted the offer, it has no effect in law till it is communicated to the proposer.
5. **An acceptance should be an unconditional consent to the proposal:** As per the Indian Contract Act, 1872, an accepted proposal is considered a promise. However, the acceptance must be unconditional. Suppose you make an offer to sell your car for ₹ 5 lakhs. Your friend communicates to you that he accepts your offer but the price should be ₹ 4.5 lakhs. This amounts to a counter offer and not an acceptance of the offer made by you. When an offer is accepted with any qualifications, it implies that the original offer is no more valid as a new offer has been made by the other person.

Suppose a supplier sends his quotation for goods to be sold to the purchaser. But the purchaser sends his purchase order with different terms and conditions than those printed on the supplier’s quotation. This amounts to the purchaser making a counter offer. The supplier now cannot supply goods assuming that the terms and conditions mentioned in his quotation are still valid.
6. **The promisor making the offer can prescribe the mode of acceptance:** This means the promisor can reject an acceptance if it is not made in the prescribed manner adhering to the terms and conditions mentioned in the proposal.
7. **Uncertain agreements cannot be legally enforced:** If the vital terms of an agreement are left to be agreed by the parties, there will be no contract. If, in the agreement, it is not clear or it is vague or ambiguous what the parties have agreed upon, then courts cannot enforce the agreement as a valid contract between the parties. This also implies that an agreement meant to ‘negotiate an agreement in future’ is not a valid contract.



NOTE

A relatively new common law development in India is the tort law. According to Salmond, a tort is a civil wrong for which the remedy is a common law action for unliquidated damages, and which is not exclusively the breach of contract, or, the breach of trust, or, other merely equitable obligation.

However, it is not necessary that every term and condition should be agreed upfront. As long as vital terms are agreed upon, parties can include an arbitration clause for settling disputes regarding the terms that are yet to be agreed.



NOTE

In case of a contract involving detriment to the promisee, no any actual loss to the promisee or benefit to the promisor should occur.

8. **Consideration can be in terms of either benefit or detriment to the promisee:** The above common law principle uses the concept of detriment along with benefit. It implies that there is no requirement that a party to a contract must receive any benefit. The test for consideration is only whether one party receives a benefit from the other, or whether the other party suffers a detriment. Also, the contract does not involve the third party as there is no consideration from him neither had he parted anything of value nor he did anything to benefit you or your friend.

Similarly, suppose you agree to sell your car free of cost to your friend. In this case, your promise to sell is a consideration from your side in terms of some detriment (parting something of value) to you. However, there is no consideration from the side of your friend – neither there is any detriment to him nor you receive any benefit through his acceptance. Hence, an agreement to sell your car free of cost is not a valid legal contract.

9. **Consideration must be mutual:** Both parties must furnish consideration to each other. (Note also that the promise for which consideration is given by the acceptor is the consideration of the proposer to the acceptor.) Suppose you and your friend enter into an agreement to provide financial help to a third person. Is there a contract between you and your friend? The answer is 'yes' as there is a detriment (parting of value) from both of you which forms consideration for each other.
10. **Consideration need not be adequate:** The promisee should accept the proposal by making a consideration to the promisor. The consideration can be one of performing an act or a reciprocal promise. However, it is not necessary that the consideration should be a balanced one. In other words, if you decide to purchase your friend's car worth ₹ 5 lakhs for ₹ 25 lakhs, it does not affect the legal validity of the contract.
11. **Consideration must be quid pro quo, i.e., given in return for the promise:** It should be clearly evident that the consideration is given by the acceptor of the proposal in return for the promise made by the proposer. For example, suppose you tell your friend that you plan to give the holiday voucher to him you have won in a competition with him as you are going elsewhere. Later, you change your plan and decide to use the voucher for yourself. Your friend cannot claim the existence of any contract as there was no consideration from his side on the promise made by you. Your friend may quote any other benefit he has done to you on that day as return consideration. But as long as the consideration was not given in return for the specific promise, there is no contract in existence.

Rule of a Stranger to Contract

- **As per the doctrine of privity of contract, only the parties to a contract can be bound by it or entitled under it:** Suppose you and your friend agree to make a contract to do something for another friend, say X, of yours. Since X is not a party to the contract, he cannot enforce the contract against you or


**Important
Concept**

Exception to the Doctrine of Privity – A beneficiary under a trust may enforce a contract even though he is not a party to the contract.

your friend. Similarly, neither you nor your friend can enforce the contract against X.

In the above case, even if the agreement involved all three people, there is a contract only between you and your friend since no consideration has passed from X to you or your friend. The consideration for you and your friend is the detriment in terms of parting something of value.

- **Two persons cannot, by any contract into which they have entered, impose liabilities upon a third party:** In the case law, *McGruther vs. Pitcher* (1904), McGruther sold some items with a condition that whoever purchases the items should not resell them at a price lower than the price quoted. Pitcher purchased the items from an agent of McGruther and resold them at a lower price. Even though the sale agreement had a condition that a resale could not take place below the stated price, McGruther could not enforce the contract against Pitcher as there was no contract between him and Pitcher. By simply printing the conditions on every item, McGruther could not impose liability on the third party. Moreover, Pitcher had a contract with only McGruther's agent. Since there was a contract between Pitcher and McGruther's agent, it was possible for McGruther's agent to enforce the contract against Pitcher.



**SELF
ASSESSMENT
QUESTIONS**

2. A/An _____ should be definite and not uncertain, and acceptance has no effect till _____.

5.4 ESSENTIAL ELEMENTS OF A VALID CONTRACT

Section 10 of the Indian Contract Act, 1872 provides that *all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not expressly declared void in the Act*. Thus, following are the essential elements of a valid contract:

- Valid agreement
- Free consent
- Capacity to contract
- Lawful consideration
- Lawful object
- Agreement not expressly declared void

It is important to note that the requirements of a valid agreement not only include the definitions and requirements pertaining to proposal and acceptance, but also all the common law principles governing valid contracts.

5.4.1 | PROPOSAL/OFFER [SECTION 2(a)]

We have already discussed the definition of a proposal and promise in the last chapter. The term “proposal” is used instead of the term “offer” in the Indian

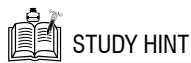
Contract Act, 1872. Section 2 of the Indian Contract Act, 1872 defines a valid offer (proposal) as follows:

1. The offeror signifies to another person his willingness to do or to abstain from doing anything
2. He does it with a view to obtain the assent of that other person to such act or abstinence

Apart from the above definition, it is also important to remember the common law principles related to offers, which we have already discussed. For example, an important common law principle pertains to the requirement of intention to create legal relations when an agreement is made, though this has not been mentioned as part of the Indian Contract Act, 1872. Another important common law principle, discussed earlier, is the differentiation between an offer and an invitation to offer. The difference between the two is summarised in Table 1:

TABLE 1: Difference Between an Offer and an Invitation to Offer

S. No.	Offer	Invitation to Offer
1.	An offer indicates the willingness of a person to enter into a contract.	An invitation to offer is made by a person who seeks offers from others.
2.	The objective of an offer is to get acceptance from another person for entering into a contract.	The objective of an invitation to offer is to negotiate the terms on which the person making invitation is willing to contract.
3.	An offer is a proposal which when accepted becomes a promise and leads to a contract with a valid consideration	An invitation to offer is neither a proposal nor a promise. The response to the invitation to offer can be termed a 'proposal' or 'offer', which may or may not be accepted by the person who made the invitation



STUDY HINT

The term 'offer' has been defined under Section 2(a) of the Indian Contract Act, 1872, while the invitation to offer has not been defined.

Offers can be classified/contrasted into the following types:

- **General vs. specific offer:** A general offer is made to the world at large while a specific offer is made to a particular individual(s).
- **Express vs. implied offer:** If an offer is expressed in words, it is an expressed offer and if an offer is implied by the conduct of the persons or circumstances of the case, it is an implied offer.
- **Positive vs. negative offer:** The proposer can signify his willingness to do or to abstain from doing something. A positive offer refers to the willingness to do something while a negative offer is one where the proposer signifies his willingness to abstain from doing something.
- **Specific vs. standing offer:** A standing offer is made for goods and services, which are required over a certain period. In such a case, a trader may invite tenders as a standing offer. Standing offer is made as and when the goods or services are required at pre-arranged prices, under set terms and conditions. A sequence of contracts can be created using a standing offer. On the other hand, if a tender is submitted for goods and services in specified quantities,

it is termed as a definite offer. As soon as the tender is accepted, it leads to the creation of a binding contract.

5.4.2 | ACCEPTANCE [SECTION 2(b)]

A proposal becomes a promise made by the offeror when the party to whom the proposal is made communicates his acceptance. A promise when it satisfies other conditions specified in the Indian Contract Act, 1872 becomes a legally enforceable agreement.

How should the acceptance of an offer be done? As per the Indian Contract Act, 1872, there are two conditions which an acceptance must satisfy:

1. The acceptance should be absolute and unqualified (if not, it becomes a counter offer as already discussed).
2. It should be expressed in some usual and reasonable manner (or in the manner prescribed in the proposal).



STUDY HINT

Reciprocal promises can be of three types: mutual and independent, conditional, and concurrent.

If the proposal prescribes a certain manner in which the acceptance should be made, and if the acceptance does not follow such criteria, then the proposer can insist that the acceptance should follow the prescribed procedures. If he fails to do so, it is presumed that he accepts the acceptance [Section 7 (2)]. The proposal will also be deemed accepted if the second party performs the conditions stated in the proposal. As we studied in the last chapter, such contracts are called unilateral contracts. If the acceptor receives any consideration for a reciprocal promise which may be offered with a proposal, then also the proposal will be deemed as accepted.

The acceptance can also be expressed or implied. The implied acceptance is gathered from the conduct of the acceptor or from the circumstances of the case.

For example, suppose you have an overdraft loan account with your bank at 15% interest p.a. and the debit balance is currently above the limit granted due to non-payment of temporary overdrafts. You receive a communication from the bank that overdraft accounts with an outstanding balance above the limit sanctioned will be levied an additional penalty interest of 5%. However, you continue to operate the account. In this case, the communication of the bank about additional penalty interest amounts to an offer (for continuing to use the overdraft account given the condition) and your act of continued use of the account amounts to a reciprocal promise that you will pay additional penalty interest. The consideration for the reciprocal promise is the bank's permission to continue to use the overdraft account (Case law: Hulas Kunwar vs. Allahabad Bank Ltd., 1958). In this case, after some period of operation of the account, you cannot claim that the proposal of levying additional penalty interest has not been accepted by you, as you have received consideration, by making a reciprocal promise of paying higher interest, by the implied action of continuing to operate the account.

Apart from common law principles pertaining to acceptance discussed earlier, some more important principles with regard to acceptance are:

1. Acceptance should be given to the person who made the offer, or to the person authorised by him.
2. Acceptance should be communicated by the offeror only.
3. Mental acceptance or silence cannot constitute an acceptance.



CASE LAW

Carlill vs. Carbolic Smoke Ball Co. (Court of Appeal-1892)

Rule of Law: A General offer may be accepted by any person from among the public who has the knowledge of it. The performance of conditions of an offer will amount to acceptance.

The case of Carlill vs. Carbolic Smoke Ball Co. is an illustration of a contract arising out of a general offer and intention to create a legal relationship. As per the facts of the case, the company issued an advertisement in a newspaper about its product, "the smoke ball" a preventive medicine against influenza. In the advertisement, the company offered to pay a sum of £ 100 as compensation to anyone who contacted influenza or a cold after having used the smoke ball according to the printed directions. The advertisement also contained that a sum of £ 100 had been deposited with the Alliance bank to show the sincerity of the company. A lady, Mrs. Carlill relying on the advertisement purchased and used the smoke balls as per directions but still caught influenza. She sued the company to claim the compensation of £ 100. The Court of Appeal held that the essential elements of a contract were all present, including offer and acceptance, consideration and an intention to create legal relations. It was a general offer and Mrs. Carlill had accepted it by her act, by performing the conditions for acceptance. She was, therefore, entitled to get the claim.

5.4.3 | COMMUNICATION OF ACCEPTANCE

In the case of unilateral contracts, the communication of acceptance is not applicable. In such contracts, the performance is considered as the acceptance. In other cases, where the contract requires communication of performance in the prescribed manner, the same must be done in accordance with the contract.



CASE LAW

Lalman Shukla vs. Gauri Dutt (Allahabad High Court-1913)

Rule of Law: Offer must be communicated. An action without the knowledge of the proposal is no acceptance.

In this case, Gauri Dutt sent his servant, Lalman to search for his missing nephew. After Lalman had left in search of the boy, Gauri Dutt announced a reward of ₹ 150 to anyone who might find out the boy. Unaware of the announcement of the reward, Lalman located the missing nephew and brought him back. It was held that Lalman was not entitled to reward since he had no knowledge of the reward, i.e., the proposal.

5.4.4 | REVOCATION OF OFFER AND ACCEPTANCE (SECTION 4)

The communication of the offer is complete with it comes to the knowledge of the person to whom it is made. An offer cannot be revoked once communication of its acceptance is complete as against the acceptor.

An offer can be revoked through the following means as per Section (6):

- By the communication of the notice of revocation by the proposer to the other party.
- By lapse of time prescribed in the proposal before which acceptance is required (if no time is specified, by the lapse of a reasonable time before acceptance is made).
- By the failure of the acceptor to fulfil a condition required for acceptance.
- By the death or insanity of the proposer, if the knowledge of that fact reaches the acceptor before acceptance.

Example: A government department issues an advertisement inviting tenders for building a bridge with specifications and other terms and conditions. Contractor A submits a proposal with his quote for the tender and mentions that the quote is valid for next one month. He also states that the acceptance of the proposal should be communicated agreeing to the terms mentioned in the proposal by registered post.

In this example:

- The invitation for tenders is the invitation for offers made by the government.
- The submission of a proposal by Contractor A is an offer made to the government.
- Suppose the contractor notices a defect in the estimate made in the proposal, he can revoke his offer by issuing a notice of revocation before the tender proposal is accepted.
- The proposal cannot be revoked by sending revocation notice if the government has already sent the communication of acceptance, even if it has not yet reached the contractor.
- The offer will automatically stand revoked if no acceptance is received within a month as per the proposal terms mentioned.
- Suppose the government responds with the acceptance letter with terms and conditions different from those specified by the contractor in his proposal. In this case, the acceptance letter will be considered as a counter-offer, and the earlier proposal of the contractor will stand revoked.
- The offer will lapse if the government rejects the offer or suggests changes in terms and conditions which will amount to counter-offer.

An acceptance may be revoked at any time before the communication of acceptance reaches the proposer. In the above case, once the government accepts the tender submitted by the contractor and the communication of acceptance reaches the contractor, it cannot revoke the acceptance for whatever reason, as a legal contract comes into existence. However, before the communication reaches the contractor (say sent by post), the government can revoke the acceptance.



NOTE

Legal capacity to contract refers to an attribute of a person who can acquire new rights, transfer rights, and assume duties according to his own will.

5.4.5 | CAPACITY TO CONTRACT

As per the Indian Contract Act, 1872, every person who meets the following requirements is competent to enter into a contract:

1. If he has attained the age of majority according to the law to which he is subject.

2. If he is of sound mind.
3. If he is not disqualified from contracting by any law to which he is subject.

According to Section 12, a person is said to be of sound mind if he is capable of understanding the contract when it is made and is able to make a rational judgment as to its effect upon his interests. However, the Indian Contract Act, 1872 explains that it is sufficient if the person was of sound mind when the agreement was made even if he is otherwise not so. Similarly, the contract of a person of sound mind won't be valid if he was not of sound mind when the agreement was made, say for reasons like illness, drunkenness, etc.



STUDY HINT

Delirious persons cannot enter into contract till the delirium lasts.

As per the Indian Majority Act, 1875, a minor is a person who has not completed 18 years of age. Some important points with regard to contracts with minors are given below:

- A contract with a minor is void which means there is no question of even existence of a legal contract in spite of the agreement satisfying other conditions.
- The contract with a minor is void *ab initio* regardless of whether the other party was aware of his minority or not.



CASE LAW

Mohori Bibee vs. Dharmodas Ghose (Privy Council-1903)

Rule of Law: A contract with a minor is void ab initio

In this case, Dharmodas, a minor, mortgaged his house for ₹ 20,000 and received ₹ 10,500 as mortgage money. Subsequently, the Dharmodas sued for setting aside the mortgage on the ground of his minority at the time of execution of mortgage deed. The Privy Council held that a minor is incompetent to contract and therefore, minor's agreement was absolutely void, not merely voidable. Hence, the mortgage was cancelled. Moreover, the mortgagee's request for refund of ₹ 10,500 was also turned down on the ground that minor's agreement was void from the beginning and, therefore, the mortgagee has no right to restitution.

- As per the "equitable doctrine of restitution", if a minor obtains property by misrepresenting his age, he can be compelled to restore it, but only so long as the same is traceable in a specie.
- Agreements made with a minor for his benefits as a promise or beneficiary are valid contracts. Such contracts are enforceable at his option, but not at the option of the other party.
- Contracts of apprenticeship with minors of age not less than 14 years are valid contracts.
- A contract for personal service by minor is void.
- A contract entered into with a minor cannot be ratified even after attaining majority age since the contract is void ab initio.

- A minor can always plead minority. The rule of estoppel does not apply to a minor.
- A minor can be appointed as an agent (Section 182) but he cannot be personally held responsible for any liability.

**Quick TIP**

An alien enemy is any person whose country is at war with India. Contracts with alien enemies are void, whereas contracts with alien friends are valid.

The third type of incompetent persons are those who are disqualified from contracting by any law to which they are subject. They are:

- Alien enemies
- Foreign sovereigns and Ambassadors
- Convict
- Company or Corporation
- Insolvents

**CASE LAW****Nash vs. Inman (King's Bench-1908)**

Rule of Law: To hold a minor's contract for necessities as an enforceable contract, two conditions must be satisfied, viz, (1) the contract must be for goods reasonably necessary to his support his station in life; and (2) he must not have already a sufficient supply of these necessities.

A minor ordered 13 fancy waistcoats from a tailor while he was already having sufficient clothes to wear. Held, the 13 waistcoats purchased were not necessities and the purchase price was irrecoverable.

5.4.6 | FREE CONSENT (SECTION 14)

Consent means two persons agreeing on the same thing in the same sense. An agreement cannot be reached without the consent of all the parties involved. However, a party may not give his consent to the agreement freely. Free consent of all the parties is required to make an agreement a legally valid contract. If the consent is obtained by means of the following methods, the consent is said to be not free.

**NOTE**

According to Section 90 of the Indian Penal Code, a consent is not such a consent as is intended by any section of this Code, if the consent is given by a person under fear of injury, or under a misconception of fact.

- **Coercion:** It is the doing or threatening or committing to do any act forbidden by the Indian Penal Code, 1860 in order to get consent or unlawfully detaining or threatening to detain any property to the prejudice of the other party. If the consent is due to coercion, then the contract is said to be obtained without free consent.
Example: An agent refused to hand over the books of account of a business to the new agent unless the principal released him of all his liabilities. Under such coercion, the principal released him from all his liabilities by executing a release deed. It was held in the court that the release deed was not a valid legal contract and voidable at the option of the principal
- **Undue Influence:** If 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, then the contract is said to be induced by undue influence. For example, a person is deemed to be in a position to dominate the will of another (a) if he holds an 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 affected due to illness. The burden of proving that there was no undue influence lies upon the person in a position to dominate the will of the other.

Example: An old Hindu woman gifted all her wealth to her spiritual guru to secure benefits to her soul in the next world. It was held in the court that undue influence was used to obtain the consent of the woman owing to the spiritual guru's position to dominate the will of the woman and the contract was set aside.



NOTE

If a contract has been entered into using fraudulent means, then the party that has been defrauded can rescind the contract or may sue the other party for damages.

- **Fraud:** It is an act done by a party or his agent with the intent to deceive another party or to induce him to enter into a contract. It includes suggestion which is not true, active concealment of a fact, a promise made without any intention of performing it, any other act fitted to deceive and any such act that is omitted by law.

Example: The directors of a company issued a prospectus containing false statements. Based on these statements, shares were purchased by a person. It was held in the court that the contract is voidable at the option of the shareholder as the statements made in the prospectus amounted to fraud.

- **Misrepresentation:** It includes any positive assertions about something which is not true, any breach of duty which gives an advantage to the person committing it by misleading another to his prejudice and causing, even if innocently, a party to an agreement, to make a mistake as to the substance of the thing which is the subject of the agreement.

Example: A and B entered into a release deed with a release in favour of B. A signed the document without reading it as he was given the impression by B that the subject matter pertains to a formal matter already settled between them. It was held in the court that even though B has no moral duty to communicate the contents, since A reposed confidence on B and based on that signed the document, the contract was said to be achieved by misrepresentation and hence set aside.

- **Mistake:** Mistakes can be made while drawing a contract. Mistakes can be made as to a matter of fact or as to the law. If both the parties to an agreement were under a mistake (bilateral mistake) as to a matter of fact, the agreement becomes void. If a mistake is on one side of the party alone (unilateral mistake), the contract is not voidable. If the mistake is made as to any law in force, the contract is not voidable.

Example: A agreed to sell a cargo of Indian corn to B which was believed to be on high seas. However, the corn was already sold by the master of the ship (as they were deteriorating in quality) of which neither party was aware. It was held that since there was a bilateral mistake as to a matter of fact, the contract is voidable.

Table 2 gives the effect on the agreement made without free consent:

TABLE 2: Effect on the Agreement made Without Free Consent

Method of Consent	Effect on agreement
1. Coercion	The agreement is a contract voidable at the option of the party whose consent was caused (Section 19). The party to the contract whose consent was not free can insist that the contract shall be performed and that he shall be put in a position in which he would have been if the representations had been true.
2. Fraud	
3. Misrepresentation	
4. Undue Influence	Contract voidable at the option of the party whose consent was so caused (Section 19A). The contract can be set aside either absolutely or upon such terms and conditions which the court may seem just
5. Mistake	<p>A. Mistake as a matter of fact</p> <p>a. Unilateral mistake – Not voidable</p> <p>b. Bilateral mistake – Void agreement</p> <p>B. Mistake as to law – Contract is valid</p>

5.4.7 | CONSIDERATION

The definition of consideration as per the Indian Contract Act, 1872 under Section 2(d) is given below: “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.”

Consideration is the price for which the promise of the proposer (offeror) is bought. It must be something of value in the eyes of law. It can be either some benefit to the promisor/offeror or detriment to the promisee as discussed earlier in the common law principles. Some principles regarding consideration are as given below:

1. Consideration can be an act, abstinence or a return promise.
2. It must be lawful.
3. It must move at the desire of the promisor. An act done at the instance of a third party or without the desire of the promisor is not a valid consideration.
4. It may move from promisee or any other person. Under the English common law, consideration must move from the promisee. But under the Indian Contract Act, 1872, it can move from a third party as long as it has moved at the desire or request of the promisor.
5. It can be of the present, past or future.
6. It need not be adequate.
7. It must be something which the promisor is not already bound to do.



STUDY HINT

If Ramesh promises Suresh that he will pay him ₹ 10,000 if Suresh does not file a case against him, then, in this case, abstinence of Ramesh is the consideration for Suresh's payment.



CASE LAW

Chinnaya vs. Ramayya (Madras High Court-1882)

Rule of Law: It does not matter who furnishes the consideration. The consideration may be moved by the promisee himself or any other person.

A, an old lady, by a deed of gift, granted certain property to her daughter R. The terms of the deed stipulated that R will pay an annuity of ₹653 to A's sister C. On the same day, R entered into an agreement with C to pay her the sum directed by A. The stipulated sum was however not paid and C sued to recover it. R contended that no consideration was moved by C to her. Madras High Court held that the words "the promisee or any other person" in

Section 2(d) of the Indian Contract Act, 1872, made it clear that consideration need not move from the promisee only and C was entitled to recover the amount. The consideration furnished by C's sister was enough to enforce the agreement between C and R.

As per the Indian Contract Act, 1872, in general, an agreement without consideration is not a valid legal contract. However, there are exceptions given in the law as listed below:

- An agreement on account of natural love and affection (provided it satisfies other requirements in this regard). As per Section 25, it should be in writing and registered, etc.
- An agreement to compensate for past voluntary services
- Promise to pay a time-barred debt
- Completed gift
- Contract of agency
- Remission by the promisee of the performance of the promise
- Contribution to charity
- Contract of guarantee
- Gratuitous bailment

 **Quick TIP**

No person, who has given any movable or immovable gift to another person, can ask it back stating lack of consideration as the reason.

5.4.8 | LEGALITY OF OBJECT AND CONSIDERATION

As per Section 23 of the Indian Contract Act, 1872, the consideration or object of an agreement is lawful unless:

- It is forbidden by law. OR
- It is of such a nature that, if permitted, would defeat the provisions of any law. OR
- It is fraudulent. OR
- It involves or implies injury to the person or property of another. OR
- The court regards it as immoral or opposed to public policy.

Every agreement whose object or consideration is unlawful will be treated as void under the Indian Contract Act, 1872.



CASE LAW

Rose & Frank Co vs. J. R. Compton & Bros. Ltd. (Court of Appeal-1924)

Rule of Law: To convert an agreement into a contract, there should be an “intention to create legal relations”.

It is a glaring example of a business deal in which the parties did not intend to create legal relations. As per the facts of the case, an agreement was drawn between the American and English firms. The agreement mentioned that “this agreement is not entered into as a formal legal agreement and shall not be subject to the legal jurisdiction of law courts”. The agreement was terminated by one of the parties and the other party brought an action for the breach of contract. Held, the agreement was not a binding contract as there was no intention to create legal relations.

Examples:

- A and B get into an agreement for division among them of the gains acquired from a business activity. However, the business activity is held fraudulent and unlawful. Since the object of the agreement pertains to an unlawful activity, the agreement is void.
- A assures B that he would get an employment in public service provided B pays a certain amount to A. The agreement is not valid as the consideration is unlawful.
- A promises to drop a prosecution which he has instituted against B for robbery. B promises to restore the value of the things taken. The agreement is void as the object is unlawful.



**SELF
ASSESSMENT
QUESTIONS**

3. Which of the following is required for a valid contract?
 - a. Both the parties should give consent to agreement freely.
 - b. The subject matter should be lawful.
 - c. There should be a lawful consideration.
 - d. All of these required.
4. Which of the following statements is wrong with regard to offer?
 - a. An offer should be addressed to any particular individual(s).
 - b. An offer cannot be general and made to the world at large.
 - c. Items displayed in a supermarket with price tags amount to valid offers.
 - d. An offer should be definite and certain.

5. Which of the following statements is true?
 - a. An acceptance should only be made in absolute and unconditional terms in order to make a valid contract.
 - b. Consideration should be balanced and just.
 - c. Considerations always benefit both parties.
 - d. A valid contract always implies consideration in form of money.
6. Which of the following is not true with regard to revoking of an offer?
 - a. A notice of revocation should be given by the proposer.
 - b. An offer remains valid till accepted or revoked indefinitely.
 - c. An offer can be revoked if the acceptance does not fulfil the required conditions.
 - d. All of these are true.
7. Suppose while contracting, the two parties were not having the same knowledge about the subject matter. The second party mistakenly believed that the contract is equally beneficial while the first party was unaware of the knowledge of the second party. This contract is voidable because of a mistake on one side of the party. (True/False)
8. A contract becomes voidable in the following cases of the method of consent:
 - a. Coercion
 - b. Fraud
 - c. Misrepresentation
 - d. All of these
9. The subject matter or object of the contract is an individual choice of the parties concerned. There is no legal provision that governs the object of a contract. (True/False)

5.5 DISCHARGE OF CONTRACT

On discharge of the contract, the contract gets terminated. Discharge can be either by the performance of the obligations as per the contract terms by both the parties or by breach of the contract by one of the parties.

As per Section 37, the parties to a contract must either perform or offer to perform their respective obligations unless such performance is dispensed with or excused under the provisions of the Indian Contract Act, 1872 or any other law.

Though the parties to a contract agree to perform promises and/or reciprocal promises for respective considerations, it is not necessary that all contracts are executed and concluded as agreed initially. There could be a breach of contract or there could be circumstances in which failure to perform is excusable due to a mutual agreement. Contracts may terminate through various means like a mutual agreement performance, lapse of time, operation of law or by breach of contract, etc.

Figure 1 shows the discharge of contract:

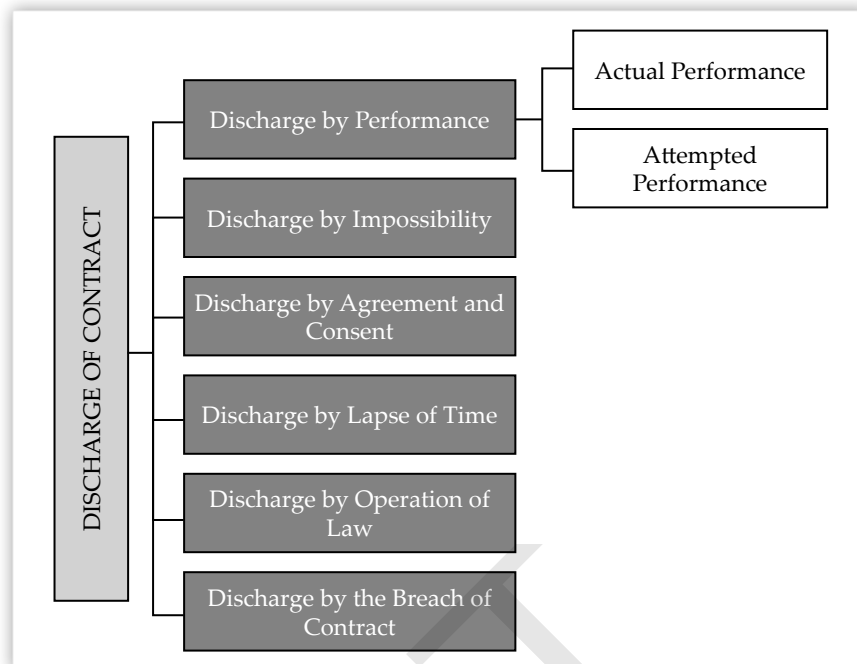


FIGURE 1: Discharge of Contract

Let us discuss various modes of discharge of a contract in the next sections.



CASE LAW

Case Law on Remedy Against Breach of Contract – Hadley vs. Baxendale (Court of Exchequer-1854)

Rule of Law: A party breaching the contract is liable for all losses that the contracting parties should have foreseen, but is not liable for any losses that the breaching party could not have foreseen on the information available to him.

Perhaps the most famous contracts case of all is Hadley vs. Baxendale. A crankshaft of a steam engine at the mill had broken and Hadley arranged to have a new one made by W. Joyce & Co. The manufacturer, W. Joyce & Co. required that the broken crankshaft be sent to them in order to ensure that the new crankshaft would fit together properly with the other parts of the steam engine. Hadley contracted with Baxendale, who were operating as common carriers under the name Pickford & Co., to deliver the crankshaft to engineers for repair by a certain date at a cost of £ 2.40. Baxendale failed to deliver on the date in question, causing Hadley to lose business. Hadley sued for the profits he lost due to Baxendale's late delivery, and the jury awarded Hadley damages of £ 25. Baxendale appealed, contending that he did not know that Hadley would suffer any particular damage by reason of the late delivery. The question raised by the appeal, in this case, was whether a defendant in a breach of contract case could be held liable for damages that the defendant was not aware would be incurred from a breach of the contract.

The Court of Exchequer declined to allow Hadley to recover lost profits, in this case, holding that Baxendale could only be held liable for losses that were

generally foreseeable, or if Hadley had mentioned his special circumstances in advance. The mere fact that a party is sending something to be repaired does not indicate that the party would lose profits if it is not delivered on time. The court suggested various other circumstances under which Hadley could have entered into this contract that would have presented such dire circumstances, and noted that where special circumstances exist, provisions can be made in the contract voluntarily entered into by the parties to impose extra damages for a breach.

5.5.1 | DISCHARGE BY PERFORMANCE OF A CONTRACT

A contract is said to be discharged by performance when both the parties to the contract fulfil their respective obligations created under the contract as per the contract terms within the stipulated time. However, if the promisor makes an offer of performance to the promisee, and the offer has not been responded to by the promisee, the promisor is not responsible for non-performance. Hence, the discharge by performance can be classified into two types:

1. **Actual performance:** Discharge by actual performance means when the contract is discharged by performance as prescribed in the contract terms wherein both the parties complete their respective obligations. Some important provisions of the Indian Contract Act, 1872 in this regard are given below:

- The performance should be done by the promisor himself if it is mentioned so in the contract. In other cases, if appropriate, the promisor or his representatives may employ a competent person to perform it (Section 40).
- If the promisee accepts performance of the promise from a third person, he cannot enforce it against the promisor later (Section 41).

Example: A promises to pay a sum of money to B. A may perform this promise either by personally paying money to B or by making payment through another person. However, if the contract involves personal skills, say a music event, the performance cannot be offered to be executed by another person. However, if A accepts performance from a third party, he cannot later enforce it against B.

- In the case of a joint promise, the promise should be fulfilled jointly and the liabilities would devolve to the survivors if any person who has promised dies.
- When two or more persons make a joint promise, the promisee may compel any one or more of such joint promisors to perform the whole of promise. Each of the two or more joint promisors may compel every other joint promisor to contribute equally to the performance of the promise unless a contrary intention appears in the contract.
- Where the contract does not specify the need for application by the promisee or the time of performance, the engagement must be performed within a reasonable time.



NOTE

Usually, the promisee or legal representatives of the promisee can demand performance.

- When the promise is to be performed on a certain day, and the promisor has undertaken to perform it without application by the promisee, the promisor may perform it at any time during the usual hours of business on such day and at the pace at which the promise ought to be performed.

Example: A promises to deliver goods to B at B's place on a particular date. On that day, A brings the goods to the specified place of B, but after the usual hour of closing, and hence is not received. In this case, A has not performed.



Quick TIP

Discharge by performance is the most natural type of discharge of a contract.

- Where an application for performance is necessary as per contract, it is the duty of the promisee to apply for performance at a proper place and within usual business hours. Similarly, if the contract requires performance without application by the promisee, and no place is fixed for performance, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for performance (Sections 46 to 49).
- The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions (Section 50).
- When a contract consists of reciprocal promises to be simultaneously performed, promisor need not perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

Example: A and B contract that A shall deliver goods to B to be paid for by B on delivery. In this case, A need not deliver goods unless B is ready and willing to pay for the goods on delivery. B need not pay for the goods unless A is ready and willing to deliver them on payment.

- When a contract consists of reciprocal promises, such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed, and the promisor of the promise fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party to the contract for any loss which such other party may sustain.

Example: A promises to sell goods to B and to deliver goods by the next day. B promises to pay for the goods within a month. A does not deliver the goods according to the promise. B's promise need not be performed and A must make compensation.

2. **Attempted performance:** When the offer to perform the contract is not accepted by the promisee, the promisor is not responsible for non-performance of the contract and he will not lose his rights under the contract. As per Section 38, every such offer must fulfil the following conditions:

- It must be unconditional.
- It must be made at a proper time and place.
- The person to whom it is made shall have a reasonable opportunity of ascertaining that the person is able and willing to perform the promise.
- If the offer is to deliver anything, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver.

For example, A agrees to deliver to B at his place a certain amount of goods on a particular date. In order to perform his offer, A must bring the goods to the B's place on the appointed date, under such circumstances that B may have a reasonable opportunity of satisfying himself that the thing offered is the same as agreed in the contract.

As per Section 39, when a party to a contract has refused to perform or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract unless he has signified, by words or conduct, his acquiescence in its continuance.

5.5.2 | DISCHARGE BY IMPOSSIBILITY



Quick TIP

Section 56 of the Indian Contract Act, 1852 mentions the doctrine of frustration. According to this Section, any act, which was to be performed after the contract, becomes unlawful or impossible to perform, and which the promisor could not prevent, then such an act will become void. Doctrine of frustration is related to discharge of contract by impossibility.

Discharge by impossibility could be of following two types: (a) Initial impossibility (pre-contractual impossibility); and (b) Subsequent (post-contractual) impossibility. Initial impossibility can occur in case of contracts where there is a bilateral mistake which makes the contract void.

As per Section 56, a contract to do an act which, after the contract is made, becomes impossible, or, unlawful by reason of some event which the promisor could not prevent becomes void. The doctrine of subsequent impossibility (also termed as the doctrine of frustration in the English common law) applies in the following cases: (a) subject matter destroyed without fault of any party, (b) a change in law making the contract illegal, (c) non-existence of contemplated things, (d) declaration of war, and (e) death or incapacity of the promisor.

The doctrine of subsequent impossibility is not applicable in the following cases:

- Difficulty of performance
- Self-induced impossibility
- Commercial impossibility
- Impossibility due to the conduct of a third party
- For reasons of strikes, lockouts & civil disturbances, or
- Failure of one of the objects

If the contract is discharged through subsequent impossibility, it has the following effects:

- The contract becomes void.

Example: A agrees with B to heal a disease by magic. The agreement is void.

- A compensation for loss shall be done for failure to the party affected.

As per Section 56, the promisor must make compensation to the promisee for any loss which such promisee sustains through the non-performance of the promise, if the promisor knew, or, with reasonable diligence, might have known the promise to be impossible or unlawful.

Example: A contracts to marry B, but A is already married to C, though polygamy is forbidden by law. A must make compensation to B for the loss caused to her by the non-performance of his promise.

- The principle of restitution shall be applied wherein a person, who has obtained advantage from a contract which has become void subsequently, is required to restore it or compensate to the person from whom he received it.

As per Section 65, when an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement is bound to restore it or to make compensation for it to the person from whom he received it.

5.5.3 | DISCHARGE BY AGREEMENT AND CONSENT (CONSENSUAL DISCHARGE)



NOTE

Novation must be done by consent of both the parties and the newly created contract must be capable of legal enforcement.

As stated earlier, it is not necessary that a contract should always be discharged by performance. The contractual obligations can also be terminated by mutual consent or agreement, since as per a general rule of law, a thing may be destroyed in the same manner as it is constituted. There are several types of discharge by mutual consent, which are listed below:

- **Novation:** Substitution of a new contract in the place of old one. Normally, the term is used when one creditor is replaced in a debt contract with another. This leads to the creation of a new contract that includes a third party leading to a trilateral agreement.

Example: A borrows money from B under a contract. It is agreed between A, B, and C that B shall henceforth accept C as his debtor, instead of A. The old debt of A to B comes to an end and a new debt from C to B has been contracted.

- **Alteration:** Change of one or more terms of the contract by mutual consent.
- **Rescission:** The object of the rescission is to release the parties from the contract.

As per Section 64, when a person at whose option a contract is voidable rescinds it, the other party to the contract need not perform any promise or contract in which he is a promisor. The party rescinding a voidable contract, if he has received any benefit, shall restore such benefit to the person from whom it was received.

- **Remission:** Acceptance of a lesser performance than what has been contracted for. As per Section 63 of the Indian Contract Act, 1872, the promisee may dispense with or remit, wholly or in part, the performance of the promises made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit.
- **Waiver:** Abandonment of the rights by the parties.

5.5.4 | DISCHARGE BY LAPSE OF TIME

Contracts must be performed within the stipulated time or within a reasonable period of time. If not performed within a reasonable period of time, the affected party need not perform his promise and can institute a suit for damages. As per the law of Limitation Act, 1963, the affected party should enforce his rights within

the time prescribed by the Indian Contract Act, 1872; else he will be deprived of his remedy by law. For contracts, the period of limitation is 3 years.

5.5.5 | DISCHARGE BY OPERATION OF LAW

Contracts can get discharged by operation of law in the following cases:

Important Concept
A contracts to sell 300 sq. ft. land to B for ₹10 lakhs. Now, if A makes any material alteration in the contract, such as changing 300 sq. ft. to 200 sq. ft., then in such a case, the contract is discharged and B is not bound to buy the land with reduced size.

- **Death:** Death of the promisor can result in a discharge of the contract if the promise pertains to his personal skills. In other cases, the promise would bind the representatives of the promisor unless a contrary intention appears in the contract.
- **Material alteration:** Law might terminate a contract if there is an unauthorised material alteration of the terms of the contract affecting the rights and liabilities or legal position of the parties.
- **Merger:** When a contract with inferior right gives rise to another contract with a superior right, the former contract stands discharged by merging in the latter.
- **Insolvency:** Upon insolvency, the rights and obligations are transferred to the official receiver or assignee of the insolvent. The person facing insolvency is discharged from the liability of all contracts entered up to the date of insolvency.

5.5.6 | DISCHARGE BY BREACH OF CONTRACT

Breach of contract occurs when a party to the contract refuses to perform the contract. Two major types of breach of contract are: actual breach of contract and anticipatory breach of contract.



SELF ASSESSMENT QUESTIONS

10. A agreed to deliver some goods to B at his warehouse in consideration for payment of goods' worth of money specified. On the specified date, A delivered goods at the place of B, but the goods were not accepted at B's place and returned back. In this case:
 - a. The contract has been discharged by performance by A.
 - b. A has offered to perform but B refused and hence A can sue for breach of contract.
 - c. A and B are deemed to have mutually consented to cancel the performance.
 - d. The contract becomes null and void.
11. It is possible that before the execution of any contract, the two parties to a contract can:
 - a. Mutually agree to terminate the contract
 - b. Substitute the old contract with a new contract
 - c. Rescind the contract and release themselves from obligations
 - d. All of these

**NOTE**

In a contract, if any party refuses to fulfil his/her contractual liabilities on the due date or performs the decided tasks incompletely, then it is considered as an actual breach. In contrast, when any party to contract denies performing his promise or presents his unwillingness to perform the contract before the time of performance, then, it is considered as an anticipatory breach.

12. A agreed to sell B ten tons of rice after one month. The price was fixed which should be paid within a month after the delivery. Two weeks after the contract, the government used statutory powers to ban private sale of rice as a measure of price control and decided to procure all rice itself. In this case:
 - a. The contract has become impossible to discharge due to subsequent impossibility and the contract becomes void.
 - b. A should compensate for the loss suffered by B.
 - c. The principle of restitution should be applied.
 - d. All of these
13. A agreed to deliver some goods to B on a specified future date. The payment shall be made within a week after the goods' delivery. Before the specified date, A found that it won't be able to fulfil the contract as it could not procure the goods. At the same time, B found that it does not require goods anymore. Together, they decided to cancel their obligations by mutual consent. This is a discharge of contract by:
 - a. Novation
 - b. Alteration
 - c. Rescission
 - d. Remission

5.6 BREACH OF CONTRACT

Breach of contract means refusal of performance of the contract by a party to the contract. When one party refuses to perform, the other party is discharged from its obligations under the contract. The breach may be anticipatory or actual. In case of breach, the aggrieved party (i.e., the party not at fault) is relieved from performing his obligation and gets a right to proceed against the party at fault. Breach of contract may either be anticipatory or actual.

Figure 2 shows the breach of contract types:

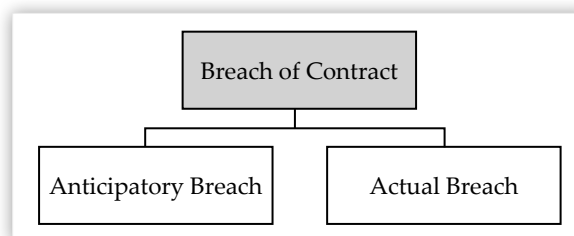


FIGURE 2: Breach of Contract Types

5.6.1 ANTICIPATORY BREACH

Anticipatory breach refers to a breach of contract caused by the rescinding or renouncing of the obligations that are not yet ripe for performance.

In the case of anticipatory breach, the affected party can exercise the following options:

1. Treat the contract as terminated and sue the other party for damages.
2. Treat the contract alive for mutual benefits of both and wait till the date of performance.

5.6.2 | ACTUAL BREACH



NOTE

Actual breach of a contract may occur when the performance of a contract is due or during the performance of the contract.

This occurs when one of the parties refuses to or fails to perform his obligations either at the time when performance is actually due or during the performance of the contract. Breach of contract does not automatically lead to the termination of the contract. The actual breach of contract gives the innocent party a right to claim damages and also the right to terminate further performance of the contract. In other words, the obligations to perform are only terminated for the future and the contract is not set aside *ab initio*.

5.6.3 | REMEDIES AGAINST BREACH OF CONTRACT

On breach of contract, the affected party is entitled to one or more of the following remedies:

- **Suit for damages:** Meant for seeking monetary compensation.
- **Suit for rescission:** Meant for termination of the contract with no further performance.
- **Suit upon quantum meruit:** Meant for restitutory remedy (as against compensatory remedy) where the original contract is discharged and a claim is made for 'as much as is earned'.
- **Suit for specific performance:** A discretionary remedy wherein court orders the parties to perform the obligations.
- **Suit for an injunction:** Order of the court directing a party at fault to actually perform the negative obligation or negative terms of the contract (injunction means requiring a person to refrain from doing some act, hence negative obligation).



SELF ASSESSMENT QUESTIONS

14. The term anticipatory breach refers to:
 - a. Terms or clauses of the contract with regard to anticipated breach
 - b. A party rescinding or renouncing his obligations before the date of actual performance
 - c. A position of impossibility for a party to perform his obligations
 - d. Circumstances when both parties agree to cancel the contract
15. In the case of anticipatory breach, a party cannot treat the contract alive for mutual benefits and wait till the date of performance. (True/False)

16. On a breach of contract, which of the following is not available for the affected party?
- Suit for damages
 - Suit for rescission
 - Suite for specific relief
 - All of the above are possible options depending on the breach.



ACTIVITY 1

Identify a contract which includes a specified date of performance on the part of one of the parties to the contract. Describe in brief the anticipatory breach of contract and the actual breach of contract in the context of this contract.

5.7 QUASI-CONTRACTS

Important Concept

Quasi-contracts are the only contracts which are created on the basis of social responsibility and without an offer, acceptance, consideration.

There are certain cases in real life where contractual obligations might arise between parties even though there were no contracts between them. Generally, these are the cases where one person gets unjust enrichment at the cost of the other. The Contract Act recognises such quasi-contracts that resemble relations created by real contracts and allows the aggrieved parties to enforce those obligations in the court of law.

The concept of quasi-contracts arises from the doctrine of unjust enrichment wherein the need for providing justice to those who have been unjustly affected is recognised. When a person fails to discharge his obligations arising out of a quasi-contract, the other party can seek legal remedies as if a real contract existed which had been broken.

Chapter V of the Indian Contract Act, 1872 provides for five kinds of quasi-contractual obligations:

- Supply of necessities to the person incapable of contracting:** As per section 68, if a person, who is incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.
- Reimbursement of payment:** As per Section 69, a person who pays money on the behalf of another, who is actually bound to pay, is entitled to be reimbursed by the other. To be eligible to become a quasi-contract, the payment of money should have been done to protect one's own interest and the other person must be legally bound to pay. In other words, the person cannot be a completely unrelated party with regard to that payment.
- Obligations of a person enjoying the benefit of a non-gratuitous act:** As per Section 70, where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered. For

example, if a tradesman leaves goods at the house of another person by mistake, and the person consumes the goods as his own, then he is bound to pay the tradesman for the goods.

4. **The responsibility of the finder of goods:** As per Section 71, a person who finds goods belonging to another, and takes them into his custody, is subject to the same responsibility as a bailee. The finder of the lost goods has obligations to take all necessary steps to trace the true owner and return the goods to him while taking due care of the goods in the intermediate period. The finder has rights to make claim for the expenses incurred by him for maintenance of goods, to sue the owner for rewards if applicable, to exercise a right of lien over the goods for the expenses incurred and the reward. The finder may sell the goods only in certain cases where it is appropriate like when the owner cannot be located even after due efforts, when the goods are perishable in nature, when the owner refuses to pay the lawful charges to the finder, etc.
5. **Liability of the person to whom money is paid by mistake:** As per Section 72, a person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay the amount or return the goods. Suppose A and B jointly owe money to C. If A alone pays the full amount to C, while B, unaware of this fact, also pays to C, then C is bound to repay the amount to B.



**SELF
ASSESSMENT
QUESTIONS**

17. Which of the following does not amount to a quasi-contract?
- a. A takes care of his friend B who is of unsound mind and hence B is liable to compensate A from his wealth.
 - b. A has a dispute with B with regard to B's claim of a payment which A is required to make to B on a particular date. Since B is in urgent need of money and A did not pay, C makes the payment to B on that date. A has a quasi-contractual liability to make payment to C.
 - c. An online order for some costly electronic goods meant for A has been wrongly delivered to B which B has started using the goods. B has quasi-contractual obligations to A.
 - d. None of these



ACTIVITY 2

From the Internet, learn about quasi-contracts and find out various examples in support of quasi-contracts.

5.8 SUMMARY



- While dealing with legal provisions of a valid contract, it is also important to take into consideration some important common law principles which are not explicitly coded in the Indian Contract Act, 1872. For example, a valid contract requires intention from the parties to create legal relations. The exception is social and domestic agreements.

- The Indian Contract Act, 1872 specifies the mandatory elements of a valid contract. The six important requirements are valid agreement (constituting an offer and acceptance), lawful consideration, lawful object, competent parties, free consent, and not expressly declared as void by the Indian Contract Act, 1872
- An offer can be specific to a person or addressed to the world at large. An offer should be differentiated from an invitation to offer
- Acceptance of an offer should be absolute and unqualified and should be expressed in some usual and reasonable manner
- It is possible to revoke an offer before its acceptance. An acceptance can be revoked at any time before the communication of acceptance reaches the proposer.
- All persons are competent to contract except those who have not attained the majority age, those who are of unsound mind and those disqualified by some law.
- If consent to an agreement is obtained by coercion, undue influence, fraud, misrepresentation, or mistake, the consent is set to be not free and the contract will not be considered a legally valid contract. Such contracts are voidable at the option of the affected party whose consent was not free.
- Consideration can be an act or abstinence or a detriment and it need not be adequate or just. It must move at the desire of the promisor and from the promisee or from any other person if desired or requested by the promisor. An agreement without lawful consideration is not a valid legal contract.
- The object of a contract should also be lawful, not fraudulent, should not involve injury to another person or property, not immoral, not opposed to public policy, etc., as governed by Section 23 of the Indian Contract Act, 1872.
- The term 'discharge of a contract' refers to the extinguishing of the rights and obligations arising out of the contract through performance. On discharge, the contract gets terminated.
- Parties to a contract must either perform or offer to perform their respective obligations unless such performance is dispensed with.
- A contract can be discharged by performance, mutual agreement, the impossibility of performance, lapse of time, breach of contract or by operation of law.
- Discharge by performance may be either through actual performance or attempted performance.
- Discharge by impossibility can be of two types: initial impossibility or supervening impossibility (also termed doctrine of frustration).
- Discharge by mutual agreement can lead to the following types: novation, alteration, rescission, remission, or waiver
- Discharge of a contract can also happen by breach of contract which can be an actual breach or anticipatory breach. In the case of anticipatory breach, the affected party can treat the contract as terminated and sue the other party for damages. He can also treat the contract as alive and wait till the date of performance

- On the breach of contract, the affected party is entitled to one or more of the following remedies: suit for damages, suit for rescission, suit upon quantum meruit, suit for specific performance, suit for injunction and suit for performance.
- The Indian Contract Act, 1872 also allows for quasi-contracts which arise from the doctrine of unjust enrichment. The Act gives five cases where quasi-contractual obligations are recognised by law.

5.9 KEY WORDS



- **Coercion:** Committing or threatening to commit any act that is forbidden by the Indian Penal Code
- **Novation:** A case wherein a contract is replaced by another contract
- **Undue influence:** A case wherein a party is in a position to dominate the other party and takes advantage of its position in an unfair manner
- **Unlawful agreements:** Agreements that cannot be modified into a contract due to their unlawful object or unlawful consideration

5.10 CASE STUDY: DISCHARGE OF CONTRACTS – COMPENSATION FOR BREACH OF CONTRACTS



This case study illustrates a case of breach of contract and remedies for breach of contract. It is a simple case but one that illustrates many important aspects with regard to the basic concepts of contract, the performance of contract and remedies for breach of contract.

A Contract for Construction and Sale

The plaintiff (one who initiates the case in the court) and the defendant (one who is defending) entered into a written agreement dated 13-4-96 for the construction and sale of a flat. The plaintiff agreed to purchase from the defendant a flat for a price of ₹ 5,50,000. As per the agreement, the plaintiff paid to the defendant a sum of ₹ 4,00,000 as earnest money by cheque and the balance of ₹ 1,50,000 was to be paid at the time of delivery of possession of the flat. The defendant was required to complete the flat construction not later than 12 months from the date of the agreement. Clause 4 of the agreement contained the terms with regard to breach of contract. The clause stipulated that if the plaintiff decided to cancel the agreement or was unable to pay the balance amount, the plaintiff would give a written notice to the defendant informing his intention to cancel the agreement by an advance notice of 30 days, and in the event of the failure on the part of the defendant to return the earnest money on the expiry of the 30th day of the notice, the defendant was to pay to the plaintiff from the day thereafter a daily fine of ₹ 1,000 in addition to the compound interest of 4% per month on the earnest money till the earnest money was paid in full.

The Breach of Contract

After seven months of the agreement, on 27-11-96, the plaintiff wrote a letter to the defendant that he had decided not to purchase the said flat due to personal

reasons and requested him to treat the said letter as the 30-day notice and return the amount of ₹ 4,00,000. He also sent a reminder on 4-12-96. The defendant in the month of March 1997 gave a post-dated cheque for ₹ 4,00,000 which bounced. Similarly, the cheques, given by the defendant later on various dates (13th May, 30th July, 14th October, 10th November, 1997), also bounced.

Filing of Suit for Damages

The plaintiff issued a legal notice on 18-10-97 and 14-11-97 demanding the payment of the amount due on the said cheques and since the defendant did not pay the amount as required on or about 17-2-97, the plaintiff filed complaints against the defendant under Section 138 of the Negotiable Instruments Act, 1881 with regard to the bouncing of the cheques.

The plaintiff also filed a civil suit on 5-4-99 for recovery of the earnest money of ₹ 4,00,000, the penalty of ₹ 8,20,000 and compound interest of ₹ 7,53,348 as per clause 4 of the said agreement

Negotiated Compromise for the Criminal Case

On 24-11-99, the plaintiff filed compromise terms in the criminal cases pertaining to the bouncing of the cheques. As per the compromise terms, both the parties agreed that the amount due on the cheques would be paid in six instalments of ₹ 75,000 each and one instalment of ₹ 50,000. The first instalment was payable on 27-12-99 and the remaining becoming payable every month thereafter. The parties agreed that both the criminal cases (i.e. cases pertaining to the two bounced cheques under the NI Act) would be dismissed as withdrawn on full and final payment of ₹ 5,00,000.

Verdict on the Suit for Damages

The plaintiff continued to pursue the civil suit filed for damages even though a settlement was already reached with regard to the bounced cheques. The defendant, on the other hand, contested the suit that the cause of action for the suit did not survive owing to the compromise already reached with regard to the bounced cheques.

The court came to the conclusion that once the plaintiff and the defendant had reached the settlement in the criminal cases, it meant that there was a renovation of the terms of the agreement between them and therefore the plaintiff cannot recover anything more than what was agreed upon in the settlement entered into. The judge held that the plaintiff was not entitled to recover anything more than ₹ 5,00,000 and since there was no provision made for the payment of interest in the said terms of the compromise, the judge proceeded to award interest to the plaintiff at the rate of 18% from 24-11-99 until the defendant paid the entire amount of ₹ 5,00,000 and therefore proceeded to decree the suit partly.

Dispute Continues

In spite of the agreement for compromise and court decreeing the suit for damages partly, there was again a dispute between the parties, with the plaintiff contending that a sum of ₹ 5,000 only having been paid by the defendant while the defendant contending that a sum of over ₹ 5,50,000 was received by the plaintiff.

Final Verdict

The issue went to the High Court of Mumbai where both the parties filed appeals against the judgment of the lower civil court. The advocate of the defendant relied on Section 62 of the Indian Contract Act, 1872 and claimed that there was novation of the contract in the case of the first agreement dated 13-4-96 which got replaced by novation with the compromise agreement reached on 24-11-99 with regard to the criminal cases. Due to novation, he claimed that the original contract need not be performed. He cited the illustrative example given for Section 62 of the Indian Contract Act.

The High Court rejected the contention of the defendant that there was any novation of the original contract. Since the civil suit was pending when the compromise on the criminal cases pertaining to the bouncing of the cheques was reached and since there was no reference to the civil suit in the terms of the compromise, the original agreement cannot be said to be cancelled by novation. The court held that the parties chose not to make any reference to the civil suit and the terms of compromise were only with respect to the criminal liability incurred by the defendant owing to cheque dishonour. A party in cases like this is permitted by law to take out both civil and criminal proceedings and both the remedies would be independent of one another with the outcome of one trial not affecting the outcome of another. When a decree is passed in the civil suit, any amount paid in the course of the criminal proceedings had to be taken note of or adjusted in the amount due and payable under the decree.

The advocate of the plaintiff submitted that the parties had agreed for payment of compound interest of 4% per month in the original agreement and the same can be awarded in favour of the plaintiff and they would not insist on payment of the penalty of ₹ 1,000 per day as per clause 4 of the original agreement but the court can decide on a reasonable amount of penalty. As per the plaintiff, even though the compound interest at the rate of 4% per month could be termed quite high, it should nevertheless be allowed as this was the penalty interest agreed upon by both the parties. It was contended that the court could not interfere with what had been agreed by the parties in the contract.

In defence, the advocate of the defendant argued that a compound interest rate of 4% per month and the penalty of ₹ 1,000 were unconscionable terms and should not be enforced. It was claimed that the defendant had already paid ₹ 5,30,000 as compared to the original liability of ₹ 4,00,000, and the plaintiff be awarded interest of 6% which would be reasonable and which may be adjusted towards the actual amount to be paid to the plaintiff.

Finally, the court held that the stipulation of ₹ 1,000 per day penalty and interest at 4% were not only unreasonable but also unconscionable and it ought not to be given effect to. The Judges cited previous judicial precedents and the English common law principles to conclude that courts have the power not to enforce any unconscionable terms of a legal contract.

Referring to Section 74 of the Indian Contract Act, the court stated that when a contract is breached, the affected party is entitled to get only reasonable compensation subject to the limit of the amount stipulated in the contract itself. It is not necessary to prove the extent of loss or damage actually suffered. The court

rejected the claim that the money was lent for a business transaction and hence an interest at the rate of 18% was payable to the plaintiff. It was not the case of the plaintiff that he had suffered any loss on the failure of the defendant to return the money. Hence, the payment of interest by the defendant at the rate of 10% will be more than adequate or reasonable compensation from 27-12-96 till 27-4-01 with further interest at the rate of 6% from 28-04-01 until payment. The plaintiff would only be entitled to recover ₹ 400,000 with interest as mentioned, subject to any sum paid or to be paid to the plaintiff under the terms of compromise filed in criminal cases which should be adjusted towards the amount of the current decree.

Source: “Carl Estate Private Limited and anr. Vs. Jagdish J.N. Counte and anr.”, LegalCrysal, <https://www.legalcrystal.com/case/358260/carl-estate-private-limited-vs-jagdish-counte>

QUESTIONS

- Both the parties mutually agreed to settle on the liability arising out of the breach of contract and thereby closed the criminal cases arising out of dishonor of cheques. The lower civil court agreed that this amounts to discharge by mutual consent in terms of substituting with a new contract (i.e., compromise settlement) which implies discharge by novation. However, the High Court held that this not a case of novation. Explain the reasons based on the Contract Act provisions.

(Hint: Though a new contract was created by mutual agreement on the same liability, there was no closure of the existing original contract. Neither the civil suit was closed nor the new contract did mention anything about the original agreement. Hence, this is not a case of substitution of the original contract by a new contract for the discharge of contract. So, this does not come under novation.)

- As per the common law principles, the court is not supposed to judge adequacy of consideration in a contract or the content of an agreement between two parties. The court can only enforce the agreement between two parties. Given this principle, why had the High Court not enforced the penalty clause of ₹ 1,000 per day?

(Hint: As per the Contract Act, the compensation for breach of contract should be as per the terms of the agreement, but as the judges have noted in the agreement, it is a common law principle that the terms of the agreement, even if obtained with free consent, cannot be unconscionable and unreasonable. In such cases, the court can interfere in the agreement terms and enforce what is legally just. Hence, the High Court’s decision on the penalty clause was in accordance with the common law principles.)

5.11 SHORT ANSWER QUESTIONS



- Common law principles may either be derived as common sense or may purely depend on _____.
- _____, etc., are an example of an invitation to offer.
- The objective of a/an _____ is to negotiate the terms on which the person making invitation is willing to contract.

4. In the case of unilateral contracts, the _____ is considered as the acceptance.
5. An acceptance may be revoked at any time before the communication of acceptance reaches the _____.
6. A consideration can be an act, _____ or a return promise.
7. Judicial and legal systems of the countries that follow the common law system depend less on the codified laws and more on the common law. (True/False)
8. The promisee prescribes the mode of acceptance of the contract. (True/False)
9. In the case of a joint promise, the promise should be fulfilled jointly and the liabilities would devolve to the survivors if any person who has promised dies. (True/False)
10. An implied acceptance is usually gathered from the conduct of the acceptor. (True/False)
11. Parties X and Y enter into a contract that has offer, acceptance and consideration. An analysis of the contract revealed that there was no intention between the parties to create legal relations. In this case, the contract is:
 - a. Legal and enforceable in court
 - b. Not legal and not enforceable in court
 - c. Not valid
 - d. Void
12. The burden of proving the intention to create legal relations lies on the _____.
 - a. offerer
 - b. offeree
 - c. party alleging the same
 - d. None of these
13. A manufacturer X enters into an agreement with a distributor Y to sell his watches on a condition that the resellers to whom Y sells the watches do not sell them in the market below the MRP marked by X. Y enters into an agreement with a reseller Z on the given conditions. However, Z sells the watches below the MRP. In this case,
 - a. X can obtain damages from Y
 - b. Y can obtain damages from Z
 - c. X can obtain damages from Z
 - d. All of these
14. Which one of the following elements is not considered as an essential element of a valid contract?
 - a. Free consent
 - b. Lawful object
 - c. Agreement not expressly declared void
 - d. Written form

15. Which of the following is not a type of offer?
 - a. Obsolete
 - b. Standing
 - c. Express
 - d. Positive
16. In which of the following conditions can an offer not be revoked?
 - a. By the communication of the notice of revocation by the proposer to the other party.
 - b. By lapse of time prescribed in the proposal before which acceptance is required (if no time is specified, by the lapse of a reasonable time before acceptance is made).
 - c. By the failure of the acceptor to fulfil a condition required for acceptance.
 - d. By the death or insanity of the proposer, if the knowledge of that fact reaches the acceptor after acceptance.
17. Consent is free if it is obtained by:
 - a. major person of sound mind
 - b. coercion
 - c. misrepresentation
 - d. mistake as to matter of fact
18. Which of the following is not an exception to the rule: "An agreement without consideration is not a valid legal contract."?
 - a. Completed gift
 - b. Partnership agreements
 - c. Contract of agency
 - d. Remission by the promisee of the performance of the promise
19. Which of the following is not a valid mode of the discharge of a contract?
 - a. Discharge by performance
 - b. Discharge by impossibility
 - c. Discharge by lapse of time
 - d. Discharge by rescission
20. The doctrine of subsequent impossibility is applicable in which of the following cases?
 - a. Commercial impossibility
 - b. Difficulty of performance
 - c. Failure of one of the objects
 - d. Death of promisor
21. Consensual discharge is not possible in case of
 - a. Unilateral novation
 - b. Alteration
 - c. Rescission
 - d. Remission

22. Which of the following is not a remedy available to an aggrieved party in case of breach of a contract?
 - a. Suit for an injunction
 - b. Suit for rescission
 - c. Suit for damages
 - d. Suit upon de minimis
23. _____ contracts resemble relations created by real contracts and allows aggrieved parties to enforce those legal obligations in the court of law.
 - a. Express
 - b. Implied
 - c. Quasi-
 - d. Adhesion
24. The finder of goods cannot sell the goods in which of the following cases?
 - a. Owner cannot be located even after due efforts
 - b. Goods are perishable in nature
 - c. If the owner of goods refuses to pay the lawful charges to that finder
 - d. Goods are not perishable in nature
25. A contract cannot be discharged by operation of law in which of the following cases?
 - a. Merger
 - b. Death of promisor
 - c. Remission
 - d. Insolvency

5.12 DESCRIPTIVE QUESTIONS



1. Explain various common law principles with regard to contracts.
2. What are the mandatory elements that make a contract legally enforceable? Explain each element with an example.
3. Briefly describe various provisions and principles pertaining to consideration of a contract.
4. What are the modes by which a contract can be discharged? Explain various modes with examples.
5. Discuss the legal provisions pertaining to breach of contract.

5.13 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Formation of Contracts	1.	True
Rules of Offer, Acceptance and Consideration	2.	offer; communicated
Essential Elements of a Valid Contract	3.	d. All of these required.
	4.	c. Items displayed in a supermarket with price tags amount to valid offers.

Topic	Q. No.	Answer
	5. a.	An acceptance should only be made in absolute and unconditional terms in order to make a valid contract.
	6. b.	An offer remains valid till accepted or revoked indefinitely.
	7.	False
	8. d.	All of these
	9.	False
Discharge of Contract	10. b.	A has offered to perform but B refused and, hence, A can sue for breach of contract.
	11. d.	All of these
	12. a.	The contract has become impossible to discharge due to subsequent impossibility and the contract becomes void.
	13. c.	Rescission
Breach of Contract	14. b.	A party rescinding or renouncing his obligations before the date of actual performance
	15.	False
	16. d.	All of the above are possible options depending on the breach
Quasi-Contracts	17. b.	A has a dispute with B, with regard to B's claim of a payment which A is required to make to B on a particular date. Since B is in urgent need of money and A did not pay, C makes the payment to B on that date. A has quasi-contractual liability to make payment to C.

B. | SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	judicial precedents
2.	Sale by auction, government tenders,
3.	invitation to offer
4.	performance
5.	proposer
6.	abstinence
7.	True
8.	False
9.	True
10.	True
11.	b. Not legal and not enforceable in court
12.	c. party alleging the same

Q. No.	Answer
13.	b. Y can obtain damages from Z
14.	d. Written form
15.	a. Obsolete
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23.	c. Quasi-
24.	d. Goods are not perishable in nature
25.	c. Remission

5.14 SUGGESTED BOOKS AND E-REFERENCES



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SPECIAL CONTRACTS

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶ Explain the basic principles of special contract laws
- ▶ Describe the features of the contract of indemnity and guarantee
- ▶ Familiarise with the terms bailment, pledge and finder of goods
- ▶ Discuss the contract of agency
- ▶ Outline the importance of employment contract

6.1 INTRODUCTION



Read

Pre-read Connect

In the previous chapter, you have studied about the general principles of contract. The essence of all commercial transactions is regulated by the law of contract.

Special contracts have been placed exquisitely by the modern business. Agreements that concern with indemnity are used to cover risks which may arise from the performance of contracts as well as other business dealings. All commercial contracts have bank guarantees and performance guarantees as their integral part. An assiduous grasp of principles governing the special contracts is important to engage with challenges in today's business environment and for sharpening professional skills.

In this chapter, you will study in detail about the contract of indemnity and guarantee. Thereafter, you will study about bailment, pledge and finder of goods. In addition, you will be familiarised with the contract of agency. Towards the end, you will study about the importance of employment contract and the characteristics of agent, agency and principal.

6.2 INDEMNITY AND GUARANTEE

The Indian Contract Act, 1872 can be viewed and interpreted in two parts, namely the general principles related to the law of contract and the special contracts. The special contracts are further divided into three types, namely:

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



Quick TIP

Different types of contracts are classified as being either general contracts or special contracts.

Indemnity and guarantee are special contracts having all the essentialities of a valid contract, e.g., consideration, competency of the parties, free consent, legal object, etc. The special legal provisions of these contracts are contained in Sections 124 to 147 of the Indian Contract Act. Let us discuss the contract of indemnity and contract of guarantee as follows:

- **Contract of Indemnity:** The term 'indemnity' literally means 'making somebody safe' or 'paying somebody back'. It means security or protection against any financial liability. It normally takes place in the form of a contractual agreement made between two parties wherein one party agrees to pay for losses or damages incurred by the other party. In corporate law, the Board of Directors and company executives are set free from personal liability by an indemnity agreement, in case someone sues them to recover the damages suffered by such party. According to Section 124 of the Indian Contract Act 1872, "A contract by which one party promises to save the other, from loss caused to him by the conduct of the promise himself or by the conduct of any other person, is called a contract of indemnity." For instance, in an insurance contract, the insurance company is the "insurer" or "indemnifier" which agrees to compensate the insured or indemnified for any damages incurred by him/her during a stipulated period of time. Indemnification/compensation may be in the form of cash, repairs or replacement, or other means as may have been agreed upon by the parties.

Important Concept

An indemnity contract covers only the loss caused by any event(s) that is (are) specified in the contract. If any loss occurs due to an event not specified in the contract it will not be compensated for.

- **Contract of Guarantee:** The object of the contract of guarantee is to enable a person to obtain employment, a loan, or some goods or service on credit. According to Section 126 of the Indian Contract Act, 1872, "A contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default." Guarantee is an undertaking by one person to pay a third party the amount due from another person. The person who gives the guarantee is called the 'surety' or 'guarantor' and the person in respect of whose default the guarantee is given is called the 'principal debtor' and the person to whom the guarantee is given is called the 'creditor' or 'beneficiary'.

6.2.1 PARTIES INVOLVED IN THE CONTRACT OF INDEMNITY AND GUARANTEE

The contract of indemnity includes two parties, namely indemnifier and indemnity holder. The party who gives indemnity or promises compensation for or to make up the loss, is called an 'Indemnifier' and the party for whose protection or safety, the indemnity/compensation is given or the party whose loss is made good is called 'indemnified' or 'indemnity holder'.

Example: X has to sell a (selected one) tape recorder to Y after 3 months under a contract. The very next day of their contract, Z approached X and insisted to sell him the same tape recorder. Here, Z promises to compensate X for any loss faced by him if X sells the tape recorder to him and X agrees to do so. The contract formed between X and Z is called indemnity contract, where Z is indemnifier and X is the indemnity holder.

Essential Features of Contract of Indemnity

Following are the essentials for a valid contract of indemnity:

- The contract of indemnity must have all the essential elements of a valid contract, such as consideration, free consent, competency of the parties, legality of object and consideration.
- It must consist of a promise to save the other party from some loss.
- The loss to be indemnified may be caused due to the conduct of promisor or any other person. Section 124 of the Indian Contract Act says that the indemnity could be for the loss sustained by a party due to the promisor's conduct himself or of anyone else.
- The contract of indemnity may be expressed, i.e., written or verbal or implied that is inferred from the conduct of the promisor.

Essential Features of Contract of Guarantee

A guarantee contract includes three parties, namely creditor, principal debtor and surety. The person who grants loan is called 'creditor', the one who takes the loan is the 'principal debtor' and the one who stands guarantee for the payment of loan is called a 'surety or guarantor'. In the case of a guarantee contract, the principal debtor has the primary liability, whereas the secondary liability is of the surety.

Example: Y seeks a loan of ₹ 100,000/- from X for which guarantee is provided by Z. Here X, Y and Z are creditors, principal debtor and surety respectively.

Important Concept
 In a contract of guarantee, the principal debtor need not be competent to contract. In such a case, the surety is liable as a principal debtor.

Following are the essentials of a valid contract of guarantee:

- **The contract of guarantee must satisfy the requirements of a valid contract:** These include consideration, free consent, competence of the parties, legality of object and consideration.
- **There must be an existing liability for which guarantee is given.**
- **Liability of the surety:** The liability of the surety shall arise only when the principal debtor makes a default. If the liability of surety arises irrespective of the 'default' of the principal debtor, it will not fall within the definition of guarantee.

6.2.2 DIFFERENCE BETWEEN THE CONTRACT OF INDEMNITY AND THE CONTRACT OF GUARANTEE

Table 1 differentiates between the contract of indemnity and the contract of guarantee:

TABLE 1: Distinction Between the Contract of Indemnity and the Contract of Guarantee

S. No.	Point of Difference	Contract of Indemnity	Contract of Guarantee
1.	Number of Parties	There are two parties, namely Indemnifier and Indemnified/Indemnity holder	There are three parties, namely Creditor, Principal debtor and Surety
2.	Number of Contracts	One contract	3 independent contracts between the principal debtor and creditor; between the principal debtor and surety; and between the creditor and surety.
3.	Nature of Liability	Liability of indemnifier is primary	Primary liability is of principal debtor. Liability of surety is secondary arising only on default by the principal debtor
4.	Risk	Liability of indemnifier is contingent	Liability of surety is an existing one
5.	Right of Recovery	After compensating the loss of indemnity-holder, the money cannot be recovered from anyone by the indemnifier	If surety makes payment to the creditor, he/she/it (surety) can recover that amount from the principal debtor
6.	Interest of Parties	Indemnifier may have other interest than indemnity such as a Del Credere agent getting commission in return for indemnification	Surety has no interest in the transaction apart from guarantee

6.2.3 | KINDS OF GUARANTEE

Though there are many kinds of guarantee, following two kinds are important from the subject point of view:



NOTE

The guarantee can be written or oral.

1. **Specific Guarantee:** It is a guarantee given for a specific transaction. Such a guarantee comes to an end as soon as the transaction is duly performed or the debt is duly discharged.
2. **Continuing Guarantee:** Continuing guarantee under Section 129 is a guarantee which extends to a series of transactions or debts and does not come to an end on the performance of a single transaction. However, the surety can fix up a limit on the extent of his liability. Thus, a continuing guarantee can be for a fixed amount or period.

Revocation of Continuing Guarantee

A specific guarantee cannot be revoked. However, a continuing guarantee can be revoked as to future transactions. The surety continues to be liable for transactions which have taken place up to the time of revocation. A continuing guarantee could be revoked in any of the following ways:

1. By notice of revocation (Section 130)
2. By death of surety (Section 131)

6.2.4 | RIGHTS OF SURETY AGAINST PRINCIPAL DEBTOR AND CREDITOR

Rights of Surety

Rights of surety can be classified into three groups, which are as follows:

1. Rights against principal debtor
2. Rights against creditor
3. Rights against co-sureties

Important Concept

After the surety has made the payment of debt to the creditor, all the rights of the principal debtor against the creditor are transferred to him.

Rights against Principal Debtor

- **Rights of subrogation:** If the surety makes payment to the creditor, he is subrogated with all the rights of the creditor. The surety has all the rights which the creditor had against the principal debtor.
- **Right of indemnity:** There is an implied promise by the promise debtor to indemnify the surety for whatever the latter has legitimately paid under the contract of guarantee.
- **Right to ask for relief from liabilities:** The surety can compel the principal debtor to relieve him from his liability.

Rights against Creditor

- **Right to get securities:** If the payments have been made to the creditor, then the surety is liable to get all securities into his possession from the creditor. If the surety makes payment to the creditor, the surety can get all securities into his possession from the creditor.

 **Quick TIP**

After the debt taken by the principal debtor has become due, the surety can advise creditor to sue the principal debtor. However, in such a case, the surety needs to indemnify the creditor.

- **Right of set-off:** On a suit by the creditor, the surety can claim set-off.
- **Right to advice to sue the principal debtor:** For the purpose of recovering the amount, the surety has the right to give advice to the creditor to take a legal action against the principal debtor.
- **Right to insist on the termination of services:** Where a guarantee is in reference to the conduct of an employee, the surety can insist on the termination of services of that employee. Here employer is equivalent to the creditor and the employee is equivalent to the principal debtor.

Rights against Co-Sureties

- **Right to ask for contribution:** When the principal debtor comes across default, the surety can ask his/her co-sureties to contribute for the amount. If the guarantee has been given for equal amounts, then the contribution also has to be equivalent.
- **Right to claim share in securities:** When the payment is made by co-sureties to the creditor, they are liable to get securities from the creditor's possession.

6.2.5 | DISCHARGE OF SURETY

A surety is supposed to be discharged from liability when his/her liability under the contract ceases. Various modes of discharge of the surety are as under:

1. **By notice of revocation of the surety:** Normally, in the case of liability, already accrued guarantee cannot be revoked. But Section 130 has provisions for revoking the continuing guarantee. For example, if A has given surety for a home loan of ₹ 5,00,000 to B from a bank, and the money has been disbursed, A has no right of revoking the guarantee, as the liability has been accrued. Likewise, where a guarantee is a continuing one and is extended to a series of transactions, there the surety as to future transactions may revoke it, by giving notice to the creditor. Although prior to the notice of revocation, the surety shall remain responsible for the acts already acted upon.
2. **By death of the surety:** In the case of a continuing guarantee, if a surety dies, in the non-existence of any contract to the contrary, then he/she is discharged from any liability with reference to future transactions (i.e., transactions after his death). In other words, there would be no liability for the surety's survivors or legal representatives unless expressly been mentioned in the contract.
3. **By variance in terms of contract (Section 133):** If any variance is made in the terms of a contract between the principal debtor and the creditor, without surety's consent, then the surety is discharged from transactions taking place which are subsequent to the variance. Let us understand this with the help of an example. C makes a contract to lend B ₹ 5,000 on March 1. A guarantees the repayment. Now C lends ₹ 5,000 to B on January 1, here A is discharged from his liability, as the contract has been altered since the loan has been released early by the creditor.
4. **By release or discharge of the principal debtor (Section 134):** According to Section 134, the creditor and the principal debtor, any of them can discharge surety by any contract by which the principal debtor is released. For example, A makes a contract with B to build a house for B at a fixed price within a stipulated time, with a condition that B will supply the required timber. C

guarantees A's performance of the contract but B fails to supply the timber. C thus gets discharged from his surety.

5. **By composition with the principal debtor (Section 135):** According to Sec.135 when the creditor, either arrives at a settlement with the principal debtor, or promises to give him more time, or promises of not suing him by a contract between the creditor and the principal debtor, without the consent of the surety then the surety's responsibility gets relieved, unless the surety has given assent to such contract.
6. **By giving more time to the principal debtor (Section 135):** Section 135 of the Act says that sometimes, the creditor gives more time to the principal debtor to repay the loan or for the performance of an obligation, without the consent of the surety. In such cases, the surety automatically gets discharged from his/her liability if he/she has not given the consent for the extension of time. However, if the consent for the extension of time is given by the surety, then he/she is not relieved from his liability. For example, A purchases a car from B and had to pay the price of the car in instalments. The instalment payment was guaranteed by C. The amount of the instalments fell in arrears; B again makes a settlement with A that he should pay a certain sum immediately and the balance by the end of the month. This settlement amounted to giving time to the principal debtor (A) and the surety (C) was relieved from his liability.
7. **By loss of security (Section 141):** If the creditor loses or parts with any security given to him, without the consent of the surety, then at that time of the contract of guarantee, the surety gets relieved from the liability to the range of the value of security. The word 'loss' here stands for loss due to carelessness or negligence. Thus, the surety will not be discharged in case if the security is lost due to an act of God or enemies of the state or unavoidable accident.
8. **Invalidation of the contract of guarantee (in between the creditor and the surety):** A surety is also likely to be discharged from the liability when the contract of guarantee (in between the creditor and the surety) is invalid. A contract of guarantee is invalid in the following case:
 - (i) Where the guarantee is obtained by misrepresenting the information or fraud or concealing as to material part of the transaction is concerned, by the creditor or with creditor's knowledge and assent (Sections 142, 143). It may be notified that under these sections the guarantee would remain valid if the misrepresentation or concealment is done by the debtor without the agreement of the creditor. For example, A appoints B as a clerk for collecting money for him. B fails to report for some of his receipts and A, as a result, summons C to furnish security for B's duly accounting. He gives his guarantee for it. A does not inform acquaint C with B's previous conduct. B makes a default afterwards. Here, the guarantee is invalid.



NOTE

In case a person gives a guarantee on a contract that the creditor shall not act upon the contract until another person has joined in as co-surety, the guarantee is not considered as valid.

6.2.6 | RIGHTS OF THE INDEMNIFIED IN CONTRACT OF INDEMNITY

Under Section 125, the indemnity holder has the following rights:

1. **Rights to claim for all damages/losses [Section 125(1)]:** The indemnified has the right to recover all the damages which he/she had paid in any suit from the indemnifier, in respect of the contract of indemnity.

2. **Rights to claim for all costs which are related to the contract:** The indemnified has the right to recover from the indemnifier all costs which he had paid in bringing or defending any suit in respect of a contract of indemnity.
3. **Rights to claim for all sums which he may have paid for the contract:** The indemnified has the right to recover the whole amount from the indemnifier, which he had paid under the terms of the compromise of such suit.

6.2.7 | COMMENCEMENT OF INDEMNIFIER'S LIABILITY

Important Concept
The Indian Contract Act, 1872 does not define any duties of the indemnified. However, as per various judgements of different Indian courts, it has been held that a person must be demnified before he can be indemnified.

As per the Indian Contract Act, there is no provision regarding the time of commencement of the indemnifier's liability. Thus, the purpose of knowing the time of commencement of indemnifier's liability, i.e., when does the indemnifier become liable to pay, we have a look into the observations of the courts in various judicial decisions. As there is a difference of opinion among different high courts, some have held that the indemnifier is not liable until the indemnified has incurred an actual loss, whereas some high courts have held that the indemnifier becomes liable to pay even before the indemnified had incurred the actual loss. The latter view is generally accepted and it lays down the equitable principle that as soon as the liability of the indemnified to put him in a position to meet the claim.

Following judicial observations are worth noting in this regard:

"Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay."



SELF ASSESSMENT QUESTIONS

1. The party who gives the indemnity is known indemnifier. (True/False)
2. In a contract of guarantee, a surety is a person on whose behalf the guarantee is given. (True/False)
3. The liability of the indemnifier to compensate the indemnified commences when he is called upon to pay. (True/False)
4. In a contract of guarantee, a person who promises to discharge another's liability is called _____.

6.3 BAILMENT, PLEDGE AND FINDER OF GOODS



STUDY HINT

'Bailer' is a French word and it means 'to deliver'. The word 'bailment' has been derived from this word.

Bailment

Bailment under Section 148 of the Indian Contract Act, 1872 is:

The delivery of goods by one person to another for some purpose, upon a contract, that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the Bailor. The person whom they are delivered is called the Bailee.

Consideration in a Contract of Bailment

In a bailment contract, the consideration is commonly in the form of money payment either by the bailor or by the bailee, as for example, when X gives his truck to Y for repairing, or when he gives his car to Y on hire, such consideration

will be in money form. The detainment suffered by the bailor, in transferring parting possession of the goods, is enough to support the contract of bailment.

Pledge

As per Section 172 of the Indian Contract Act, 1872, pledge (or pawn) is defined as under:

The bailment of goods as security for payment of a debt or performance of a promise. The person who offers security is called a pawnor (or pledgor) and the person to whom the goods are delivered as security for the payment of a debt or performance of promise is called the Pawnee or Pledgee.

Therefore, in the case of a pawn or pledge (i) there should be bailment of goods, and (ii) the object of such bailment should be to hold the goods as a security for the payment of a debt or performance of promise and not for safe custody or any other purpose.

Legal Position of the Finder of Goods

The duties and liabilities of a finder are treated as same to be as the bailee. Therefore, the finder's position has been considered along with bailment. The legal provision in the Indian Contract Act in itself says that responsibility of the finder of goods would duplicate the responsibility of a bailee in a contract of bailment.

6.3.1 NATURE AND ESSENTIAL FEATURES OF BAILMENT AND PLEDGE

Bailment includes the following elements:

1. **Agreement:** There should be an agreement between the bailor and the bailee. This agreement could be either expressed or implied. However, a bailment is implied by the law too. For example, the bailment between a finder and the owner of goods.
2. **Delivery of goods:** The delivery of goods must take place. It means that the possession of goods must be transferred by the bailor to the bailee for some purpose on a contract. In this connection, the following may be taken into consideration:
 - i. The delivery must be voluntary, for example, the forcible delivery of jewellery to a thief by the shop does not create a bailment because the delivery is not voluntary.
 - ii. Delivery may be actual or constructive.
3. **Purpose:** There should be some intended purpose for the delivery of goods. For example, wrong delivery of goods to Jaipur Roadways instead of Patel Roadways does not create any bailment. When the purpose of creating bailment is achieved, it is accomplished, the goods are to be returned or disposed of according to instructions of the bailor.
4. **Return of specific goods:** Goods which are the subject matter of a bailment should be returned to the bailor or else disposed of according to the bailor's directions after the purpose is achieved or after the period of the bailment is expired. It may be noted that the same goods must be returned in their original form or desired.

Important Concept

When any customer deposits a certain amount with any bank in any type of account, the bank is obliged to return only an equivalent amount to the customer when the customer demands it, but the bank is under no obligation to return the same money notes or coins deposited by the customer. Therefore, it is not a case of bailment.

6.3.2 | KINDS OF BAILMENT

Figure 1 shows the major types of bailment:

NOTE
Bailors are of two types, namely gratuitous bailor and bailor for reward.

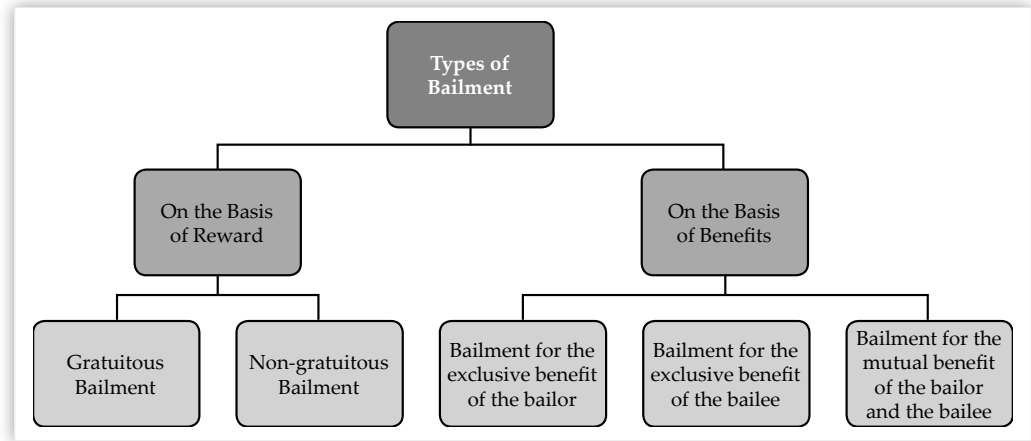


FIGURE 1: Types of Bailment

Let us discuss these bailment types in detail.

I. On the Basis of Reward

NOTE
A gratuitous bailor must disclose all the known facts about the goods or articles that he is lending to a bailee.

1. **Gratuitous Bailment:** Gratuitous bailment is kind of a contract of bailment wherein no consideration passes from the bailor and the bailee.
2. **Non-gratuitous Bailment:** Non-gratuitous bailment is a kind of a contract of bailment wherein some consideration passes from the bailor and the bailee. Table 2 distinguishes between gratuitous and non-gratuitous bailment:

TABLE 2: Distinction between Gratuitous and Non-Gratuitous Bailment

S. No.	Basis of Distinction	Gratuitous	Non-gratuitous
1.	Consideration	There is no case of consideration passing between the bailor and the bailee	Some consideration passes between the bailor and the bailee
2.	Benefit	It exclusively benefits either the bailor or the bailee	It mutually benefits the bailor and the bailee
3.	Liability of bailee for unknown defects (Section 151)	If the bailor does not know any defects in the goods and loses them, then he/she is not liable to the bailee for the loss incurred	If the bailor does not know any defects in the goods and loses them, then also he/she is liable to the bailee for the loss incurred
4.	Bailee's duty to bear expenses (Section 158)	The bailor must repay all necessary expenses to the bailee, which the bailee had already incurred for the purpose of bailment	The bailor must repay only extraordinary expenses to the bailee, which the bailee has already incurred for the purpose of bailment

S. No.	Basis of Distinction	Gratuitous	Non-gratuitous
5.	Bailment for a specified period purpose	Even though the bailment was for a specified period or purpose, it can be terminated at any time.	It is terminated only on the expiry of a specified period or on the fulfilment of a specified purpose.
6.	Effect of death of bailor/bailee	It gets terminated by the death of either the bailor or the bailee.	It does not get terminated by the death of either the bailor or the bailee.

**NOTE**

A Bailment that benefits only the bailor is also referred to as a gratuitous bailment.

II. On the Basis of Benefit

- Bailment for the exclusive benefit of the bailor:** It is a contract of bailment which is executed only for the benefit of the bailor and the bailee does not derive any benefit from it.
- Bailment for the exclusive benefit of the bailee:** It is a contract of bailment which is executed only for the benefit of the bailee and the bailor does not derive any benefit from it.
- Bailment for the mutual benefit:** A contract of bailment, whose execution benefits both the bailor and bailee mutually.

6.3.3 BAILMENT FOR REWARD AND GRATUITOUS BAILMENT

Gratuitous bailment is a kind of a contract of bailment wherein no consideration passes from the bailor and the bailee. In this type of bailment, neither the bailor nor the bailee is entitled to any remuneration or reward. Such a kind of bailment may be for the full benefit of either of the parties.

- **Bailment for the exclusive benefit of the bailor:** In this case, goods delivered by the bailor are for the exclusive benefits and the bailee does not derive any benefit out of it.
- **Bailment for the exclusive benefit of the bailee:** This is the case where the goods are delivered by the bailor to the bailee for the bailee's exclusive benefits and the bailor does not gain anything from the contract himself. For example, X lends his dress to his friend for a week without any charge or favour. In this case, the recipient of the dress as a bailee is the sole beneficiary of this transaction of bailment.

6.3.4 DUTIES AND RIGHTS OF A BAILOR**Duties of a Bailor**

- Duty to disclose defects (Section 150)**

In case of gratuitous bailment

The bailor is bound to disclose to the bailee, all the defects in the goods bailed which are known to him, and which materially interfere with the use of them or expose the bailee to extraordinary risks.

In case of non-gratuitous bailment

If the bailee suffers any loss due to any defect in the goods, the bailor is liable to the bailee for such loss whether he knows those defects or not.

ii. **Duty to bear expenses (Section 158)**

In case of gratuitous bailment

The bailor must repay all necessary expenses to the bailee which he/she has already incurred for the purpose of bailment.

In case of non-gratuitous bailment

The bailor must repay to the bailee all extraordinary expenses which the bailee has incurred for the purpose of bailment.

- iii. **Duty to indemnify the bailee in the case of premature termination of gratuitous bailment (Section 159):** A gratuitous bailment may be terminated by the bailor anytime even though the bailment was for a specified time or purpose. The bailor must indemnify the bailee in case the loss arising due to premature termination of the bailment exceeds the benefits actually derived by the bailee.
- iv. **Duty to indemnify the bailee against the defective title of bailor and receive back goods (Section 164):** The bailor is responsible for any loss to the bailee, which he may suffer because of the defective title of the bailor and the bailor must receive goods back when the bailee returns them back in accordance with the terms of bailment.
- v. **Duty to bear the risk of loss (Section 152):** The bailor should bear the risk of loss of goods condition being that the bailee has taken all responsible steps to protect them from loss.

Rights of a Bailor

- i. **Right to claim damage in the case of negligence (Section 152):** If the bailee has not taken good or special care, then the bailor has a right to claim damages for the loss, destruction or withering of the goods bailed.
- ii. **Right to terminate the contract in the case of an unauthorised use (Section 153):** In the case of any inconsistent act with the conditions of the bailment by the bailee in respect of the goods, then the bailor has a right to terminate the contract of bailment.
- iii. **Right to claim compensation in case of an unauthorised use (Section 154):** In case goods are not used by the bailee which are bailed according to the conditions of the bailment, then the bailor has all rights to claim the compensation from bailee for any damage arising to the goods from or during such use of them.
- iv. **Right to claim the separation of goods in case of unauthorised mixture of goods (Section 156):** In case the goods are mixed by the bailee with his own goods without the permission of the bailor, then the goods can be separated and the bailor has a right to claim his goods after separation.
- v. **Right to claim compensation in the case of unauthorised mixture of goods which cannot be separated (Section 157):** In case the goods are mixed by

the bailee with his own goods without the permission of the bailor, and the goods cannot be separated then the bailor has a right to claim for the loss of his goods.

- vi. **Right to demand return of goods (Section 160):** The bailor has all rights to demand the return of goods after the achievement of their purpose or the expiry of the period of bailment.
- vii. **Right to claim compensation in case of unauthorised retention of goods (Section 161):** If the goods are not returned or delivered by the bailee according to the bailor's directions after the achievement of purpose or after the expiry of the period of bailment, then the bailor has all rights to claim compensation for any loss, destruction or withering of goods from that time.
- viii. **Right to demand accretions to goods (Section 163):** In the absence of a contract to the contrary, the bailor has rights to demand for any increase or profit which may have accumulated from the bailed goods.

6.3.5 | DUTIES AND RIGHTS OF A BAILEE

Duties of a Bailee

- i. **Duty to take care of the goods bailed (Sections 151 & 152):** The bailee is supposed to take care of the goods bailed to him as much as an ordinary man would under similar situations would take for his own goods of the same bulk, quality and value.
- ii. **Duty not to make any unauthorised use of goods (Section 154):** If the bailee does not use goods bailed according to the conditions of the bailment, then he/she is liable to make compensation to the bailor for any damage arisen to the goods from or during such use of them.
- iii. **Duty not to mix bailer's goods with his own goods (Section 155 to 157):**
 - a. **In the case of mixture with the bailor's consent (Section 155):** Both the bailor and the bailee shall have an interest in proportion to their respective shares in the mixture thus produced.
 - b. **In the case of mixture without the bailor's consent when the goods can be separated (Section 156):** The bailor has a right to claim his goods after separation.
 - c. **In the case of mixture without the bailor's consent when the goods cannot be separated (Section 157):** The bailor has a right to claim for the loss of his goods.
- iv. **Duty to return the goods (Sections 160 & 161):** The goods should be returned or delivered by the bailee according to the bailor's directions without demand, after their purpose is accomplishment or after the expiry of the period of bailment.
- v. **Duty to return accretion to the goods (Section 163):** The bailee is bound to deliver to the bailor any increase or profit which may have accrued from the goods bailed, in the absence of any contract.
- vi. **Duty not to set up any adverse title:** The bailee must not commit any act, inconsistent with the title of the bailor.



NOTE

Example of Bailee's duty not to set up any adverse title:

No bailee has any right against his bailor to claim that a bungalow under bailment belongs to him or to any third person.

Rights of a Bailee

i. **Right to claim damage (Section 150)**

In the case of gratuitous bailment

If the defect is not disclosed in goods by the bailor, which are known to him and the bailee suffers any loss due to such defects; in that case, the bailee has a right to claim damages.

In the case of non-gratuitous bailment

If any loss is suffered by the bailee, due to any defect in the goods, then the bailee has a right to claim damages.

ii **Right to claim the reimbursement of expenses (Section 158)**

In the case of gratuitous bailment

The bailee can claim the reimbursement of all necessary expenses, which he/she has already suffered for the purpose of bailment.

In the case of non-gratuitous bailment

The bailee can claim reimbursement of all the extraordinary expenses, which are already borne by the bailee for the purpose of bailment.

iii. **Right to be indemnified in case of the premature termination of gratuitous bailment (Section 159):** The bailee has a right to be indemnified in case the loss arising due to premature termination of the gratuitous bailment exceeds the benefits actually derived by him.

iv. **Right to recover loss in the case of bailor's defective title (Section 164):** The bailee has a right to be indemnified in case he suffers any loss because of the defective title of the bailor.

v. **Right to recover loss in the case of bailor's refusal to take the goods back (Section 164):** In case any loss suffered by the bailee because of the bailor's refusal to take the goods back is then he/she has a right to be indemnified.

vi. **Right to deliver goods to any one of the joint bailors (Section 165):** In case there is the absence of any contract to the contrary, the bailee can deliver goods back to anyone of the joint owners or may deliver the goods back according to the directions of one of the joint owners without having everyone's consent.

vii. **Right to deliver goods to the bailor in the case of bailor's defective title (Section 166):** If the bailee, in good faith, delivers the goods back to, or according to the directions of the bailor and the bailor has no title to the goods, then the bailee will not be responsible to the owner in respect of such delivery.

viii. **Right to particular lien (Section 170):** Where the bailee has provided any service in accordance with the purpose of the bailment which involves the exercise of labour or skill in respect of the goods bailed, he/she has a right to retain such goods, in the absence of a contract to the contrary, until he/she receives due payment for services he/she has given in respect to them.



NOTE

Delivery can be of three types namely actual, symbolic and constructive.

6.3.6 | TERMINATION OF BAILMENT

- I. **Termination of every contract of bailment (whether gratuitous or not)**
- II. **Termination of Gratuitous Bailment**

Every contract of bailment comes to end under the following circumstances:

- a. **On the expiry of a fixed period:** If goods are bailed for a fixed time period, the bailment gets terminated on the expiry of that fixed time period.
- b. **On the fulfilment of the purpose:** If goods are bailed for a specific purpose (which gets fulfilled), then the bailment is terminated.
- c. **Inconsistent use of goods:** In the case of goods are used inconsistently as per the conditions laid in the bailment, then the bailment may be terminated.
- d. **Destruction of the subject matter of bailment:** A bailment is terminated if the subject matter of the bailment is destroyed or becomes incapable of being used for bailment because of some change in the nature of the goods.

6.3.7 | COMPARISON BETWEEN PLEDGE AND BAILMENT

Pawn (pledge) and bailment are similar in many aspects. In both the cases only movable goods are delivered, they have a condition of being delivered back after the purpose of contract is over or after the expiry of stipulated time. Both of the contracts are created by agreement between the two parties. However, pawn/pledge is different from bailment in the sense that pawn is made for a specific purpose i.e. for the repayment of a debt or performance of a duty, whereas, the bailment is for all kind of purposes. Secondly, the pawnee is not allowed to use the goods pawned, but, in bailment, the bailee could use the goods which are bailed if the terms of bailment have such provision. Thirdly, the pawnee can sell the goods, pledged with him after he/she gives a notice to the pawnor, whereas a bailee may either keep in his possession or sue bailor for his dues.

Important Concept
In a bailment contract, the consideration may or may not be present while it is always present in case of a pledge.

6.3.8 | RIGHTS AND DUTIES OF PLEDGEE (PAWNEE) AND PLEDGOR (PAWNOR)

Rights of Pawnee

- **Right of retainer (Section 173)**
The pledged goods may be retained by the pawnee:
 1. For payment of the debt of the performance of the promise,
 2. For the interest of the debt of the performance of the promise,
 3. All necessary expenses incurred by the pawnee in respect of the possession or in preserving the goods pledged.
- **Right to claim the reimbursement of all extraordinary expenses (Section 173):** The pawnee is entitled to receive extraordinary expenses which are incurred in the preservation of goods from the pawnor.

Important Concept

There are certain circumstances under which a non-owner who is in the possession of the goods is permitted to pledge the goods. For instance, a mercantile agent may pledge the goods if he has the consent of the owner.

- **Right to sue pawnor (Section 176):** If any default is made by the pawnor in the payment of the debt or performance of the promise, then the pawnee has a right to sue the pawnor for recovering the amount due or for the performance of the promise and retain goods pledged as the pawn's security.
- **Right to sell (Section 176):** If any default is made by the pawnor in the payment of the debt or performance of the promise, the pawnee can sell the goods pledged after giving a fair notice of the intended sale, to the pawnor.
- **Right against true owner (Section 178A):** When the goods pledged are possessed by the pawnor under an avoidable contract under Section 19 or 19A which was not revoked at the time of the pledge, then the pawnee acquires a good title to the goods provided he/she acts in good faith and without the notice of the pawnor's defect of title.

Duties of a Pawnee

- Duty to take reasonable care of the goods pledged
- Duty not to make unauthorised use of goods
- Duty not to mix pawnor's goods with his own goods
- Duty to return goods
- Duty to return accretion to the goods

Rights of Pawnor

- **Right to get pawnee's duties duly enforced:** The pawnor has the right to get pawnee's duties duly enforced (for example, right to get back the goods pledged, right to receive any accretions to the goods pledged).
- **Right to redeem (Section 177):** If time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made and the pawnor makes default in the payment of the debt or performance of the promise at the stipulated time, he may redeem goods pledged at any subsequent time before the actual sale of them; but he must, in case pay in addition, any expenses which have arisen from his default.

Important Concept

The pawnor also enjoys a right of proper care which means that the pawnor can enforce the pawnee to do proper care of the goods pledged.

Duties of Pawnor

- Duty to comply with the terms of pledge
- Duty to compensate the pawnee for extraordinary expenses (Section 175)

6.3.9 | FINDER OF LOST GOODS

Rights of a finder of goods are as follows:

- **Right of lien:** A finder of goods has the right to keep goods in his possession, till he has paid his expenses. He can exercise the right of lien against the goods found which is available against the true owner until the finder of goods has received any compensation for expenses and trouble suffered by him to find out the true owner and preserve the found goods. However, he has no right to sue the real owner for such compensation.

**NOTE**

As per the Indian Contract Act, the position of the finder of the lost goods is the result of the quasi-contractual situation.

- **Right to sue for reward:** If the true owner of goods has declared some award for the return of lost goods, the finder can sue the owner for such award. He will have the right of lien over the goods till he receives the award.
- **Right of sale:** A finder of goods has a right to sell goods found by him under the following circumstances:
 - Where the owner cannot be found, who is with a fair assiduousness, and if such owner is found, he/she refuses to pay the legal charges of finder of goods, or
 - Where the found goods are such as they are commonly the subject of sale, or
 - Where the goods are in danger of perishing or losing greater part of their value, or
 - When the finder's legal charges amount to two-thirds of the value of the thing for preservation and finding out the owner,

Duties of a Finder of Goods

Under Section 71 of the Contract Act, a finder of goods has the same duties as that of a bailee with regards to the goods found. Hence,

- The finder must take good care of the goods which are found.
- The goods should not be taken in his/her personal use.
- The goods found should not be mixed with his/her own goods.
- It becomes his/her duty to find the real owner of the goods and then to assign the goods to him.

For example, if in any event, an attendee guest finds a gold chain and she reports it to the host of that event and also few other people present about it, then she has performed her duty to find the owner.

**SELF ASSESSMENT QUESTIONS**

5. _____ is a special kind of bailment.
6. In a pledge, the ownership of the goods pledged does not pass to the pledgee. (True/False)
7. It is duty of the finder of goods to take good care of the goods which are found. (True/False)
8. It is the duty of a pawnor to compensate the pawnee for all extraordinary expenses incurred by him for preserving the goods pawned. (True/False)

6.4 CONTRACT OF AGENCY

A legal contract which involves creating a trustee relationship through which the first party ("the Principal") agrees to the actions of a second party ("the agent") is an agency agreement. It binds the "principal/first party" to agreements made by the agent/second party as if the principal had himself made them personally.

An agency is a relationship between an agent his principal created by an agreement. Section 182 of the Contract Act defines an Agent as “a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, or whom is so represented is called the principal”.



STUDY HINT

If Mr. Suraj is a partner in a company, he is a partner in individual capacity. However, if Mr. Suraj is a partner in a company on behalf of another company, then, he is a partner in representative capacity.

6.4.1 | ESSENTIAL FEATURES OF AGENCY

1. The principal
2. The agent
3. An agreement
4. Consideration not necessary
5. Representative capacity
6. Good faith
7. The competence of the principal

6.4.2 | CREATION OF AGENCY

The Agency may be created by any of the following ways:

1. **Agency by express agreement (Expressed Agency, Section 187):** When an agent is appointed through verbally or in written, then his authority is said to be express. A ‘power of attorney’ is when an agent is appointed with the means of executing a deed.
2. **Agency implied from circumstances (Implied Agency, Section 187):** When agency is the result of the conduct of the parties or is inferred from the circumstances of the case, then it will be called implied agency.

Example: Arindam belongs to Chennai and has a shop in Kolkata. Biswas, the manager of the shop, normally orders and purchases goods from Chandan for the shop’s purpose. The goods purchased are regularly paid from the funds provided by Arindam. Here, Biswas shall be considered to be an agent of Arindam by his conduct.

Wife as an implied agent of her husband

- (a) In a husband-wife relationship, where both are living together in a domestic establishment of their own, the wife has an implied authority to pledge the credit of her husband for her necessities. This implied authority could be challenged by her husband only in the following set of conditions:
- (1) The husband has expressly banned the wife to borrow money or buy goods on credit.
 - (2) The articles which are purchased do not come under necessities for the wife.
 - (3) Husband had given sufficient funds to the wife for purchasing articles she needed to the knowledge of the seller.
 - (4) The creditor had been expressly asked to not lend any credit to the wife.

(b) Where the wife is living apart from her husband without any fault of her, she has an implied authority to bind her husband for necessities, in case he is not providing for her maintenance.

3. **Agency of necessity:** Under certain conditions, a person could be driven to act as an agent to the other, e.g., the master of the ship can borrow money, to carry out necessary repairs of the ship in order to complete the voyage where the owner of the ship is not present. In such a case of necessity, the person acting as an agent need not necessarily have the authority of the principal.

Example: A fruit seller on finding that the fruits are rapidly perishing is entitled to dispose them off at the best price available in order to bind the consignor as an agent by necessity.

4. **Agency by estoppel (Section 237):** When any acts are done or obligations are incurred by an agent without authority to third persons on behalf of his/her principal, and if the principal has induced the third person either by his words or conduct to trust that those obligations and acts were in the jurisdiction of the agent's authority then the principal is bound by such acts.

Example: If X in the presence of C admits to Y for being C's agent and C does not speak, and Y supplies goods of ₹ 10,000 to Y considering him as C's agent, then, in this case, C is responsible for the payment of the price of these goods.

5. **Agency by Ratification (Section 196 to 200):** If the principal accepts and adopts any act done by the agent without any authority from him is called agency by ratification.

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

Example: The manager of a company claiming to act as an agent on the company's behalf but without the company's authority accepted an offer extended by B, and the B thereafter withdrew the offer, but the company approved the manager's acceptance. Then B will be held to be bound by that acceptance. His revocation of the offer will be held to be invalid.

Conditions for Agency by Ratification

In order to ratification be legal and valid, the following essentials must be satisfied:

- (1) The act should be in the principal's name.
- (2) Principal should have been in presence and competent to do contract at the time when the agent acted on his behalf as well as on the date of ratification.
- (3) The act must be legal which is under the competency of the principal. It should be done with full knowledge of all the material facts (Section 198).
- (5) Since ratification of a part of act is not valid, therefore it should relate associate or link to the whole act and not to a part of it (Section 199).

- (6) If an act is prejudiced for a third person then that act would not be considered to be valid. (Section 200).
- (7) There should be a fixed time or a reasonable time allocated for ratification of an act after the contract was entered into by the agent.

6.4.3 | TERMINATION OF AGENCY

The termination of agency stands for the revocation or cancellation of the agent's authority. The modes of termination of agency may be classified as:

- (a) Termination of Agency by the Act of the Parties
 1. By revocation of authority by the principal
 2. By renunciation (giving up) of business of agency by the agent
 3. By mutual agreement
- (b) Termination of Agency by the Operation of Law
 1. Completion of business of agency
 2. Death or insanity of principal or agent
 3. Insolvency of the principal
 4. Destruction of subject matter
 5. Expiry of time
 6. Agency subsequently becoming unlawful
 7. Termination of sub-agent's authority

6.4.4 | AGENT AND PRINCIPAL

Agent

An agent is a person who does services for some other person (the principal) under an expressed or implied agreement and who is under the direct of the principal or his manner of providing services is controlled by the principal. One can also be an agent without receiving compensation for services provided. The agency agreement may be oral or written. An agent can be given the power of attorney by the principal. Thus, he has an authority to act on behalf of the grantor, as specified by the grantor in a power of attorney document.

Kinds of Agents

Following are different kinds of agents:

- **Mercantile/commercial agent:** It may be defined as an agent who has the authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods or to raise the money on the security of the goods on behalf of his principal [Section 2(9) of the Sale of Goods Act].
- **Non-mercantile/non-commercial agent:** It may be defined as an agent who does not usually deal in the buying or selling of goods. As a matter of fact, he/she is the agent appointed by his/her principal to do some acts which are not done by mercantile agents. A mercantile agent who has the authority to sell or dispose goods in his possession is called a factor.

Extent of Agent's Authority (Section 186 to 189)

Principal has the liability of his/her agent's acts done within the scope of his authority. An authority is said to be expressed when it is verbally given or in written manner. An authority is implied when it is inferred from the circumstances of the case (Sections 186 to 187).

The agent's authority extends to every legal performance required to do an act for which he/she has been appointed (Section 188).

An agent has been authorised to do every act legally in order to prevent the principal from loss as would have been done by him for himself normally. The emergency must be real not permitting the agent to communicate with the principal (Section 189).

Principal

According to Section 182 of Indian Contract Act, 1872 a principal is described as under:

A person for whom an act is done or who is so represented is called principal. The relationship between the principal and the agent is called the "agency".

Example: A appointed B to purchase 100 bags of wheat on his behalf. In this case, A is the Principal, and B is the Agent. And the relationship between A and B is called an Agency.

The Agent's Duty to the Principal

The agent's duties/obligations are widely defined by the terms of the contract but some additional duties are established by agency law, unless they are clearly excluded or modified by the contract itself. The duties arise from the trust and confidence which lays the base of an agency relationship and are called fiduciary duties. They are owed by the agent to his/her principal.

Loyalty

An agency relationship exists for the benefit of the principal, hence an agent must try to benefit the principal and support his interests by making true and best efforts. Thus, the agent must not be undertaking such activities which confront the principal's interest. Generally, an agent is banned from "dealing with himself" when conducting the affairs of his/her principal. For example, if an agent sells his principal's property to him/herself or involves in transactions on the principal's behalf representing potential conflicts of interests and require the informed consent of the principal after all relevant facts have been disclosed.

Duty to Act with Skill and Care

An agent should perform his/her duties with the similar skill and care of what any person in similar location and circumstances would do. A gratuitous agent is lowly rated than a paid agent. But it is not true in professional agencies where the same standard is usually required. The standards of care are calibrated by the agreement and the agent even give expressed or implied warrant for his performance to be satisfactory.

Duty to Notify

An agent should notify the principal immediately on important issues that are either related to or might be associated with the business of the principal. A responsibility which is aggravated by the fact that the agent's knowledge can be accused by the principal.

Duty to Account

An agent must forward all money, property, or incidental benefits (such as bribes arising from the agent's breach of loyalty or third-party gifts, etc.) that are received during the course of the agency relationship, to the principal's account. Also the agent is supposed to maintain business transactions records of the principal accurately and make them available to the principal. The principal's funds/assets must be kept separate from the agent's accounts.

Remedies of the Principal

Following remedies are available for the principal in case an agent breaches a duty either fiduciary or established in the contract:

- a. If the relationship was through a contract, the principal is liable to recover damages from the breach of contract.
- b. The agency contract could be abrogated if the agent works for two principals with conflicting interests without the disclosure of relevant facts.
- c. If an agent retains money or property despite being due to the principal, then the agent should pay the full amount of unjust enrichment.
- d. Many criminal acts allow recovery for negligent actions (such as failing to notify the principal or follow instructions) or misappropriating the principal's property (conversion) by theft, transfer or destruction.



NOTE

A principal also has certain remedies against third parties such as terminating the contracts entered by the agent and claiming profits which have been made secretly by the agent/third party.

Principal's Duties to the Agent

Agency law establishes that there are several duties that a principal has towards the agent, most of which can be modified or eliminated by the agreement between the parties:

- **Duty to compensate:** Generally, the agent's due compensation is fixed in the contract. Although in case of no such provisions. The conditions around the agency relationship determine the level of compensation. At such times, it could be based on the market value or the traditional price of services provided by the agent. In these circumstances, it's compensation may be dependent on the achievement of a specified result (e.g., some attorneys work on a contingent fee basis, as do real estate agents). Compensation on a contingent/dependant fee basis generally does not include the expenditures of the agent and the principal should cooperate with, and not discourage the agent's activities, otherwise compensation will be due disregarding the failure to achieve the specified result.
- **Duty of reimbursement and indemnity:** The agent is liable for the reimbursement of expenditure borne on behalf of the principal, unless he/she is on a contingent fee basis, or otherwise agreed upon. Such expenditures should be a direct request by the principal or fairly inferred from the

requested services by the principal. Another related duty is of indemnity. Under agency law, the agent is impliedly promised by the principal to be indemnified for any losses that are incurred while undertaking activities that are authorised by the principal. These are usually legal liabilities arising when the agent becomes liable on a contract undertaken for the principal (but not including liabilities for actions that the agent knew, or should have known were illegal).

- **Remedies of the Agent:** Generally, the breach of duty by a principal is on a contract basis and the remedies available for such contract disputes are available except for specific performance, which might aggravate the problems between the agent and the principal's relationship.



**SELF
ASSESSMENT
QUESTIONS**

9. A person appointed to contract on behalf of another person is known as _____.
10. For an agency to be valid, there must be _____ or _____ agreement.
11. In which of the following cases does an agency not terminate?
 - a. Completion of agency business
 - b. Death of principal or agent
 - c. Insolvency of principal
 - d. Agent exceeding given authority
12. There may be a valid ratification by a person whose knowledge of the facts of the case is materially defective. (True/False)
13. A _____ agent to whom the possession of the goods is given for the purpose of selling the same is known as factor.

6.5 CONTRACT OF EMPLOYMENT

An employment contract refers to an agreement signed between an employee and an employer. This contract reflects the rights and responsibilities of both the parties namely employee and the employer. As per Indian labour laws, an employer is not mandated to share a written contract of employment with new employees. The contract can be communicated orally as well. However, the main purpose of employment contract is to reflect terms and conditions related to employment along with matters related to disclosure of information, non-competition, non-solicitation, etc. Thus, in India, it is a predominant practice to have a written contract of employment.

A typical employment contract includes the following:

- **Salary or wages:** An employment contract clearly mentions the salary, wage, or commission that has been agreed upon by both the parties. It also includes details of benefits offered to employees by the employer apart from salary. These benefits may include medical insurance, vacation and sick leaves, expense reimbursements, etc.

- **Schedule:** The contract also mentions days and hours an employee is expected to work.
- **Duration of employment:** The part mentions whether the employment given to an employee is permanent, full-time, part-time or contractual. In case of contractual job, the contract contains information on when the contract can be extended and under what conditions.
- **General responsibilities:** The contract lists duties and tasks an employee is expected to fulfil while employed.
- **Confidentiality:** Although an employee has to sign a separate non-disclosure agreement, a contract might include a statement about confidentiality.
- **Clause for non-competition:** This clause in contract prevents the employee from doing any job or business that will put him or her in competition with the company after the termination of the contract with the company.
- **Notice period:** It specifies the duration of the notice period to be served in case of termination of the contract by the employee. It also mentions circumstances under which the organisation can terminate the contract without prior notice to the employee.



**SELF
ASSESSMENT
QUESTIONS**

14. The contract of employment should only be shared in a written format and not in oral form. (True/False)
15. Which of the following prevents the employee from doing any job or business that will put him or her in competition with the company after the termination of the contract with the company?
 - a. Schedule
 - b. Duration of employment
 - c. Confidentiality
 - d. Clause for non-competition

6.6 SUMMARY



- A contract of indemnity is a type of contract wherein there is a promise made from one party to the other to indemnify/compensate it from any loss caused either by the conduct of the promisor or any other person.
- A contract of guarantee is a contract to discharge the promise or the liability of a third person in his fault is there.
- The contract of guarantee must be supported by consideration. The consideration received by the principal debtor may be sufficient consideration to the surety for giving guarantee.
- The liability of surety and principal debtor are related. In some cases surety is liable, though the principal debtor is not (i) principal debtor is found to be incapable to contract. (ii) principal debtor is thought to be insolvent.

- A contract of guarantee becomes invalid, when (i) it is obtained by fraud/misrepresentation (ii) it is obtained by concealment of material facts (iii) co-surety does not join the contract (iv) or when consideration fails.
- Bailment is the handing over of possession of goods. In a legal sense, there is a change of possession of goods from one person to another for a specific purpose.
- Depositing currency notes in a bank- It is not a bailment as currency notes or money are not goods as per the definition of goods given under the Sale of Goods Act, 1930 and also no same note is returned to the depositor by the bank.
- No consideration passes between the bailor and the bailee and the bailor is not responsible for the damages in respect of the faults which were not known to him.
- When goods are bailed as a security for the payment of a debt/performance of a promise. Pawnor is a person who pledges goods as security and pawnee is a person who receives the goods as security.
- Basic distinction between bailment and pledge is that all the pledges are said to be bailments but all the bailments cannot be pledges.
- An agent and his principal can have an express/implied agreement relation which authorises an agent by his principal to create contractual relations with third parties.
- Agency can be either expressed or implied. When a person is compelled by certain circumstances to act as an agent for someone else without an expressed authority the agency by necessity comes into existence by the operation of law
- When the principal is not disclosed by his/her agent and his existence remains uncovered then the principal of such agent is known as undisclosed principal.

6.7 KEY WORDS



- **Agent:** A person who performs services for another person under an express or implied agreement and who is subject to the other's control or right to control the manner and means of performing the services
- **Creditor:** The person to whom the guarantee is given is called the 'creditor'
- **Guarantee:** An undertaking by one person to pay the amount due from another person
- **Indemnified:** A party for whose protection or safety is given or the party whose loss is made good
- **Indemnifier:** A party who promises compensation for or to make up the loss
- **Indemnity:** An act of making somebody safe or paying somebody back
- **Principal debtor:** The person in respect of whose default the guarantee is given is called the 'principal debtor'

- **Principal:** A person for whom an act is done or who is so represented
- **Surety:** A person who is granting the loan or is utilising the amount of loan

6.8 CASE STUDY: RIGHTS AND LIABILITIES OF SURETY



Mr. Sudershan is appointed in a private limited company as an accountant on a salary of ₹ 15,000 per month, on contractual terms for a period of three years, and for this, Ms. Savita acts as a surety. After three months, the company's profitability deteriorated, and it reduces Mr. Sudershan's salary to ₹ 8,000. Two months later, the company finds that Mr. Sudershan had used the cash in a misappropriate manner, due to which the company suffered a huge loss.

The company sues Ms. Savita and files a case against her in a civil court for the recovery of the misappropriated cash, and states that, as Ms. Savita was acting as a surety for the performance of Mr. Sudershan, she is liable to compensate for the loss suffered by the company.

Ms. Savita contests and states that she is not liable to pay, as she was in a position of a surety, and the creditor had changed the commercial terms without taking permission or intimating the surety. Hence, she is not liable to pay any amount as damage.

She further quotes Section 133 of the Indian Contract Act, which states that "*any variance in the commercial terms made without surety consent in the terms of the Contract between the principal debtor and the creditor discharges the surety*".

QUESTIONS

1. In the above case, do you feel that the case of the private limited company is maintainable against Ms. Savita?
(**Hint:** Ms. Savita is liable only for the first three months.)
2. On what basis did Ms. Savita contest that she was not liable to pay?
(**Hint:** The creditor had changed the commercial terms without taking permission or intimating her.)

6.9 SHORT ANSWER QUESTIONS



1. _____ is a guarantee given for a specific transaction and it comes to an end as soon as the transaction is duly performed or the debt is duly discharged.
2. In case of a pledge, there should be _____ of goods with an object to hold the goods as a security for the payment of a debt or performance of promise and not for safe custody or any other purpose.
3. _____ bailment does not get terminated by the death of either the bailor or the bailee.
4. In the case of any inconsistent act with the conditions of the bailment by the bailee in respect of the goods, the bailor has a right to _____ the contract of bailment.

5. As per Section 164, if any loss is suffered by the bailee because of the bailor's refusal to take the goods back, then the bailee has a right to be _____.
6. A pawnee can sell the goods pledged with him after the pawnee gives a notice to the pawnor, whereas a bailee may either keep goods in his possession or _____.
7. The contract of indemnity may be expressed, i.e., written or verbal. (True/False)
8. The bailment between a finder and the owner of goods is an express contract. (True/False)
9. As a general principle, indemnity requires that the party to be indemnified shall never be called upon to pay. (True/False)
10. In case of gratuitous bailment, the bailor must repay only extraordinary expenses to the bailee, which the bailee has already incurred for the purpose of bailment. (True/False)
11. Which of the following is not a feature of the Contract of Indemnity?
 - a. Anticipation of loss
 - b. Depends on good faith
 - c. Contains all essentials of a valid contract
 - d. Unlawful
12. Which of the following terms or phrases cannot be necessarily associated with the Contract of Indemnity?
 - a. Making somebody safe
 - b. Paying somebody back
 - c. Cash compensation
 - d. Protecting against financial liabilities
13. Select the odd one out of the following options:
 - a. Contract of Indemnity – 2 parties; C Contract of Guarantee – 3 parties
 - b. Contract of Indemnity – 3 parties; C Contract of Guarantee – 2 parties
 - c. Contract of Indemnity – 3 parties; C Contract of Guarantee – 3 parties
 - d. Contract of Indemnity – 2 parties; C Contract of Guarantee – 2 parties
14. The person who grants loan is called _____, the one who takes loan is called _____, and the one who stands guarantee for the payment of loan is called a _____.
 - a. principal debtor; creditor; surety
 - b. surety; principal debtor; creditor
 - c. creditor; surety; principal debtor
 - d. creditor; principal debtor; surety

15. Which of the following is not a right of the indemnity-holder under Section 125 of the Indian Contract Act?
 - a. Right to claim damages
 - b. Right to claim set-off
 - c. Right to claim sums paid
 - d. Right to claim costs
16. Which of the following is not a duty of a bailor?
 - a. Disclosing defects
 - b. Bearing expenses
 - c. Claiming damages
 - d. Bearing risk of loss
17. In a contract of bailment, the delivery cannot be _____.
 - a. actual
 - b. symbolic
 - c. partial
 - d. constructive
18. Balram purchases 5-metre cloth and delivers it to a tailor Kanhaiya for stitching. Kanhaiya promises to get two pants ready in a week. This is a case of:
 - a. Pledge
 - b. Bailment
 - c. Indemnity
 - d. Guarantee
19. Under which of the following conditions would bailment not be terminated?
 - a. Payment of debt
 - b. Fulfilment of specific purpose
 - c. Expiry of the bailment period
 - d. Inconsistent use of goods
20. Which of the following options is incorrect in case of a Pawnee's right to sell, if any default is made by a pawnor?
 - a. A pawnee has the right to sell the pledged goods after giving notice of intended sale to pawnor.
 - b. Pawnee can mortgage the goods pledged after giving a fair notice of the intended sale to the pawnor.
 - c. Pawnee can sue the pawnor.
 - d. None of these

21. Which of the following is not a legal right of the finder of goods?
- Right of lien
 - Right to personal use of goods
 - Right to sue for reward
 - Right of sale
22. A contract of agency binds the _____ to agreements made by the _____.
- agent; principal
 - agent; bailor
 - principal; agent
 - agent; pawnee
23. Which of the following is not an essential feature of an agency?
- Agreement
 - Good faith
 - Competence of the agent
 - Representative capacity
24. Shilpa owns a superstore which is managed by Tarun. Tarun purchases goods for superstore from Varun Suppliers and pays for them using funds provided by Shilpa. In this case, Tarun acts in the capacity of a/an
- agent
 - bailor
 - bailee
 - pawnee
25. Chirag lends Dushyant's money to Gopi without being authorised to do so. Afterwards, Dushyant authorises this transaction. This is a case of agency by:
- necessity
 - estoppel
 - express agreement
 - ratification

6.10 DESCRIPTIVE QUESTIONS



1. Explain the contract of indemnity. What are the essentials and legal rules for a valid contract?
2. "There can be no valid contract of guarantee unless there is someone primarily liable." In light of this statement, explain the essential features of a contract of guarantee. What will be the position of surety if the principal debtor is a minor?

3. What are the surety's rights against the principal debtor and the creditor? Does he have any right against the co-sureties? If yes, enumerate.
4. Define bailment. Explain the essentials of a valid bailment with suitable examples and the duties of a bailee.
5. "Goods can be pledged by the owner only except in certain circumstances." Discuss and state the cases in which the goods can be pledged by non-owners.
6. What are the rights of a bailor and a bailee, pawnor and a pawnee?
7. Define the terms agency, principal and agent. What are the essential and valid rules of a legal agency?
8. Discuss 'agency by estoppel' and 'agency by ratification'.
9. Briefly explain various modes by which an agency may be created.
10. Discuss briefly the rights and duties of an agent.
11. Discuss the importance of employment contract in an organisation.
12. What does an employment contract include?

6.11 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Indemnity and Guarantee	1.	True
	2.	True
	3.	False
	4.	Surety
Bailment, Pledge and Finder of Goods	5.	Pledge
	6.	True
	7.	True
	8.	True
Contract of Agency	9.	agent
	10.	expressed; implied
	11.	d. Agent exceeding given authority
	12.	False
Contract of Employment	13.	mercantile
	14.	False
	15.	d. Clause for non-competition

B. | SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	Specific guarantee
2.	bailment
3.	Non-gratuitous
4.	terminate
5.	indemnified
6.	sue bailor for his dues
7.	True
8.	False
9.	True
10.	False
11.	d. Unlawful
12.	c. Cash compensation
13.	a. Contract of Indemnity – 2 parties; C Contract of Guarantee – 3 parties
14.	d. creditor; principal debtor; surety
15.	b. Right to claim set-off
16.	c. Claiming damages
17.	c. partial
18.	b. Bailment
19.	a. Payment of debt
20.	a. A pawnee has the right to sell the pledged goods after giving a fair notice of the intended sale to the pawnor.
21.	b. Right to personal use of goods
22.	c. principal; agent
23.	c. Competence of the agent
24.	a. agent
25.	d. ratification

6.12 SUGGESTED BOOKS AND E-REFERENCES**SUGGESTED BOOKS**

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AMIT

SALE OF GOODS ACT, 1930

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶ Explain the basic principles and definitions of the Sale of Goods Act, 1930
- ▶ Discuss formalities of a contract of sale
- ▶ State the importance of goods
- ▶ Outline the significance of price
- ▶ Distinguish between conditions and warranties

7.1 INTRODUCTION



Pre-read Connect

In the previous chapter, you studied about the Indian Contract Act. In this chapter, you will study about the Sale of Goods Act, which is an important part of the business contracts.

A contract to sale is a contract in which the seller of the goods transfers or agrees to transfer the goods to the buyer for a price or consideration. A contract to sale is different from other agreements like hire purchase and contract of work and labour. The chapter also highlights these points in detail.

The chapter has discussed the concept of the contract of sale. It also explains the contract pertaining to work and labour as well as hire purchase. Further, the chapter describes the doctrine of caveat emptor and the performance of the contract of sale.

7.2 DEFINITION AND ESSENTIALS OF A CONTRACT OF SALE



NOTE

The Sale of Goods Act, 1930 governs and regulates the sale of goods all over India except Jammu and Kashmir.

According to Section 4 (1) of the Sale of Goods Act, 1930, a contract to sell is *a contract in which the seller of goods transfers or agrees to transfer the goods to the buyer for a price or consideration*. In this type of contract, there are two parties. One party agrees to sell goods and receives a price for it, and the other party receives the goods and pays the price for it.

Following are the elements essential to form a contract of sale:

- There must be two parties in the contract of sale. One is the buyer and the other is the seller.
- The subject-matter of sale must be movable goods. It may be either existing goods or future goods.
- A transfer of goods must be made from the seller to the buyer.
- There should be a price or consideration for the goods to be transferred.
- The contract to sale must be absolute and unconditional.
- Other essential elements of the contract must also be present in this contract of sale.



EXHIBIT

REQUISITES OF A VALID CONTRACT OF SALE

A valid contract of sale must consist of the following essential elements:

- **Two parties:** A contract of sale has two parties, namely a buyer and a seller as a person cannot sell his goods to himself.
- **Transfer of property:** The term 'property' here refers to the ownership of the good. The main intent of the contract of sale of goods is to make the buyer an owner of goods. The exact time of the transfer of the ownership depends upon parties' intentions.
- **Goods:** Goods may be existing goods, future goods, specific goods and unascertained goods.

- **Price:** Price is an essential requirement in order to make a Contract of Sale of Goods. The buyer has to pay a certain price as a consideration of return for the seller's promise to sell the goods.
- **'Sale' or 'Agreement to sell':** A contract of sale of goods may be either a sale or an agreement to sell. If the property in goods is transferred to the buyer at the time a contract is made, it is a 'sale'; and when the property in goods is to be transferred to the buyer at a point of time in future after the contract is made—either on the fulfilment of any pre-laid condition or after a passage of the time given, it is an 'agreement to sell'.

Important Concept

In context with the Sale of Goods Act, 1930, goods are said to be delivered when there is a voluntary transfer of possession from one person to another.

7.2.1 SALE AND AGREEMENT TO SELL

In a contract, when goods or any other movable property is sold by a seller to the buyer, the contract is known as a contract of sale. The sale made is called an absolute sale. In an agreement to sell, the ownership of the goods does not transfer. The goods are transferred at a future date after the fulfilment of certain conditions. Therefore, it is called a conditional sale.

Thus, the main difference between a contract of sale and an agreement to sell is the time of transfer of the ownership of goods from the seller to the buyer. In a contract of sale, the ownership is transferred immediately, but in an agreement to sell, the ownership is transferred at some point in the future. The difference between a sale and an agreement to sell is shown in Table 1:

TABLE 1: Distinction Between Sale and Agreement to Sell

Points of Distinction	Sale	Agreement to Sell
Nature of Contract	Sale is an executed contract. Under this contract, one of the parties has already performed its part of the contract	Agreement to sell is an executor contract. Under this contract, both the parties are yet to perform their mutual promises within the agreed time
Transfer of Property	The property in the goods is transferred to the buyer with the risk	The risk and property do not transfer to the buyer immediately
Remedies on Breach of Contract	The seller is entitled to sue for the price of goods	The seller has the right only to sue for damages for non-performance of the contract
Risk of Loss	The loss is borne by the buyer even if the possession of goods is with the seller	The loss is borne by the seller as the ownership of the goods has not passed to the buyer
Insolvency of Seller if the Buyer has already Paid the Price	The buyer is entitled to receive goods from the official assignee or receiver of the seller	The buyer has to prove the amount it has paid and can only claim a rateable dividend. The buyer cannot compel the receiver to sell and deliver the goods



NOTE

In Sale of Goods Act, 1930, Section 4 deals with the sale and agreement to sell.

7.2.2 | SALE OF GOODS AND WORK AND LABOUR

Sale of Goods

In a contract, when there is a delivery of goods from the seller to the buyer, the contract is termed as a contract or agreement to sell or sale. In this case, a physical object is transferred, which is movable and is tangible. Ownership gets transferred from one person to the other.

Work and Labour

Work and labour is a kind of service where no physical goods are involved. If gold is transferred to the goldsmith for making ornaments, it is termed as work and labour. Similarly, if a painter is painting a picture, then what he/she is doing can be termed as work or labour. The agreement in which no physical form of goods is transferred is called Agreement of Work and Labour. It is also referred to as "Contract of Service".

7.2.3 | CONTRACT FOR WORK AND LABOUR

In an agreement, when there is no transfer of goods, it cannot be said to be a sale or an agreement to sell. In such cases, what is included in the agreement? What is transferred between the parties in the agreement? Is there any consideration or price in that agreement?

An agreement that includes the utilisation of workforce in order to complete some work is called an agreement for work and labour. In this type of contract, no goods are transferred from the seller to the buyer. A contract of work and labour relates to a service. Basically, two types of contracts exist according to the object clause available in the essentials of a contract. These are as follows:

- Contract of goods
- Contract of service

In the contract of goods, movable, physical or tangible property is transferred from the seller the buyer. In this case, the ownership of the commodity is transferred from one party to another party. The contract of goods can be made for the past, present or future transfer of goods.

However, in the case of a contract of service, a service has to be rendered by one party to the other. It includes the facilitation of some work for the convenience of the other party for which a price or consideration is paid to that party. As no goods or commodity exist in this type of contract, it cannot be made for the past or future.

7.2.4 | HIRE PURCHASE

Hire purchase is an agreement in which the possession of an asset is transferred from one person to another, but ownership of the asset remains with the vendor. The payment for the asset is made in instalments by the buyer to the seller. The ownership gets transferred on complete payment of price. Till that time, the ownership remains with the seller. However, the buyer can continue using the assets for his own benefit till he makes the full payment for that asset.

Important Concept

According to Section 4(3) of the Sale of Goods Act, 1930, agreement to sell is where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled.

The main features of a hire purchase agreement are as follows:

- It includes two parties, the hirer and the owner. The hirer is the person who takes the assets.
- There is no transfer of ownership. Ownership is transferred only when full payment of the value of the asset is made.
- The agreement consists of elements of bailment and elements of option to buy.
- The hire purchase agreement generally includes two elements, element of bailment and element of sale.
- There is no obligation on the part of the buyer to purchase the asset. Options are available with him to either buy or decline the hire purchase agreement.

The main differences between a hire purchase agreement and a sale are as follows:

- Sale is governed by the Sale of Goods Act, 1930, while the hire purchase agreement is governed by the Hire Purchase Act, 1972.
- In the case of sale, ownership is transferred immediately upon payment while in the case of the hire purchase agreement, no ownership is transferred.
- Lump sum payment is generally made in the case of sale while in hire purchase agreements, payment is made in instalments.
- On the non-payment of the amount of the asset, the seller cannot take back the assets in the case of a sale. However, in the case of hire purchase, the owner can take back the asset if the instalments are overdue.
- In the case of sale, the buyer only pays the actual price of the assets to the seller, but in case of hire purchase, some amount of interest is also paid by the hirer to the owner of the asset.
- Once a sale has been made, the assets cannot be given back to the original owner. In the case of hire purchase, the owner of the asset can take it back before the total instalments are received.



STUDY HINT

In case of hire purchase, along with the price for the asset, hirer also pays interest towards the use of assets.

7.2.5 | RULES FOR TRANSFER OF TITLE

The transfer of title plays a crucial role in the sale of goods contract. The legal rights and duties of the buyer and the seller are decided by the ownership of goods. Thus, primary rules are applied to legal rights and the transfer of the ownership of goods is described as follows:

- In an unconditional contract, when the delivery of the goods is ready, the ownership is set to be transferred as and when the contract is made. For example, in an electronics shop, the seller sells a television to a buyer through a contract. The ownership gets transferred as and when the buyer decides to purchase the television.
- When the goods are not in a deliverable state and the seller has to do work on it to bring it to a workable condition, the ownership does not get transferred until the seller does that work and the buyer is satisfied with it.
- In the case of sale of future goods, if the goods are in a deliverable state and the seller has agreed to sign a contract with the buyer, the ownership gets transferred only at the time of execution of the contract.



NOTE

Transfer of title takes place when the ownership of the goods transfers from one person to another person. Sections 27 to 30 of the Sale of Goods Act, 1930 discuss the transfer of title.

Sale by Non-Owners

A seller cannot transfer a better title than he himself has. This means that if the seller is not the real owner of goods, then as per the general rule, the seller cannot sell the desired goods to the buyer. A seller can only sell those goods on which he has his ownership. The rule is also expressed in the Latin maxim as “Nemo dat quod non habet”, which means that nobody can sell that he does not have. The buyer is not entitled to get the ownership of the goods if the seller is not the real owner of those goods.

For example, if A has stolen someone’s bag and sells it to C, then C is not the real owner of the bag.

Transfer of Title by Non-Owner

The exceptions to the above rule are defined as follows:

1. **Sale by a mercantile agent:** A sale made by a mercantile agent in possession of goods or the document of title to goods can transfer a goods title to the buyer if the following conditions are fulfilled:
 - a. The agent must be authorised by the real owner of goods or documents.
 - b. The sale must be made in the normal course of business by an agent.
 - c. The buyer must not be in receipt of any notice that the agent is not authorised to sell goods to him.
2. **Sale by one of the joint owners:** If any of the joint owners has the possession of goods with the permission of other joint holders to sell goods, then that joint owner can sell goods to the buyer, and the buyer will get the ownership of goods.
3. **Sale by party having possession of goods under voidable contracts:** A person who acquires the possession of goods under a contract which is voidable due to factors like fraud, misrepresentation, coercion and undue influence can sell his goods and transfer a legal title to any person.
4. **Sale of goods by a person in possession of goods after sale:** When a person has sold any goods to a party but is still in possession of the goods, then he may sell them and transfer a good title to a third person if that person obtains goods in good faith and without obtaining the notice of the previous sale.
5. **Sale without getting the physical delivery of goods:** A buyer who obtains the ownership of goods that he has bought from the seller in good faith but does not get the delivery of the goods can still sell the goods to another person and the third person gets it in good faith.
6. **Sale by an unpaid seller:** An unpaid seller having the right of lien on goods, he can sell those goods to anyone and transfer a legal title to him.
7. **Sale under other Acts:**
 - a. A pawnee can sell goods and transfer a good title to the buyer.
 - b. When a finder of goods sells them, he can transfer a good title to the buyer.
 - c. Sale made by a liquidator of a company can easily transfer a valid title to other persons.

7.2.6 | DOCTRINE OF CAVEAT EMPTOR

Caveat emptor means “Let the buyer beware”. When a buyer purchases goods or any commodity displayed by the seller, and some defect is found in it, the seller cannot be held responsible for it. It is the duty of the buyer to satisfy the seller about the selected product. If the goods or products are not according to his requirements or are defective, then the seller cannot be held responsible for it. The buyer has to use his own skills and judgement while selecting the product.

Section 16 of the Sale of Goods Act, 1930 describes this doctrine. It specifies that “subject to the provisions of the Act or of any other law that is being enforced in the time, there will be available no implied warranty or condition for the quality of the goods or for the fitness as to the purpose of the buyer under the contract of sale”.

The principle of caveat emptor does apply in the following conditions:

1. When the buyer tells the seller his requirement and the seller uses his own skill and judgement in choosing the product.
2. When a description is written on goods, it is implied that the goods shall correspond with the description.
3. The doctrine of caveat emptor does not apply to a sample of products.
4. When the seller sells the product by misrepresenting it to the buyer or sells wrong or expired goods.

7.2.7 | DELIVERY IN A CONTRACT OF SALE

The performance of the contract of sale starts with the seller who has the duty to deliver goods to the buyer and the buyer to accept goods delivered and to make payment accordingly as appropriate. The first component is the delivery of goods. It is an integral part of a contract of sale. Delivery of goods refers to their transfer from the seller’s place to the buyer’s place.

Delivery is of the following three types:

1. **Actual delivery:** It refers to the actual transfer of goods from the place of the seller to the place of the buyer. An agent may be preferred by the seller to deliver goods.
2. **Symbolic delivery:** When goods are bulky and cannot be delivered immediately, the seller usually resorts to symbolic delivery. For example, if the goods are lying in the warehouse, then the seller may give its key to the buyer in order to complete the symbolic delivery.
3. **Constructive delivery:** In constructive delivery, goods are delivered without any change in the actual or visible custody of the goods. In this case, goods are with a person who holds them on behalf of the seller.

The second component in the performance of the contract is acceptance of goods by the buyer. The important points to remember here are as follows:

1. On delivery of the goods, the buyer has a right to check whether they are correct and are not broken or stolen. He has the right to examine goods for his satisfaction.

Important Concept

The vital part of the Sale of Goods Act, 1930 is the Doctrine of Caveat Emptor. The Sale of Goods Act, 1930 defined the Doctrine of Caveat Emptor in Section 16 of the Act. “There is no implied warranty or condition as to the quality or the fitness for any particular purpose of goods supplied under such a contract of sale.”

2. A buyer is deemed to have accepted the goods when:
 - a. He tells the seller that he has received the goods and they are appropriate.
 - b. He does any action on the goods which, according to the seller, is inappropriate.

Another important component in the performance of the contract of sale is the payment of the price for the goods delivered by the seller to the buyer. The following points must be kept in mind in this regard:

- The price paid must be absolute and must be paid as per the contract.
- The price paid must reach the seller on time.
- The seller must be satisfied with the price at which he has sold the goods.

7.2.8 | RIGHTS OF UNPAID SELLER

When is a Seller Considered Unpaid?

The term 'unpaid seller' is defined under Section 45 of the Sale of Goods Act, 1930. It states that the seller of the goods is treated as an unpaid seller in the following circumstances:

1. The price for the goods is not paid in full by the buyer to the seller and the seller has an immediate right to claim the full amount.
2. A cheque or bill of exchange given to the seller has been dishonoured or returned.

Rights of Unpaid Seller

The seller in the position of an unpaid seller has the following rights:

A. Rights against goods

- **Right to lien:** Lien is the right to retain the possession of the goods till the full payment has been received by the seller. However, the unpaid seller loses his right to lien in case he loses possession. The right also stands void when the buyer lawfully obtains the possession of goods.
- **Right to stop the goods in transit:** In case the goods are in transit and are not delivered, the seller has a right to stop goods in transit. He can issue instructions to the carrier to bring back the goods.
- **Right of resale:** The seller has full authority to resell goods that were earlier provided to a party that has not paid for them. Since no payment has been received, the seller can sell goods to another buyer. However, if some payment has been received from the party, goods can be returned to the original buyer.

B. Personal rights of unpaid seller against the buyer

- **Suit for claiming the price:** The unpaid seller can claim or file a suit in the court against the buyer to recover his balance payment for the goods delivered to the buyer. When the goods are delivered to the buyer, he can also demand payment for them.

Quick TIP

When the right of lien ends, you can say that the right of stoppage in transit begins.

- **Suit for damages for non-acceptance:** In case the buyer wrongfully rejects goods or neglects to accept them, the seller can file a suit against the buyer for the damages caused due to the non-acceptance of the contract.
- **Repudiate contract before date:** When the buyer refuses to accept the contract before the date of delivery, the seller can claim damages caused for non-delivery. This is also known as 'rule of anticipatory breach contract'.



EXHIBIT

TERMINATION OF LIEN AND RIGHT OF STOPPAGE IN TRANSIT
Termination of Lien

The lien of an unpaid seller of goods is lost in the following cases:

- When goods are delivered by a seller to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods with him;
- When the buyer/his agent legally obtains the possession of the goods;
- By the abdication of lien or the right of retention.

An unpaid seller of goods (who has a lien with respect to them) does not lose his/her lien by reason only that he/she has obtained a decree for the price of the goods.

Rights of Stoppage in Transit

The unpaid seller who has parted with the possession of goods has the right of stopping goods in transit, in case the buyer of goods becomes insolvent, i.e., he may resume possession of goods which are in the course of transit, and may retain them until payment of the price.

Duration of Transit

- Goods are said to be in the course of transit from the time they are delivered to a carrier or any other bailee for the purpose of transfer to the buyer, until the buyer or his agent takes delivery of them from the carrier or any other bailee.
- If the buyer or his agent obtains delivery of goods, before their arrival at the selected destination the transit is at an end.
- If, on the arrival of the goods at the selected destination, the carrier or another bailee acknowledges to the buyer or his agent to hold the goods on his behalf and continues in ownership of them as a bailee for the buyer or his agent, the transit will be at an end.
- If the carrier or other bailee continues in possession of the rejected goods by the buyer, the transit is not said to be at an end, even if the seller has refused to receive them back.
- When goods are delivered to a ship leased by the buyer, it is a question depending on the conditions of a particular case whether they are in the possession of the master as a carrier or as an agent to the buyer.

How Stoppage in Transit is Affected?

- (1) The right of stoppage in transit of an unpaid seller can be exercised either by taking actual possession of the goods or by giving a notice of his claim to the carrier or other bailee in whose possession the goods are.
- (2) The notice is ineffective if given to the principal unless it is given at such a time and under such circumstances that the principal may communicate it to his servant or agent by the exercise of reasonable diligence, in time to prevent a delivery to the buyer.
- (3) When notice of stoppage in transit is given to the carrier or other bailee in possession of the goods by the seller, he must re-deliver goods according to the directions of, the seller; and the expenditure of re-delivery must be borne by the seller.

Resale by Buyer: Effect of Sub-Sale by the Buyer

- (1) The right of lien or stoppage in transit of an unpaid seller's is not affected by any sale or other disposition of the goods which the buyer may have made, unless the seller has agreed to it.
- (2) Where a document of title to goods has been legally done to a buyer or owner of the goods and that person also transfers the document to a person who considers it in good faith and for valuable consideration, then-
 - (a) If the last-mentioned transfer was done through sale, the unpaid seller's right of lien or retention/stoppage in transit is defeated; and
 - (b) If the last-mentioned transfer was made through pledge, the unpaid seller's right of lien or retention/stoppage in transit can only be exercised subject to the rights of the transferee.

Rescission: Re-Sale by Seller

- (1) A contract of sale is not rescinded by the mere exercise by an unpaid seller of his right of lien or withholding or stoppage in transportation.
- (2) Where an unpaid seller re-sells goods in exercise of his right of lien or stoppage in transit, the buyer acquires the good title to them as against the original buyer.
- (3) Where the goods are of a perishable nature, or where the unpaid seller has given a notice to the buyer of his intention to re-sell goods, and the buyer does not pay the price within a reasonable time, the unpaid seller may resell goods and recover damages for any loss occasioned from the original buyer by his breach of contract.
- (4) Where the seller explicitly reserves a right of resale in the case of buyer making a default, the original contract of sale is rescinded/annulled but without bias to any claim the seller may have for damage.



**SELF
ASSESSMENT
QUESTIONS**

1. According to Section 4(1) of the Sale of Goods Act, 1930, a contract to sell is a contract in which the seller of goods transfers or agrees to transfer the goods to the buyer for a price or consideration. (True/False)
2. Thus, the main difference between a contract of sale and an agreement to sell is the time of transfer of the ownership of goods from the seller to the buyer. (True/False)
3. Under which contract are both the parties yet to perform their mutual promises within the agreed time?
4. _____ is an agreement in which the possession of an asset is transferred from one person to another, but ownership of the asset is not transferred.
5. The legal rights and duties of the buyer and the seller are decided by the sale of goods. (True/False)
6. The right to lien also stands _____ when the buyer lawfully obtains the possession of goods.
7. Which of the following are the rights of an unpaid seller?
 - a. Right of lien
 - b. Right of stoppage of goods in transit
 - c. Right to claim the price
 - d. All of these
8. A _____ is an agreement under which a buyer takes the delivery of goods and promises to pay the goods' price through a certain number of instalments and hire charges for using goods until the full payment is made.

7.3 FORMALITIES OF THE CONTRACT OF SALE

To constitute a contract of sale, no particular form is required. It is just like other contracts which are made by the general method of an offer made by one party and its acceptance by the other.

Section 5 of the Sale of Goods Act, 1930 mentions how the contract of sale is made:

- (1) A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery or payment by instalments, or that the delivery or payment or both shall be postponed.
- (2) Subject to the provisions of any law for the time being in force, a contract of sale may be made in writing or by word of mouth, or partly in writing and partly by word of mouth or may be implied from the conduct of the parties.

Following are the essentials for the formation of the contract of sale:

- **Offer and acceptance:** A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of a stipulated price. A contract may have a provision of either immediate delivery of goods or immediate payment of the price or both, or also of the delivery or payment to be made by instalments. Or, it could also be that the payments or delivery are postponed.
- **Implied either verbal or written:** A contract of sale may be in writing or by the word of mouth, i.e., verbal or it may be implied from the conduct of parties involved in the contract.
- **Invitation to make an offer:** A statement or conduct inviting the making of an offer does not by itself bind the seller to accept the customer's offer, such as the display of goods in a shop does, even at the price displayed or advertised. Such an invitation to entice therefore is different from an offer, which intends to be imperative on the person making it and is capable of being accepted without any further negotiation. However, where the approachability to goods is intended in an offer which is capable of being accepted by the customer's act, the question of obtaining the seller's approval does not arise. For example, filling the petrol tank of a car from a self-service pump or taking goods intended for sale from an automatic vending machine.
- **Ownership passes on price payment:** Sub-section 1 emphasises the consistent nature of a contract of sale. Sale can be completed even without having an effect on the immediate delivery and immediate payment. In a contract of sale, the title in goods passes immediately to the buyer while in an agreement to sell, it passes at a stipulated time in future subject to the fulfilment of laid conditions thereafter, on the acceptance of the goods by the buyer and on receiving the price by the seller, the sale is deemed to be complete.
- **Earnest to be the value of goods:** Earnest whether given in money or not must be something of value actually given by the buyer and kept by the seller.



NOTE

If a person acquires the possession of the goods by unfair method, then there is no delivery of goods.



SELF ASSESSMENT QUESTIONS

9. In the contract of sale of goods, transfer of ownership of goods is not necessary. (True/False)
10. A contract may have a provision of either immediate delivery of goods or immediate payment of the price or both, or also of the delivery or payment to be made by instalments. (True/False)
11. Sale can be completed even without having an effect on the immediate _____ and immediate payment.

7.4 GOODS – SUBJECT MATTER OF CONTRACT

The contract of sale moves around goods. Section 2 (7) conveys that “goods” means all kinds of movable properties other than money or actionable claims. As money and actionable claims are not supposed to be goods, therefore, these cannot be bought and sold. Money here stands for legal tender money. It does not include solid coins which are sold like goods, e.g., silver or gold rupee coins. An actionable claim stands for a debt/a claim for money which a person may have

against another and which he/she can recover by suit. According to the Section 2 (12) of the Act, “quality of goods” means their state or condition.

Price

Price, which is the essence of a contract of sale, means the consideration of money for a sale of goods. It may be the money which is actually paid or is promised to be paid accordingly, depending on the agreement whether for cash sale or credit sale. If money is not given consideration, it is not to be deemed as a sale. In an agreement to sell, if the seller becomes insolvent and the buyer has paid the price then the only remedy available for the buyer is to claim for estimable value. But if in a sale, the seller becomes insolvent then the buyer can recover his goods from the liquidator because the ownership in goods has been passed to him. The price can be fixed by the contract or determined as per the deal between the involved parties. In the absence of either of these provisions, the buyer should pay an acceptable price, whose amount is determined by the facts of each particular case.

Sale and Contract for Work and Materials

A contract of sale must be differentiated from a contract for work and materials. The Sale of Goods Act applies to the contract of sale and not to the contract for work and materials. The former foresees the delivery of goods whereas the latter involves the exercise of skill and labour by one party in respect of materials supplied for another, where the delivery of goods is only subsidiary or incidental.



Quick TIP

In Bailment, the one who delivers the goods is called Bailor and the one who gets the goods from Bailor for some purpose is called Bailee.

Earnest (Deposit) Money

The buyer pays the seller an amount which acts as a guarantee or token of good faith, which is known as the earnest money as a promise of fulfilment of the contract. If the buyer at all fails to fulfil the contract, the earnest money gets penalised by the seller but if he/she fulfils the contract, the earnest money or the deposit is treated as a part-payment of the total price, and only the balance is required to be paid to make up the full payment.

Sale and Bailment

Bailment is the delivery of goods from a bailor to a bailee on a condition that goods shall be returned to the bailor when the bailee’s purpose is met. Bailment/ temporary entrusting may be with or without consideration, whereas a sale is the delivery of goods in return of monetary payment and no such provision of return of those goods is applicable. In a sale, the buyer becomes the absolute owner of goods but in bailment, the question of transferring of the ownership does not arise at all.

7.4.1 | EXISTING OR FUTURE GOODS

As per the Act, goods which make the subject of a contract of sale are either existing goods or owned/ possessed by the seller, or the goods which are to be manufactured or acquired by the seller on the making of the contract of sale are future goods the existing goods may be specific goods or uncertain goods.

There may be a contract of sale of goods whose acquisition by the seller depends on a contingency which may or may not happen. Whereby, in a contract of sale,

the seller reasons to affect the present sale of future goods, the contract functions as an agreement for the sale of goods.

7.4.2 | GOODS PERISHING BEFORE THE MAKING OF CONTRACT

If in a contract for the sale of specific goods, the goods have perished at the time when the contract was made, without the seller's knowledge, the contract is deemed as void.

Example: A sold specific goods to B which were lying in A's godown. Unknown to both the parties, the goods got destroyed due to floods. Such a contract will be void.

The term 'perishing of goods' does not only mean their physical destruction, but also includes goods losing their commercial value as well. The risk of loss here remains with the seller as the transfer of property has not taken place. The contract as a whole will be void also when a part of goods have perished if it was an indissoluble contract requiring total goods by the seller but if the contract can be seen as a divisible contract, the contract for goods which are intact shall remain valid.

7.4.3 | GOODS PERISHING BEFORE SALE AND AFTER AGREEMENT TO SELL

When an agreement to sell specific goods is made and the goods perish before the sale without any fault of either the buyer or the seller, the risk passes to the seller and the agreement is considered to be void. The contract of sale becomes void on the ground of an ensuing impossibility of performance. However, the following conditions must be satisfied:

- The contract of sale must only be an 'agreement to sell' and not an 'actual sale'.
- The 'agreement to sell' must be made for the sale of specific goods only.
- The goods must have perished before the buyer becomes the owner of goods.
- The goods must have perished without the fault of the buyer or the seller.

Example: A cow was delivered to B by R for a trial of 8 days. It was agreed that the sale would be complete if the cow was found suitable for B's purpose. The cow died on the 5th day without any fault of either of the parties. The contract was void and R could not recover the price from B.



SELF ASSESSMENT QUESTIONS

12. "Goods" mean all kinds of movable properties other than money or actionable claims. (True/False)
13. An _____ stands for a debt/a claim for money which a person may have against another and which he/she can recover by suit.
14. Specific goods are identified and agreed upon mutually when the contract of sale is made. (True/False)

15. Bailment is the delivery of goods from a bailor to a bailee on a condition that goods shall be returned to the bailor when the bailee's purpose is met. (True/False)

7.5 PRICE

Price, which is the essence of a contract of sale, means the consideration of money for a sale of goods. It may be the money which is actually paid or is promised to be paid accordingly, depending on the agreement whether for cash sale or credit sale. If money is not given consideration, it is not to be deemed a sale. In an agreement to sell, if the seller becomes insolvent and the buyer has paid the price, the only remedy available for the buyer is to claim for the estimable value. But if in a sale, the seller becomes insolvent, the buyer can recover his goods from the liquidator because the ownership in goods has been passed to him. The price can be fixed by the contract or determined as per the deal between the involved parties. In the absence of either of these provisions, the buyer should pay an acceptable price, whose amount is determined by the facts of each particular case.

7.5.1 ASCERTAINMENT OF PRICE

The price of goods is an essential element of a valid sale. It is the consideration for transfer or agreement to transfer the property in goods from the seller to the buyer. Thus, there can be no valid sale without price. According to Section 2 (10) of the Sale of Goods Act, "Price means the money consideration for a sale of goods". In other words, the money paid for purchasing goods is called price. It could be fixed in various ways. The different modes of ascertaining the price are contained in Section 9 of the Sale of Goods Act, are as under:

- **Fixation by the contract itself:** The most common way of fixing the price is when both the parties make the contract of sale, they generally mention the price to be paid for goods.
- **Fixation in accordance to an agreed manner:** When the parties agree that the price to be paid will be the price prevailing in the market on the date of supply of goods.
- **Fixation of price by the course of dealings:** If parties regularly trade, then the customs or usage of trade gives certain principles for the price determination of goods.
- **Fixation of a reasonable price:** At times, when none of the above principles is applicable, the buyer shall pay a reasonable price to the seller.
- **Fixation of price by a third party:** Both the seller and the buyer may agree to sell and buy goods on the condition that the price shall be fixed by the valuation of a third party. The agreement will become void if such third party cannot or does not make such valuation but if the third party is barred from making the valuation by the fault of seller or buyer, the party which retains a case for damages is one which is not at fault against the party in fault.

Example: A agreed to sell his 500 bags of sugar to B at a price to be fixed by C. If C fails to fix the price, the agreement is void. If A prevents C from making the valuation of goods and fix the price then B can claim damages from A.

7.5.2 | AGREEMENT TO SELL AT VALUATION

Section 10, the Sale of Goods Act, 1930 states agreement to sell at valuation as under:

- (1) Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party, and it cannot or does not happen, then the agreement is considered to be void, but if the goods or any part of them have been delivered to and appropriated by the buyer he must pay a reasonable price for them.
- (2) Where the third party is barred from making the valuation by the fault of the seller or the buyer, the party which retains a case for damages is one which is not at fault against the party in fault.



SELF ASSESSMENT QUESTIONS

16. Price means the money consideration for a sale of goods. (True/False)
17. Section 9 of the Sale of Goods Act provides for:
 - a. Different modes of ascertaining the price
 - b. Valuation of a third party
 - c. Fault of the seller or the buyer
 - d. Stipulations as to time

7.6 CONDITIONS AND WARRANTIES IN A CONTRACT OF SALE



STUDY HINT

Warranty is assurance, whereas guarantee is commitment.

A contract of sale of goods contains various terms or stipulations about the quality of goods, price and mode of its payment, delivery of goods and its time and place. These are also known as the conditions of the contract. A condition can be defined as a promise or statement of fact, which is an essential term of the contract. The breach of a condition gives the concerned party the right to terminate or repudiate the contract. A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.

Example: Suresh is a tour manager. He asks a car dealer to suggest a car that would be suitable for the touring purpose. The dealer suggests a particular car, and Suresh purchases it from him. Later, however, Suresh finds the car unsuitable for the purpose it was bought. As per the contract signed between the two parties, suitability of the car for the touring purpose is one of the conditions of the contract. Therefore, Suresh is entitled to reject the car and have a refund of the price paid. A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject goods and treat the contract as repudiated.

Example: Suresh asks a car dealer to suggest a good fuel-efficient car. The dealer suggests a car and claims that it runs 20 km per litre of petrol. Suresh purchases the car but later finds out it runs only 15 km per litre of petrol. In this case, the statement made by the seller was a warranty. Therefore, Suresh is not entitled to reject the car but entitled to claim damages.

There is no hard and fast rule as to which stipulation is a condition and which is a warranty. Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition though called a warranty in the contract.

The main differences between a condition and a warranty are shown in Table 2:

TABLE 2: Distinction Between Condition and Warranty

Points of Distinction	Condition	Warranty
Stipulation	A condition is an essential stipulation to the main purpose of a contract	Warranty is a stipulation collateral to the main purpose of a contract. It is basically an assurance
Breach	Breach of a condition gives the right to repudiate the contract and also to claim damages	Breach of the warranty gives the right to claim damages only
Treatment	Breach of a condition may be treated as a breach of warranty	Breach of warranty cannot be treated as a breach of a condition

7.6.1 | EXPRESSED CONDITIONS AND WARRANTIES

Conditions and warranties may either be expressed or implied. They are said to be expressed when they are inserted in a contract after taking the full consent of the associated parties.

Example: A buyer wants to buy a refrigerator with model number 3999. Here, the model number is an express condition. The compressor of the refrigerator has a guarantee of 5 years, which is an express warranty.

7.6.2 | IMPLIED CONDITIONS AND WARRANTIES

Conditions and warranties are said to be implied when the law automatically presumes the existence of some terms in a contract though they have not been put in express words. The law incorporates into a contract of sale of goods under the following implied conditions:

- a. **Conditions as to title:** In every contract, there is an implied condition on the part of the seller that:
 - i. In the case of a sale, the seller has a right to sell goods.
 - ii. In the case of an agreement to sell, the seller has a right to sell goods at the time when the title of the property is to pass.

Example: Ram purchases some stolen goods from Suresh, who is a thief. Shyam is the true owner of stolen goods. He demands from Ram that the



Quick TIP

Guarantee is given for a product, service and person, while warranty is given only for a product.

goods be returned to him. In this case, Ram has to return goods to Shyam. He cannot sue Suresh as the knowledge of the buyer has negated the implied conditions as to title.

b. **Conditions in a sale by description:** As per the Sale of Goods Act,

“Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description” The description may be in terms of the qualities or characteristics of the goods.

Example: X bought a machine from Y who claimed it to be only six months old. However, after using it, X finds out that the machine is extremely old. X has the right to reject the machine as the description of the machine does not match the one provided by the seller.

c. **Conditions in a sale by sample:** When under a contract of sale, goods are to be supplied according to a sample agreed upon, the implied conditions are that the:

- bulk shall correspond with the sample in quality
- buyer shall have a reasonable opportunity of comparing the bulk with the sample
- goods shall be free from any defect (latent)

d. **Conditions as to fitness or quality:** Under a contract of sale, there is no implied condition related to the quality or fitness of goods supplied. In fact, in most of the agreements, this assurance is specifically disclaimed by the seller. This is expressed by the principle of Caveat Emptor (i.e., let the buyer beware). However, the buyer has the right to satisfy himself/herself about the quality of goods. An implied condition is deemed to exist on part of the seller that the goods supplied shall be reasonably fit for the purpose for which the buyer wants them, if the following conditions are satisfied:

- i. The particular purpose for which goods are required must have been disclosed (expressly or impliedly) by the buyer to the seller.
- ii. The buyer should rely on the seller’s skill or judgement.
- iii. The seller’s business must be to sell such goods.

Example: Suppose you purchase a hot-water bottle from a shopkeeper. However, the bottle breaks when you pour hot water into it. In this case, the shopkeeper is liable to refund the price because the bottle was unfit for the purpose for which it was purchased.

e. **Conditions as to merchantability:** There is an implied condition that the goods shall be of merchantable quality, unless specifically disclaimed by the seller, or the goods are specifically stated to be sold on an “as is” condition (i.e., with all their defects).

The expression merchantable quality means that the goods should be free from any hidden defects. The quality and condition of the goods must be such that an individual would accept them as the goods of that description.

Example: You purchased a bottle of champagne. While opening its cork, the bottle breaks, and you are injured. In this case, you are entitled to claim damages as the bottle was not of merchantable quality.

- f. **Condition as to wholesomeness:** This condition is applied in the case of eatables or provisions or food stuff. There is an implied condition that eatables should be free from any defect and fit for human consumption.

Example: W bought milk from H's diary. The milk was contaminated with typhoid bacteria. As a result, when W consumed the milk, he fell ill. In this case, H is held liable to W's illness as the milk was not fit for human consumption.

Implied Warranties

Unless otherwise agreed, the law also incorporates the following implied warranties:

- a. **Warranty of quiet possession:** There is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. This is an extension of the implied condition as to title.

Example: X purchases a second-hand mobile phone from Y. X spends some money on its repair. However, the mobile phone is a stolen one, and therefore X is entitled to file a suit against Y for recovery of damages, including the cost of repairs.

- b. **Warranty of freedom from encumbrances:** There is an implied warranty that the goods sold are free from any charge or encumbrance in favour of any third person if the buyer is not aware of such charge or encumbrance.

Example: You borrow ₹500 from Y and hypothecate your phone with Y as security. Later on, you sell the phone to Z who buys it in good faith. Here, Z can claim damages from you because his possession is disturbed by Y having a charge.

- c. **Warranty of disclosing the dangerous nature of goods to the ignorant buyer:** This means that the seller must disclose the dangerous nature or danger related to the goods he is selling. It is an implied warranty on the part of the seller.

Example: A purchases a tin of disinfected powder from B. B knows that the lid of the tin is defective and may be dangerous if it is not opened carefully. However, B does not tell this to A. A opens the tin and the disinfectant powder flies into his eyes, causing a major injury. In this case, B is liable to pay for damages caused to A.



SELF ASSESSMENT QUESTIONS

18. Conditions and warranties are said to be implied when the law automatically presumes the existence of some terms in a contract though they have not been put in express words. (True/False)
19. Under a contract of sale, there is no _____ related to the quality or fitness of goods supplied.

20. Which of the following is not a condition to be met for an implied condition deemed to exist on part of the seller that the goods supplied shall be reasonably fit for the purpose for which the buyer wants them?
- The particular purpose for which goods are required must have been disclosed (expressly or impliedly) by the buyer to the seller.
 - The seller should rely on the buyer's skill or judgement.
 - The seller's business must be to sell such goods.
 - All of these



ACTIVITY 1

A sells goods to B, for which payment is made through a cheque. However, before B could obtain the delivery of the goods, the cheque is dishonoured by the bank. A, therefore, refuses to deliver the goods until the payment is made. Is A's action justified? Make a group and discuss this scenario.

7.7 SUMMARY



- According to Section 4 (1) of the Sale of Goods Act, 1930, a contract to sell is a contract in which the seller of goods transfers or agrees to transfer the goods to the buyer for a price or consideration.
- In a contract, when goods or any other movable property is sold by a seller to the buyer, the contract is known as a contract of sale.
- In an agreement to sell, the ownership of the goods does not transfer. The goods are transferred at a future date after the fulfilment of certain conditions. Therefore, it is called a conditional sale.
- Sale is an executed contract. Under this contract, one of the parties has already performed its part of the contract.
- Agreement to sell is an executor contract. Under this contract, both the parties are yet to perform their mutual promises within the agreed time.
- Hire purchase is an agreement in which the possession of an asset is transferred from one person to another, but ownership of the asset is not transferred.
- The transfer of title plays a crucial role in the sale of goods contract. The legal rights and duties of the buyer and the seller are decided by the ownership of goods.
- Caveat emptor means "Let the buyer beware". When a buyer purchases goods or any commodity displayed by the seller, and some defect is found in it, the seller cannot be held responsible for it.
- The performance of the contract of sale starts with the seller who has the duty to deliver goods to the buyer and the buyer to accept goods delivered and to make payment accordingly as appropriate.

- Delivery can be of three types namely actual delivery, symbolic delivery and constructive delivery.
- The term 'unpaid seller' is defined under Section 45(a) of the Sale of Goods Act, 1930.
- The person or seller in the position of an unpaid seller has some rights. These rights are right to lien, right to stop in transit and right of resale.
- The rights of an unpaid seller against the buyer are suit for claiming the price, suit for damages for non-acceptance and repudiate contract before date.
- The essentials for the formation of the contract of sale are earnest to be the value of goods, implied either verbal or written, invitation to make an offer, ownership passes on price payment and offer and acceptance.
- Price, which is the essence of a contract of sale, means the consideration of money for a sale of goods. It may be the money which is actually paid or is promised to be paid accordingly, depending on the agreement whether for cash sale or credit sale.
- A contract of sale of goods contains various terms or stipulations about the quality of goods, price and mode of its payment, delivery of goods and its time and place.
- Conditions and warranties may either be expressed or implied. They are said to be expressed when they are inserted in a contract after taking the full consent of the associated parties.

7.8 KEY WORDS



- **Buyer:** A person who buys or agrees to buy goods
- **Delivery:** Voluntary transfer of possession of goods from one person to another
- **Seller:** A person who sells or agrees to sell goods
- **Warranty:** An agreement with reference to goods which are the subject of a contract of sale

7.9 CASE STUDY: A CASE ON SALE OF GOODS ACT, 1930



Mr. Shiv and Mr. Sanjeev enter into a contract on 3rd March, 2014, wherein Mr. Sanjeev agrees to supply 500 bales of cotton to Mr. Shiv at a rate of ₹ 1,000 per bale on or after 31st May, 2014 but before 10th June 2014.

Mr. Sanjeev supplies 600 bales of cotton on 5th June 2014. However, Mr. Shiv rejects them, stating that, as per the agreement, he had asked for only 500 bales of cotton, and as 600 bales were supplied, he would not accept even a single bale of cotton.

Mr. Sanjeev contests that as only 500 bales of cotton were asked for, so he can accept 500 bales of cotton.

QUESTIONS

1. Do you feel that it is mandatory for Mr. Shiv as per the Sale of Goods Act, 1930 to accept the 500 bales of cotton?
(Hint: As per Section 37 of the Sale of Goods Act, Mr. Shiv can reject the goods as the wrong quantity was delivered to him.)
2. If Mr. Shiv wants to buy all 600 bales of cotton, at what rate should he do so?
(Hint: Contract rate.)

7.10 SHORT ANSWER QUESTIONS



1. A _____ can be defined as a promise or statement of fact, which is an essential term of the contract.
2. In a contract, when goods or any other movable property is sold by a seller to a buyer, the contract is known as a _____.
3. The agreement in which no physical form of goods is transferred is called _____.
4. _____ is an agreement in which the possession of an asset is transferred from one person to another but ownership of the asset remains with the vendor.
5. _____ means "Let the buyer beware".
6. Delivery can be of three types, namely actual delivery, symbolic delivery and _____.
7. Conditions and warranties may either be expressed or implied. (True/False)
8. The contract of sale does not become void in case the goods have perished without the fault of the buyer or the seller. (True/False)
9. Actual delivery refers to the actual transfer of goods from the place of the seller to the place of the buyer. (True/False)
10. "Nemo dat quod non habet" means that nobody can sell what he or she does not have. (True/False)
11. Among the following, which one is collateral to the purpose of the contract?
 - a. Condition
 - b. Guarantee
 - c. Warranty
 - d. None of these
12. In which year was the Sale of Goods Act enforced?
 - a. 1930
 - b. 1940
 - c. 1935
 - d. 1960
13. Which among the following are the types of existing goods?
 - a. Specific goods
 - b. Uncertain goods
 - c. Both a and b
 - d. None of these

14. According to the Sale of Goods Act, 1930, goods do not include which one of the following?
- a. Stock
 - b. Actionable claims
 - c. Crop
 - d. None of these
15. Which among the following is called the voluntary transfer of possession from one person to another?
- a. Delivery
 - b. Transfer
 - c. Change of possession
 - d. None of these
16. This refers to the delivery of goods from a bailor to a bailee on a condition that goods shall be returned to the bailor when the bailee's purpose is met. Which one is correct?
- a. Pledge
 - b. Bailment
 - c. Both a and b
 - d. None of these
17. Which one from the following options refers to a type of delivery in which goods are delivered without any change in the actual or visible custody of the goods?
- a. Actual delivery
 - b. Constructive delivery
 - c. Symbolic delivery
 - d. None of these
18. Which among the following are the goods identified and agreed upon at the time a contract of sale is made?
- a. Specified goods
 - b. Ordinary goods
 - c. Scheduled goods
 - d. None of these
19. As per Section 2(12) of the Sale of Goods Act, the quality of goods includes which one among the following options?
- a. Conditions of goods
 - b. State of goods
 - c. Both a and b
 - d. None of these
20. Which of the following options refers to a kind of moveable property other than actionable claim and money?
- a. Future goods
 - b. Goods
 - c. Both a and b
 - d. None of these
21. Which Section provides the definition of the rights of an unpaid seller?
- a. Section 47
 - b. Section 46
 - c. Section 45
 - d. None of these
22. Which among the following are essential for the formation of the contract of sale?
- a. Offer and acceptance
 - b. Invitation to make an offer
 - c. Ownership transfer
 - d. All of these

7.12 ANSWER KEY**A. SELF ASSESSMENT QUESTIONS**

Topic	Q. No.	Answer
Definition and Essentials of a Contract of Sale	1.	True
	2.	True
	3.	Agreement to sell
	4.	Hire purchase
	5.	False
	6.	Void
	7.	d. All of these
	8.	8. Hire-purchase agreement
Formalities of the Contract of Sale	9.	False
	10.	True
	11.	Delivery
Goods – Subject Matter of Contract	12.	True
	13.	Actionable claim
	14.	True
	15.	True
Price	16.	True
	17.	a. Different modes of ascertaining the price
Conditions and Warranties	18.	True
	19.	Implied condition
	20.	b. The seller should rely on the buyer's skill or judgement.

B. SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	condition
2.	contract of sale
3.	contract of service
4.	Hire purchase
5.	Caveat emptor
6.	constructive delivery
7.	True
8.	False
9.	True
10.	True

Q. No.	Answer
11.	c. Warranty
12.	a. 1930
13.	c. Both a and b
14.	b. Actionable claim
15.	a. Delivery
16.	b. Bailment
17.	b. Constructive delivery
18.	a. Specified goods
19.	c. Both a and b
20.	b. Goods
21.	c. Section 45
22.	d. All of these
23.	c. Section 9
24.	a. Contract of sale
25.	d. All of these

7.13 SUGGESTED BOOKS AND E-REFERENCES



SUGGESTED BOOKS

- Sheth, T. (2011). *Legal Aspects of Business*. Pearson India.
- Tulsian, P. (2014). *Business Law*. New Delhi: McGraw Hill Education (India) Private Limited.

E-REFERENCES

- Conditions and Warranties in Sale of Goods. (2018). Retrieved from <https://www.lawteacher.net/free-law-essays/commercial-law/conditions-and-warranties-in-sale-of-goods-commercial-law-essay.php>
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CONSUMER PROTECTION

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MIT



LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Describe the major laws concerning consumer protection
- ▶▶ Explain various rights of consumers
- ▶▶ Describe the objective and scope of the Indian Consumer Protection Act, 2019
- ▶▶ Describe the consumer protection mechanism under the new Consumer Protection Act, 2019
- ▶▶ Discuss the changes proposed in the Consumer Protection Bill, 2018 meant to replace the existing Act

8.1 INTRODUCTION



Read
Pre-read Connect

In the previous chapter, you studied about the Sale of Goods Act, 1930. The chapter discussed the essentials and the formalities of the contract of sale. The chapter also discussed important concepts, such as price, conditions and warranties.

The consumer's interests have been taken into account when devising laws, such as the Contract Act, 1872 and the Sale of Goods Act, 1930. Strictly speaking, any consumer can file a civil suit against a seller under the Indian Contract Act if the seller is caught cheating or committing fraud. The protection provided to consumers by these major laws is mainly meant for an orderly conduct of businesses. However, these have been found to be insufficient in the context of consumption of goods and the related consumer rights.

Suppose you purchase a grocery item from a superstore. Your purchase of the grocery item amounts to a contract between you and the retailer. When you see the price tag on the item kept for sale in the superstore, it amounts to an offer for sale by the retailer. When you take out the product for purchase, it is an acceptance of the offer. When you pay the consideration in terms of the legal tender, the contract is complete. This whole transaction involves an implicit contract between you and the retailer and can be theoretically viewed as a contract under the Indian Contract Act.

However, if you find that the product is defective or does not meet the requirements specified, and a dispute arises between you and the retailer, it may not be easy to sue the retailer under the Contract Act. It requires filing a suit in court under civil law, which is an elaborate and time-consuming process. Effective consumer protection cannot be ensured through general business laws like the Sale of Goods Act which is mainly biased in favour of traders. The Sale of Goods Act, 1930 has not been helpful in protecting consumer rights. In order to resolve these problems, the Consumer Protection Act, 1986 was developed. This law was quite useful and has been able to solve a lot of consumer issues and provide protection to consumers. However, with changing times, this act became obsolete and has been replaced with a new and more elaborate act known as the Consumer Protection Act, 2019.

In this chapter, you will be introduced to the major laws related to consumer protection in India. Next, you will be acquainted with the rights of consumers and various aspects of the Consumer Protection Act, 2019. Towards the end, the chapter discusses the overall mechanism of consumer protection in India.

8.2 MAJOR LAWS CONCERNING CONSUMER PROTECTION

Adam Smith wrote even before full-scale industrialisation that *although the sole end and purpose of all production is consumption, the interest of the consumer is almost constantly sacrificed to that of the producer*. Industrialisation and mass production had transformed business organisations by introducing complex and efficient production techniques, innovative sales and marketing strategies leading to unprecedented market conditions that made the position of the consuming public vulnerable. The modern concept of marketing and advertising strategies rendered

traditional skills of consumers in evaluating the quality and price of products totally inadequate.



NOTE

According to **A.K. Chandra**, the Consumer Protection Act is a socio-economic legislation that has been enacted to protect the interests of consumers in India.

In fact, during the early part of the 19th century, when mass production and complex marketing strategies were introduced in advanced economies like the United States, protecting consumers became a major issue for government agencies. Media and consumer activists continually exposed dangers and tragedies arising from the newly emerged American marketplace of the 1900s. This ultimately led to the pioneering concept of enacting separate laws to protect consumers. One of the first major laws introduced in America was the Pure Food and Drug Law enacted in 1906, which led to the establishment of the now-famous US Food and Drug Administration. This was followed by several other laws meant to protect consumer rights, like the Meat Inspection Act of 1906, the Federal Trade Commission Act of 1914, etc.

To protect the interests of consumers, governments keep enacting laws regularly. The major Indian laws and enactments in this regard are as follows:

- The Indian Penal Code, 1860
- The Code of Civil Procedure, 1908
- The Indian Contract Act, 1872
- The Indian Sale of Goods Act, 1930

All the above-mentioned laws are the laws of general nature to protect consumers. The major laws that were specifically enacted to protect consumer interests are as follows:

- Bureau of Indian Standards Act, 1986
- Cigarettes (Regulation of Production, Supply and Distribution) Act, 1975
- Drug and Magic Remedies (Objectionable Advertisements) Act, 1954
- Drugs and Cosmetics Act, 1940
- Drugs Control Act, 1950
- Essential Commodities (Special Provisions) Act, 1981
- Essential Commodities Act, 1955
- Hire Purchase Act, 1972
- Indian Standards Institution (Certification Marks) Act, 1952
- Industries (Development and Regulation) Act, 1951
- Monopolies and Restrictive Trade Practices Act, 1969
- Multi-State-Co-operative Societies Act, 2002
- Narcotic Drugs and Psychotropic Substances Act, 1985
- Prevention of Black Marketing and Maintenance of Supplies of Essential Commodities Act, 1980
- Prevention of Food Adulteration Act, 1954
- Standards of Weights and Measures (Enforcement) Act, 1985

- Standards of Weights and Measures Act, 1976
- Trade and Merchandise Marks Act, 1958

The scope of each of these acts is different. For instance, the Drugs and Cosmetics Act, 1940 is meant for protecting consumers from spurious drugs by regulating the import, manufacturing, distribution and sales of drugs and cosmetics. The Prevention of Food Adulteration Act, 1954 is meant for protecting consumers from the sale of adulterated food articles. The Essential Commodities Act, 1955 is meant to protect consumers from malpractices like hoarding and profiteering of essential commodities performed by traders. The Standards of Weights and Measures Act, 1976 is meant to provide the basis for determining the degree and extent of adulteration. The Bureau of Indian Standards Act, 1986 is meant to protect consumers by regulating and standardising products by preventing sale and manufacturing of defective and substandard products.

These Acts were meant to protect consumer interests, but none of these acts was complete and effective in achieving the desired goals due to certain drawbacks as follows:

- Some major laws tend to favour sellers more than consumers. For example, transactions like hire-purchase under the Sale of Goods Act appear more favourable to sellers than customers.
- There are problems with regard to speedy justice and disposal of cases. For example, the Essential Commodities Act does not provide any time limit for prosecution completion.
- All these laws are silent on some important points that are crucial for the legal protection of consumers. For example, the Essential Commodities Act is silent as to how the prices would be determined.
- The laws are difficult to enforce from the perspective of consumer interests. For example, in the case of the Prevention of Food Adulteration Act, there are problems with the establishment of standards of quality for food articles. The enforcement of the Act is difficult.
- Many laws require tedious and cumbersome legal procedures that allow the opposite party to easily escape the clutches of the law. For example, the MRTP Commission has tedious procedures to deal with the complaints and it takes a lot of time to get justice under the Act.

Important Concept

The Consumer Protection Act (CPA), 2019 provides a three-tier machinery system to protect the interests of consumers by settling consumer disputes and prescribes measures or remedies to safeguard consumers against unfair trade practices.



NOTE

The Consumer Protection Bill, 2019 was passed in the Parliament on 6th August, 2019. On 9th August, 2019, this bill received the assent of the President of India following which it was published in the official gazette.

Due to all these reasons, a need was felt for enacting a separate law for protecting consumers. In fact, the consumer rights movement became a world-wide phenomenon and the United Nations passed a resolution in the General Assembly with regard to guidelines for consumer protection in 1985.

The Indian government also decided to enact a separate law for consumer protection and, thus, was born the Indian Consumer Protection Act in 1986. The separate law for consumer protection provided better protection of consumer interests and made provisions for the establishment of consumer councils and other authorities for easy and effective settlement of consumer disputes. The Consumer Protection Act, 1986 (henceforth termed, Act) was comprehensive legislation with its main thrust on providing simple, speedy and inexpensive redressal of consumer

grievances under a three-tier quasi-judicial redressal agency at the district, state and national levels.

In the last two decades, there has been a tremendous increase in digital transactions. This era is characterised by the presence and dominance of e-commerce and digital branding. All these also have a bearing on customer expectations. Due to digitisation, consumers are now able to conveniently access a large variety of choice and can also make payments conveniently by using digital platforms. Overall, they are able to experience improved services and better shopping experience. Although digitisation has a lot of positive effects on the Indian market and consumers, they have also led to the development of certain consumer issues and made it necessary to make changes for consumer protection.

The Consumer Protection Act, 1986 remained effective from 1986 till recently. In August 2019, this Act was repealed and replaced by the Consumer Protection Act, 2019. This Act will come into effect on a date specified by the Central Government. As of December 12, 2019, the central government has not notified the date from which this Act will come into force.



STUDY HINT

Non-compliance of standard, price rigging, false representation of product or service to maximise the sale of particular goods or services comes under unfair trade practices.



SELF ASSESSMENT QUESTIONS

1. The Drugs and Cosmetics Act, 1940 is meant for protecting consumers from _____ by regulating the import, manufacturing, distribution and sale of drugs and cosmetics.
2. In August 2019, the Consumer Protection Act, 1986 was repealed. (True/False)



ACTIVITY 1

Download the United Nations Guidelines for Consumer Protection. Review and analyse the contents and write a summary report on various important and salient features of these guidelines.

8.3 RIGHTS OF CONSUMERS

A person who buys any good or avails any service for consideration is called a consumer. However, any person who obtains a good for resale or a service for commercial purpose is not considered as a consumer. The consumer may transact using either offline or online mode, such as electronic commerce, teleshopping, multi-level marketing or direct selling. Throughout the world, consumers have been bestowed with certain rights to protect their interests.

US President John F. Kennedy first outlined a vision of consumer rights in a special message to US Congress on 15th March, 1962 – the date which is now celebrated as the 'World Consumer Rights Day'. In his speech, he outlined the four basic consumer rights as follows:

1. **The right to safety:** The right to be protected against the marketing of goods and services which are hazardous to life and property.

2. **The right to be informed:** The right to be informed about the quality, quantity, purity, standard and price of goods or services, as the case may be, so as to protect the consumer against unfair trade practices.
3. **The right to choose:** The right to be assured of, wherever possible, access to a variety of goods and services at competitive prices.
4. **The right to be heard:** The right to be heard and to be assured that consumer's interests will receive due consideration.

Four more rights were added, as given below, by the international coalition of consumer groups in the 1980s:

1. **The right to satisfaction of the basic needs:** The right to have access to the basic, essential goods and services, such as food, clothing, shelter, health care, education, public utilities, water and sanitation.
2. **The right to redressal:** The right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers.
3. **The right to consumer education:** The right to be made duly aware of various consumer rights and the means to resolve issues.
4. **The right to a healthy environment:** The right to have a safe, clean, healthy and sustainable environment.

In addition to these eight rights, there are five more new rights of consumers, which are as follows:

1. **Right to file a complaint from anywhere:** Now consumers have the right to file a complaint with the District Consumer Commission or the State Consumer Commission from anywhere. Earlier, consumers had to file a case only at the place where the product was purchased or where the seller of the product has his registered office. The Department of Consumer Affairs under the Ministry of Consumer Affairs, Food and Public Distribution has been given the task of framing rules for electronic filing of complaints and also specify the norms for paying the fees digitally. This new change will make the process of filing complaints extremely convenient.
2. **Right to seek compensation under product liability:** The complainants have the right to file a case against the manufacturer or the seller of the product if the complainant has faced loss due to defective products or if the product does not conform to the express warranty. In such cases, the manufacturer or the seller can be held liable. This applies to e-commerce sellers also.
3. **Right to protect consumers as a class:** At times, there can be certain products or services the use of which does not violate any person's rights in individual capacity, but they may be harmful to the interests of all consumers as a class. For instance, unfair trade practices and misleading advertisements are harmful for all consumers as a class. In such cases, an individual may take the following action: he/she may forward a written or electronic complaint to the district collector or commissioner of regional office or to the Central Consumer Protection Authority (CCPA) for class action.
4. **Right to seek a hearing using video conferencing:** Whenever a complaint is filed, it is presented before the district commission along with an affidavit



Quick TIP

On 24th December, 1986, the President of India gave recognition and assent to the Consumer Protection Act, 1986, which highlighted six consumer rights. This day is also known as National Consumer' Day.

and documentary evidence. In the complaint application, the complainant may request for a hearing through video conference mode and the district commission has the right to allow it.

5. **Right to know why a complaint was rejected:** It is mandatory for all the commissions to hear the complainant without which they cannot reject any complaint. Also, the commission has to admit or reject a complaint within 21 days after receiving such complaint and if such a decision is not made, it is assumed that the complaint has been admitted.



**SELF
ASSESSMENT
QUESTIONS**

3. The right to be made duly aware of various consumer rights and the means to resolve issues is called the _____.
4. Product liability does not apply in case of e-commerce. (True/False)

8.4 CONSUMER PROTECTION ACT, 2019

The Consumer Protection Act, 2019 is the latest and most important law that has been enacted in India for protecting the interests of consumers. Let us study about objectives, scope and features of this Act in the upcoming sections. The differences between the 1986 and 2019 versions of the Consumer Protection Act are also discussed in an upcoming section.

8.4.1 OBJECTIVE AND SCOPE OF CONSUMER PROTECTION ACT, 2019

The major objective of the Consumer Protection Act, 2019, as laid down in the official gazette, is to protect and strengthen the rights of consumers and establish authorities for timely and effective administration, and settlement of consumers' disputes. The objectives of the Consumer Protection Act, 2019 are:

- Simplifying the consumer grievance redressal process
- Deploying a grievance redressal mechanism in a manner as to dispose off the consumer complaints swiftly
- Helping in disposing the already existing and pending cases in consumer courts throughout India

It has already been mentioned that prior to the Consumer Protection Act, 2019, the Consumer Protection Act, 1986 was in place. The reasons for repealing the old Act and replacing with an entirely new Act are as follows:

- Changes in the nature of consumer markets from physical to a combination of physical and digital
- Development of complex products and services
- Globalised supply chains
- Increase in international trade
- Increase in e-commerce

- Introduction of new delivery systems for goods and services
- Consumers are now much more vulnerable to unfair and unethical practices in trade and business
- Misleading advertisements
- Rise of telemarketing, multi-level marketing, direct selling and e-tailing

The Consumer Protection Act, 2019 is an exhaustive consumer protection law and it extends to the whole of India (Scope of the Act).

8.4.2 CONSUMER PROTECTION ACT, 1986 VS. CONSUMER PROTECTION ACT, 2019

Some of the key differences between the old and the new Consumer Protection Act are listed in Table 1:

TABLE 1: Differences Between the Consumer Protection Act, 1986 and the Consumer Protection Act, 2019

S. No.	Parameter	Consumer Protection Act, 1986	Consumer Protection Act, 2019
1.	Applicability	The former Act considered all goods and services under the ambit of law. All free and personal services were excluded.	This new Act considers all goods and services including telecom, housing, construction, and all the modes of payments under its ambit. All free and personal services are excluded.
2.	Types of unfair practices	The old Act included six practices under unfair practices, including false representation, misleading advertisements, wrongful or deceitful permissions or expressions, etc.	This new Act added three types of practices to the already existing six as follows: (i) failure to issue a bill or receipt; (ii) refusal to accept a good returned within 30 days; and (iii) disclosure of personal information given in confidence, unless required by law or in public interest. Also, this law may notify that contests/lotteries are not considered as unfair trade practices.
3.	Product liability	There was no provision for product liability in this Act.	This new Act has a provision for product liability. A complainant may claim for product liability against the manufacturer, seller or service provider.
4.	Unfair contracts	There was no provision to deal with unfair contracts in this Act.	This new Act has a provision for unfair contracts. It also lists six contract terms that can be held as unfair.

S. No.	Parameter	Consumer Protection Act, 1986	Consumer Protection Act, 2019
5.	Central Protection Councils (CPCs)	In the former Act, the CPC's role was to promote and protect the rights of consumers. And the CPCs were established at three levels, namely district, state and national levels.	In this new Act, the CPCs have been made as advisory bodies for promotion and protection of consumer rights. Here also, they follow the same three-tier structure of district-, state- and national-level CPCs.
6.	Regulator	In the former Act, there was no regulator to oversee the CPCs.	In the new Act, the Central Consumer Protection Authority (CCPA) has been created as the regulator and its work is to promote, protect and enforce the rights of consumers as a class. It is very well within the powers of the CCPA to: Issue safety notices Pass orders to recall goods, prevent unfair practices, and reimburse purchase price paid Impose penalties for false and misleading advertisements
7.	Pecuniary Jurisdiction of Commissions	In the former Act, the district commissions were allowed to take up cases whose valuation was up to ₹ 20 lakhs. State commissions could take up cases whose valuation was in the range of ₹ 20 lakhs and ₹ 1 crore. National commissions could take up cases whose valuation was above ₹ 1 crore.	In the new Act, district commissions are allowed to take up cases whose valuation is up to ₹ 1. State commissions can take up cases whose valuation is in the range of ₹ 1 crore and ₹ 10 crores. National commissions can take up cases whose valuation was above ₹ 10 crores.
8.	Composition of Commissions	In the former Act, the district commissions were headed by current or former district judges and two members; the state commissions were headed by a current or former High Court Judge and at least two members; and the national commission was headed by a current or former Supreme Court Judge and at least four members.	In the new Act, the district commissions are headed by a President and at least two members; the state commissions are headed by a President and at least four members; and the national commission is headed by the President and at least four members.

S. No.	Parameter	Consumer Protection Act, 1986	Consumer Protection Act, 2019
9.	Appointment	In the former Act, a selection committee comprising a judicial member and other officials used to recommend the members for the three levels of commissions.	In the new Act, there is no provision for constituting any selection committee and the central government appoints the members through notification.
10.	Alternate Dispute Resolution (ADR)	In the former Act, there was no provision for ADR.	In the new Act, there is a provision to attach mediation cells to the district, state and national commissions.
11.	Penalties	Under the former Act, penalty and punishment for a person not complying with orders of commissions was imprisonment between one month and three years or a fine between ₹ 2,000 and ₹ 10,000 or both.	Under the new Act, the penalty and punishment for a person not complying with orders of the commissions is imprisonment up to three years or a fine between ₹ 25,000 and ₹ 1,00,000 or both.
12.	E-commerce	In the previous Act, there was no provision or definition for e-commerce transactions.	In the new Act, the terms, such as direct selling, e-commerce and electronic service provider have been defined. Also, it is expected that the central government may prescribe rules related to e-commerce and direct selling in order to prevent unfair trade practices.
13.	Structure of the Act	In the previous Act, there were only 31 sections divided into 4 chapters.	In the new Act, there are 107 sections divided into 8 chapters.

The new Act also contains definitions for a range of terms including:

- Advertisement
- Central Authority
- Consumer Rights
- Design
- Direct Selling
- Director-General
- E-commerce
- Electronic Server Provider
- Endorsement
- Establishment
- Express Warranty
- Harm
- Injury
- Mediation
- Mediator
- Misleading Advertisement
- Product and Product Liability
- Product Liability Action
- Product Manufacturer
- Product Seller
- Product Service Provider
- Regulator
- Unfair Contract

Important Concept
 Pecuniary jurisdiction is the ability of a court to hear a case depending upon the amount of money involved or the valuation of the case.

Apart from these, some important definitions that have been included in the Consumer Protection Act, 2019 are as follows:



NOTE

In the Consumer Protection Act, 2019, the word 'telecom' has been added in the definition of service. It means that telecom services are covered under this Act.

- **Complainant:** A complainant means any consumer or any voluntary registered consumer association or central/state government or central authority or one or more consumers in case all of them have the same interests or legal heir or representative of a consumer in case of his death or the parent or guardian of the consumer in case of a minor.
- **Consumer:** A person who buys any goods or avails any services either through offline or online mode or through teleshopping or direct selling or multi-level marketing is considered as a consumer.
- **Deficiency:** Any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance or any act of negligence, omission or commission which causes loss or injury to the consumer is called deficiency.
- **Goods:** Goods mean any movable property which also includes food as defined in Section 3 (1) (j) of the Food Safety and Standards Act, 2006.

8.4.3 | KEY FEATURES OF THE CONSUMER PROTECTION ACT, 2019

Some of the key features of the Consumer Protection Act, 2019 are as follows:

- Provision of 'Product Liability' has been introduced. This provision will discourage the providers of goods and services from selling and delivering defective or deficient products or services.
- All e-commerce transactions related to purchase and sale of goods/services have been included in the new Consumer Protection Act.
- The new act provides for the setting up of a Central Consumer Protection Authority (CCPA) to promote, protect and enforce the rights of consumers as a class.
- Pecuniary jurisdiction of the district, state and national commissions has been increased substantially.
- The process of dispute resolution has been simplified.
- Higher penalties.
- Complaints can be filed for misleading advertisements and adulterated products.
- An application is deemed to be admitted after 21 days.
- Consumer commissions have been empowered to enforce their orders.
- E-filing facility.
- Provision for video-conferencing.
- Provision for Alternate Dispute Resolution (ADR) and mediation has been inserted.



**SELF
ASSESSMENT
QUESTIONS**

5. The new Act provides for the setting up of a Central Consumer Protection Authority (CCPA) to promote, protect and enforce the rights of _____.
6. What is the pecuniary jurisdiction of the National Commission?



ACTIVITY 2

Find out whether or not the healthcare services are covered under the Consumer Protection Act, 2019.

8.5 CONSUMER DISPUTES REDRESSAL MECHANISM UNDER CONSUMER PROTECTION ACT, 2019



NOTE

Consumer Disputes Redressal Commissions are also known as Consumer Courts.

Under the new Consumer Protection Act, 2019, multiple bodies will be set up. For instance, under this Act, Consumer Protection Councils (CPCs) will be set up at three levels. A regulatory body named Central Consumer Protection Authority (CCPA) will also be set up. Consumer Disputes Redressal Commissions (CDRCs) will also be set up at three levels.

Let us now study about the work, purpose and objectives of various bodies established under the Act.

8.5.1 CONSUMER PROTECTION COUNCILS (CPCs)

Under this Act, CPCs will be formed at three levels, namely central, state and district levels.

Central Consumer Protection Council (Central Council)

A Central Consumer Protection Council (CCPC), also known as Central Council, will be formed by the central government. The Central Council will be an advisory council and the chairperson of this council is the Minister in-charge of the Department of Consumer Affairs. The Central Council should meet at least once in a year, but it may meet as frequently as required. The major objective of the Central Council is to provide advice with respect to the promotion and protection of consumers' rights under this Act at the national level.

State Consumer Protection Council (State Council)

Under this Act, every state is required to establish a State CPC (SCPC) which is also known as State Council. The State Council will be an advisory council and the chairperson of this council is the Minister in-charge of Consumer Affairs in the State Government. The State Council should meet at least twice in a year, but it may meet as frequently as required. The major objective of the State Council is to provide advice with respect to the promotion and protection of consumers' rights under this Act within the state.

District Consumer Protection Council (District Council)

Under this Act, every state is required to establish a District CPC (DCPC) for every district, also known as District Council. The District Council will be an advisory

council and the chairperson of this council will be the Collector of the district. The District Council should meet at least twice in a year, but it may meet as frequently as required. The major objective of the District Council is to provide advice with respect to the promotion and protection of consumers' rights under this Act within the district.

8.5.2 | CENTRAL CONSUMER PROTECTION AUTHORITY (CCPA)

Under the former Consumer Protection Act, 1986, there was no dedicated authority to look into the matters and take suitable actions to prevent unfair trade practices and consumer rights' violations. However, under the new Act of 2019, the Central Government will establish a regulatory authority known as Central Consumer Protection Authority (CCPA), which is also known as the Central Authority. The objective of CCPA is to:

- Regulate matters related to the violation of rights of consumers
- Regulate unfair trade practices
- Regulate false or misleading advertisements
- Promote, protect and enforce the rights of consumers as a class

It is well within the powers of the CCPA to initiate an enquiry into the consumer rights' violations and unfair trade practices in any of the following cases:

- After receiving a complaint
- After receiving directions from the central government
- After taking *suo motu* cognizance of the irregularities

The CCPA has also been empowered to file complaints under the Act so that it may proactively take steps in order to prevent violation of consumer rights and to undertake suitable action against defaulting parties.

The CCPA is headed by the Chief Commissioner. The Authority also comprises other commissioners that are appointed by the central government. The headquarters of the CCPA would be located at a place within the National Capital Region (NCR). However, its regional offices can be located at multiple places throughout India. The central government has power to notify the rules with respect to the Chief Commissioner and other commissioners as follows:

- Qualifications for appointment
- Method of recruitment
- Procedure for appointment
- Term of office
- Salaries and allowances
- Resignation
- Removal
- Other terms and conditions of service



NOTE

False and misleading advertisements need to be regulated because they are harmful for public and consumers as a class.



Quick TIP

The phrase 'Consumers as a Class' is used to refer to all customers together.

The Central Authority has the authority to engage any number, as it deems necessary, of experts and professionals who have knowledge and expertise in matters related to consumer rights and welfare, consumer policy, law, medicine, food safety, health, engineering, product safety, commerce, economics, public affairs or administration.

With respect to the administrative matters of the CCPA, the Chief Commissioner enjoys powers of general superintendence, direction and control. Under CCPA, an Investigation Wing will be established. This wing will be headed by a Director-General for conducting enquiry and investigation in matters that are brought to it.

If the District Collector of a district receives a complaint or receives a matter referred to him/her by the Central Authority or from any Commissioner of a regional office, he/she must inquire into the complaint. Any nature of complaint, such as violation of rights of consumers as a class, violation of consumer rights, unfair trade practices, false or misleading advertisements, etc., must be inquired into as far as that complaint falls within his/her jurisdiction. After conducting the enquiry, he/she has to submit his report to the Central Authority or to the Commissioner of a regional office (the same source through which the complaint was received).

Any individual can file a complaint in either writing or through electronic mode to the District Collector or the Commissioner of the regional office or to the CCPA in case of violation of consumer rights, unfair trade practices, misleading advertisements, etc., which are harmful to the interests of consumers as a class.

The powers and functions of the CCPA as contained in Section 18 of the Act are as follows:

- *Protect, promote and enforce rights of consumers as a class, and prevent violation of consumers' rights.*
- *Prevent unfair trade practices and ensure that no person engages himself in unfair trade practices.*
- *Ensure that no false or misleading advertisement is made of any goods or services which contravenes the provisions of this Act.*
- *Ensure that no person takes part in the publication of any false or misleading advertisement.*
- *Enquire or order an investigation into violations of consumers' rights or unfair trade practices, either suo motu or on a complaint received or on the directions from the Central Government.*
- *File complaints before the District Commission, the State Commission or the National Commission.*
- *Intervene in any proceedings before the District Commission or the State Commission or the National Commission in respect of any allegation of violation of consumer rights or unfair trade practices.*
- *Review the matters relating to, and the factors inhibiting enjoyment of, consumer rights, including safeguards provided for the protection of consumers under any other law for the time being in force and recommend appropriate remedial measures for their effective implementation.*
- *Recommend adoption of international covenants and best international practices on consumer rights to ensure effective enforcement of consumer rights.*

- Undertake and promote research in the field of consumer rights.
- Spread and promote awareness on consumer rights.
- Encourage non-Governmental organisations and other institutions working in the field of consumer rights to co-operate and work with the consumer protection agencies.
- Mandate the use of unique and universal goods identifiers in such goods, as may be necessary, to prevent unfair trade practices and to protect consumers' interest.
- Issue safety notices to alert consumers against dangerous or hazardous or unsafe goods or services.
- Advise the Ministries and Departments of the Central and State Governments on consumer welfare measures.
- Issue necessary guidelines to prevent unfair trade practices and protect consumers' interest.



NOTE

Before finalising any order, the CCPA must hear arguments of services or goods provider against whom it is passing an order.

On receiving a complaint and upon preliminary investigation, if the Central Authority is satisfied and there is sufficient evidence to prove that violation of consumer rights or unfair trade practices by a person has indeed occurred, then the CCPA may order one of the following three actions:

1. Recall goods or withdraw dangerous, hazardous or unsafe services.
2. Reimburse purchasers against the price of goods or services recalled.
3. Discontinue unfair practices that are harmful to consumers' interest.

Apart from these three actions, the CCPA may also impose a penalty of up to ₹ 10 lakhs on the manufacturer or endorser of the good/service for the first contravention/offence. For the subsequent contraventions, the CCPA may impose penalty amount up to ₹ 50 lakhs. Also, if the CCPA deems it necessary, it may order that the endorser of such false and misleading advertisement be prohibited from endorsing any good/service for a maximum period of one year for the first offence. For the subsequent contraventions, the period of prohibition may extend up to 3 years.

If any person has been aggrieved by any order passed by the CCPA, then, he/she may file an appeal with the National Commission within 30 days of receiving such an order.

The CCPA must maintain its accounts and records and also prepare an annual statement of accounts in the prescribed manner. It is essential because the accounts of CCPA will be audited by the Comptroller and Auditor-General (CAG) of India at regular intervals. The CCPA is also required to prepare an annual report containing the details of its activities in the previous year.

8.5.3 CONSUMER DISPUTES REDRESSAL COMMISSIONS (THREE-TIER CONSUMER DISPUTES REDRESSAL)

All applications or complaints related to consumer disputes can be handled by consumer courts which have been developed in a three-tier structure. Consumer courts are set up at district, state and national levels.

District Consumer Disputes Redressal Commission (DCDRC)

The District Consumer Disputes Redressal Commission (DCDRC) is also called District Commission or District Forum or District Consumer Court. Each state government must establish a District Commission in each of its districts. Each District Commission consists of one President and a particular number of members not less than two as decided upon by State Government after consulting the central government. Various rules related to different aspects of the President and other members of the District Commission, such as their qualifications, methods of recruitment, procedure for appointment, term of office, salaries and allowances, resignation and removal are decided by the Central Government.

Employees and officers that are required by a District Commission for discharging its duties and functions are provided by the State Government. The District Commission can admit and handle all complaints which fall within its jurisdiction and where the consideration paid for goods or services is not more than ₹ 1 crore. This amount may be revised by the Central Government if it deems it necessary.

A complaint may be filed in a written or electronic form with the District Commission by the consumer or by any consumer association or by one or more consumers or by the State Government or by the Central Government or by the CCPA. The complaint must be accompanied with the required amount of fees.

Every case proceeding must be conducted by the President and at least one more member of the commission. After the President receives the complaint, he may decide to admit or reject the same. No application can be rejected by the President if the complainant has not been heard. The President has to decide whether to admit or reject within a period of 21 days and if no decision is made by these number of days, the complaint is deemed to be admitted automatically.

After admitting the case and during the proceedings of the case, if the District Commission finds that there exists certain elements of settlement which might be acceptable to both the parties, then the District Commission may ask the parties to settle their matter through mediation after they have submitted an application for the same within five days. If the parties are able to settle their matters through mediation, the provisions relating to Chapter V – Mediation of the Act shall apply. However, if parties fail to settle their matter through mediation, the District Commission proceeds with the case. After admitting the case, a copy of complaint is provided to the party against which a case has been filed within 21 days of admitting. The other party has to provide their reply within 30 days.

After the case hearing is over and the district commission is satisfied that the goods against which complaint was made contain defects or if the complaints made against service or unfair trade practices are proved right or claims for product liability are proved right, then the District Commission has the right to order for replacement or return of goods along with ordering for providing compensation to the complainant. Apart from these, the District Commission may also order:

- Paying compensation as product liability action
- Removing defects in goods or deficiencies in services
- Discontinuing unfair or restricted trade practices and not repeat
- Not offering hazardous or unsafe goods for sale

- Withdrawing hazardous goods so that they may not be offered for sale
- Ceasing the manufacturing of hazardous goods
- Abstain from offering hazardous services
- Broadcasting corrective advertisements in order to neutralise the effect of misleading advertisement
- Discontinuing and abstaining from airing any misleading advertisements

If any of the orders passed by the District Commission appears to be erroneous, then the District Commission has the power to review its order by its own motion or on the basis of an application received from any of the parties. However, such an application has to be filed within 30 days of the order. The parties also have the option to file a review with the State Commission within 45 days of such an order.

State Consumer Disputes Redressal Commission (SCDRC)

The State Consumer Disputes Redressal Commission (SCDRC) is also called State Commission or State Consumer Court. Each state government must establish a State Commission in its state which is ordinarily located in the state capital. Each state commission consists of a President and not less than four members decided upon by the State Government after consulting the central government. Various rules related to different aspects of the President and other members of the State Commission such as their qualifications, methods of recruitment, procedure for appointment, term of office, resignation and removal are decided by the Central Government. The rules for deciding the salary and allowances of the President and other members of the State Commission shall be taken by the State Government. Employees and officers that are required by a State Commission for discharging its duties and functions are provided by the State Government.



NOTE

If any terms of a contract are unfair to any consumer, they may be declared as null and void by the State Commission.

The State Commission can admit and handle all complaints which fall within its jurisdiction and where the consideration paid for goods or services is more than ₹ 1 crore, but less than ₹ 10 crores. This amount may be revised by the Central Government if it deems it necessary. Apart from such cases, the State Commission shall also entertain appeals that have been filed against orders of the District Commissions.

If any of the orders passed by the State Commission appears to be erroneous on the face of it, then the State Commission has the power to review its order by its own motion or on the basis of an application received from any of the parties within 30 days of such an order. The parties also have the option to file a review with the National Commission within 30 days of such an order.

All the complaints filed with the State Commissions and the National Commissions should ideally be disposed off within 90 days after admitting such a complaint.

National Consumer Disputes Redressal Commission (NCDRC)

The National Consumer Disputes Redressal Commission (NCDRC) is also called National Commission or National Consumer Court and it is established by the Central Government. The National Commission should be located in the National Capital Region (NCR). The National Commission comprises a President and not less than four members.

Various rules related to different aspects of the President and other members of the National Commission, such as their qualifications, methods of recruitment, procedure for appointment, term of office, salaries and allowances, resignation and removal are decided by the Central Government.

The National Commission can admit and handle all the complaints which fall within its jurisdiction and where the consideration paid for the goods or services is more than ₹ 10 crores. This amount may be revised by the Central Government if it deems it necessary. The National Commission may also hear appeals against the orders of the State Commission and the CCPA.

If any of the orders passed by the National Commission appears to be erroneous on the face of it, then the District Commission has the power to review its order by its own motion or on the basis of an application received from any of the parties within 30 days of the order.

If in any case, the National Commission passes any order on *ex parte* basis, then the aggrieved party can make an application for setting aside such an order.

Upon receiving an application from a complainant or on its own, the National Commission or the State Commission may be of the opinion that such an application is in the interest of a large number of consumers. In such a case, the State or the National Commission has the power to direct any individual or organisation or expert to assist the said Commission.

Any party that has been aggrieved by an order made by the National Commission, may file an appeal against such order in the Supreme Court of India within 30 days of such an order.

The National Commission has the power to develop certain standards for better protecting the interests of consumers after duly consulting the Central Government. The National Commission also has administrative control over all the State Commissions in respect of the following:

- Monitoring the status of disposal and pendency of cases
- Investigating the allegations made against the President or any member of a State Commission
- Issuing instructions for hearing of matters
- Issuing instructions on how to service of copies of documents produced by one party to the opposite parties
- Issuing instructions for furnishing English translation of judgments that are originally produced in any state language
- Overseeing the functioning of the State Commission and District Commission by inspection or other means

The President of the National Commission constitutes the monitoring cells which oversee the administrative functioning of the State Commissions.

8.5.4 | MEDIATION

The mediation cells will be established at three levels, namely district level, state level and national level. The State Government has to establish consumer

mediation cells attached to each District Commission and State Commission in the state. And, the Central Government has to establish a consumer mediation cell attached to the National Commission and for each of its regional benches. The number, qualifications, etc., of the members to be included in each mediation cell must be prescribed by the State/Central Government as the case may be.

It will be the duty of the mediation cells to maintain a list of all its empanelled members (mediators) and all the cases that it is handling. It also has to keep a record of all its proceedings. Each mediation cell also has to submit a report with respect to its functioning on a quarterly basis with the District, State or National Commission to which it is attached. The members of the mediation cells are selected by the President and other members of the concerned commission. Each member of the mediation cell is appointed for a term of 5 years. It is the duty of mediators in the mediation cell to disclose certain facts, such as any personal, professional or financial interest in the outcome of the consumer dispute or any circumstances owing to which a doubt can be raised with respect to his/her independence or impartiality.



NOTE

Mediators must follow principles of natural justice while carrying out the mediation process.

When parties to a dispute are able to reach some agreement over all or some points of dispute, all terms of all such agreement are converted into a written form and must be signed by both the parties or their authorised representatives. In such a case, the mediator prepares a report of settlement and along with the agreement sends it to the concerned commission.

When the concerned commission receives such a report, he/she has to pass a suitable order within 7 days after receiving the settlement report and disposes off the matter accordingly.

In those cases where the agreement has been reached only on some issues, the concerned commission will record issues that have been settled and continue to hear the issues which could not be resolved through mediation.

There may be certain cases in which the parties fail to agree on any of the issues and the mediation stands failed. In these cases, a mediation failed report has to be sent to the concerned commission and the case would be taken up accordingly.

8.5.5 | PRODUCT LIABILITY

Product liability (claim for compensation) can be claimed in the following cases:

- Harm has been caused by a defective product manufactured by a product manufacturer
- Harm has been caused as a result of some service/product service provider/seller

A complainant has the right to bring a product liability action against a product manufacturer or a product seller or a service provider if he/she has suffered harm due to a defective product or service. However, in such product liability actions, the complainant has to prove that the harm caused to him/her was due to the product/service of the defendant.

A product manufacturer can be held liable in the following cases:

- Product has a manufacturing defect.
- Product has a defective design.
- Product is not as per the manufacturing specifications.
- Product is in non-conformance of the express warranty.
- Product does not contain adequate instructions regarding the proper and correct usage of the product so that no harm is caused as a result of incorrect usage.

In any product liability action, product manufacturers would be held liable even if they are able to prove that they were not negligent or fraudulent in making the express warranty of a product.

A product service provider can be held liable in the following cases:

- Service provided by the service provider was faulty, imperfect, deficient, inadequate in terms of quality, nature or manner of performance
- Act of omission or commission
- Conscious withholding of any information due to which harm was caused
- Failure of the service provider to issue adequate instructions or warnings to prevent any harm
- Non-conformance to express warranty
- Non-conformance with respect to the terms and conditions of the contract

A product seller can be held liable in the following cases:

- If the seller had exercised substantial control over the designing, testing, manufacturing, packaging or labelling of a product due to which harm was caused
- If the seller had altered or modified the product due to which harm was caused
- If the seller has made an express warranty of a product independent of any express warranty made by a manufacturer and the harm was caused due to failure of such express warranty
- If the seller fails to exercise reasonable care in assembling, inspecting or maintaining the product
- If the seller fails to convey the warnings or instructions of the product manufacturer with respect to the dangers involved, proper usage of the product, and the cause of harm was such failure

Certain cases under which product liability action can be exempted are as follows:

- If the product was misused, altered, or modified at the time of harm, no product liability action can be taken against the product seller.

- If the product was originally meant only for use legally under the supervision of an expert(s) and the manufacturer had provided warnings or instructions for the same.
- If the product was originally sold for being used as a component in another product and all the required warnings and instructions were given in this regard, but the harm was caused to the purchaser/complainant as a result of the product along with which the product was meant to be used.
- If the complainant is under the influence of alcohol or any other prescription drug at the time of using the product which had not been prescribed by any medical practitioner.
- If the complainant suffers harm due to his/her failure to take care of the precautions that are commonly known to users of such products, then the manufacturer shall not be held liable.

8.5.6 OFFENCES AND PENALTIES

Penalties and punishment for different types of offences under this Act are as follows:

- Anyone who fails to comply with the orders of the CCPA can be punished with imprisonment extending up to six months or a fine of ₹ 20 lakhs or both.
- Manufacturers engaging in misleading or false advertisements that are harmful to the interest of consumers can be punished with an imprisonment of up to 2 years and a fine that may extend up to ₹ 10 lakhs for first offence. For each subsequent offence, the manufacturer may be imprisoned for a term of five years and a fine that may extend to ₹ 50 lakhs.
- There are different types of punishments and penalties for persons who manufacture or store or sell or distribute or import any products that contain adulterants for sale:
 - i. If such an adulterated product does not harm the consumer, the manufacturers, distributors, etc., can be imprisoned for up to six months and a fine that may extend up to ₹ 1 lakh.
 - ii. If such an adulterated product causes a non-grievous harm to the consumer, the manufacturers, distributors, etc., can be imprisoned for up to one year and a fine that may extend up to ₹ 3 lakhs.
 - iii. If such an adulterated product causes a grievous harm to the consumer, the manufacturers, distributors, etc., can be imprisoned for up to seven years and a fine that may extend up to ₹ 5 lakhs.
 - iv. If such an adulterated product results in the death of the consumer, the manufacturers, distributors, etc., can be imprisoned for not less than seven years and a fine that will not be less than ₹ 10 lakhs.



Quick TIP

Adulterant refers to any extraneous matter or substance the use of which makes a product unsafe.

In all these four cases, the court may also order for suspending the license for a period of two years for the first offence and may cancel the license permanently for the subsequent offences.



EXHIBIT

Grievous hurt has been defined in Section 320 of the Indian Penal Code (IPC) as follows:

- Emasculation
- Permanent privation of the sight of either eye
- Permanent privation of the hearing of either ear
- Privation of any member or joint
- Destruction or permanent impairing of the powers of any member or joint
- Permanent disfiguration of the head or face
- Fracture or dislocation of a bone or tooth
- Any hurt which endangers life or which causes the sufferer to be during the space of twenty days in severe bodily pain, or unable to follow his ordinary pursuits

- There are different types of punishments and penalties for persons who manufacture or store or sell or distribute or import any spurious products for sale:
 - i. If such a spurious product causes non-grievous harm to the consumer, manufacturers, distributors, etc., can be imprisoned for up to one year and a fine that may extend up to ₹ 3 lakhs.
 - ii. If such a spurious product causes grievous hurt to the consumer, the manufacturers, distributors, etc., can be imprisoned for up to seven years and a fine that may extend up to ₹ 5 lakhs.
 - iii. If such spurious product results in the death of the consumer, the manufacturers, distributors, etc., can be imprisoned for not less than seven years and a fine that will not be less than ₹ 10 lakhs.

In all these three cases, the court may also order for suspending the license for a period of two years for the first offence and may cancel the license permanently for subsequent offences.

All those cases in which the consumer suffers a grievous hurt or dies due to adulterated or spurious products are cognizable and non-bailable.

- All those cases of vexatious search in which the Director-General or any other officers order for search or seizure of records/documents without having any reasonable grounds can be imprisoned for a term of one year or a fine extending up to ₹ 10,000 or both.



**SELF
ASSESSMENT
QUESTIONS**

7. Under the Consumer Protection Act, 2019, _____ is also known as the Central Authority.
8. The CCPA has the power to order for recall of products. (True/False)

8.6 SUMMARY



- To protect the interests of consumers, governments keep enacting laws regularly. These include the Indian Penal Code, 1860, the Indian Contract Act, 1872, the Indian Sale of Goods Act, 1930, the Bureau of Indian Standard Act, 1986, the Drugs and Cosmetics Act, 1940, the Prevention of Food Adulteration Act, 1954, etc.
- These Acts were meant to protect the consumer interests, but none of these Acts was complete and effective in achieving the desired goals which led to the creation of the Consumer Protection Act, 1986, which was followed by the enactment of the Consumer Protection Act, 2019.
- Some important consumer rights include:
 - The right to safety
 - The right to be informed
 - The right to choose
 - The right to be heard
 - The right to satisfaction of the basic needs
 - The right to redressal
 - The right to consumer education
 - The right to a healthy environment
 - The right to file a complaint from anywhere
 - The right to seek compensation under product liability
- The objectives of the Consumer Protection Act, 2019 are to simplify the consumer grievance redressal process and deploy a grievance redressal mechanism to dispose off consumer complaints swiftly.
- Some key differences between the Consumer Protection Act, 1986 and the Consumer Protection Act, 2019 are as follows:
 - This new Act has a provision for product liability.
 - Establishment of the Central Consumer Protection Authority (CCPA) in the new Act.
 - Increased pecuniary jurisdiction in the new Act.
 - Provision of mediation in the new Act.
 - Inclusion of e-commerce transactions in the new Act.
- Under the new Act, the Consumer Protection Councils (CPCs) will be formed at three levels, namely central, state and district levels.
- Under the new act of 2019, the Central Government will establish a regulatory authority known as Central Consumer Protection Authority (CCPA), which is also known as the Central Authority.
- All applications or complaints related to consumer disputes can be handled by consumer commissions (courts) which have been developed in a three-

tier structure. The consumer courts are set up at district, state and national levels.

- The State Government has to establish consumer mediation cells attached to each District Commission and State Commission in the state. And, the Central Government has to establish a consumer mediation cell attached to the National Commission and for each of its regional benches.
- A complainant has the right to bring a product-liability action against a product manufacturer or a product seller or a service provider if he/she has suffered harm due to a defective product or service.

8.7 KEY WORDS



- **Consumer dispute:** The Consumer Protection Act, 2019 defines a consumer dispute as a dispute where the person, against whom a complaint has been made, denies or disputes the allegations contained in the complaint
- **Consumer grievance:** A consumer grievance or consumer complaint refers to the allegations levelled against a person or a company in writing or through online mode and the purpose of such a complaint is to obtain a certain relief
- **Hoarding:** An act of collecting or accumulating something such as food or money in a secret place beyond the limits that have been prescribed for such things
- **Official gazette:** A public and legally authorised document of the Indian Government that is published on a weekly basis
- **Product liability:** The legal liability of a seller or manufacturer of a good or service that he incurs as a result of selling faulty products
- **Profiteering:** A practice of seeking unfair profits
- **Prosecution:** Act of charging someone with certain crime(s) and putting them under trial
- **Repeal:** A term used to refer to the annulment of laws that become obsolete
- **Restrictive trade practice:** Any act related to trade, which is deceptive, fraudulent or hurts a consumer
- **Spurious drugs:** The counterfeit drugs are the drugs that resemble some other popular drugs to mislead and cheat the buyers and to take advantage of the popularity of the original drugs

8.8 CASE STUDY: CONSUMER AWARENESS STUDY AT JALNA CITY, MAHARASHTRA



It is a commonly held view that 'Customer is the King'. But, do the Indian manufacturers and service providers actually go by this adage. Not really. Due to lack of information or due to misinformation or due to fraudulent and misleading tactics of manufacturers, customers often become the victims of unfair trade practices, are exploited, and may even suffer financially and/or physically. The level of consumer awareness is directly related to the satisfaction level and the standard of living of consumers.

It is important for consumers to be aware of their rights and all legal options that have been made available to them by the Indian government, such as the Sale of Goods Act, 1930 and the Consumer Protection Act, 2019.

Various studies conducted in the past have also shown that the level of consumer awareness in India remains low due to the following reasons:

- Illiteracy
- Indifferent attitude
- Ignorance of law
- Lengthy legal procedures

Indian consumers fall victim to various consumer rights' violations, such as the following:

- Inappropriate standard of goods and services
- False guarantees
- Exorbitant prices
- Fraudulent tactics

In India, as of 2014 data, it has been estimated that the overall illiteracy rate is 30.9%. This figure is even more in rural areas. There is a dire need to increase the levels of consumer awareness and increase the level of consumer education in India. In India, even the educated people are not very well aware of their rights and the laws that have been created for their protection.

In 2006, Dr. Murlidhar Lokhande published his study and findings in the Indian Journal of Marketing. The study was conducted in the Jalna city of Maharashtra and was related to the following aspects:

- Understand the level of consumer awareness in Jalna district
- Reaction of consumers with respect to the service-providing agencies
- Propose all possible suggestions to overcome problems related to consumer awareness

In our present case, we will present a synopsis of the study, its methodology and its findings.

Jalna is a small district in the Indian state of Maharashtra and the study is based on the field survey of 90 consumers living in Jalna. All respondents included in this sample were selected using random sampling. There were 50 (55.66%) male and 40 (44.44%) female respondents.

The findings of the study with respect to education, occupation, income, sources of finance and consumer awareness are as follows:

1. **Education:** Since illiteracy is a big obstacle in imparting consumer awareness education, an analysis of the education level of respondents was carried out and the results so obtained are shown in Table A:

TABLE A: Analysis of the Education Level of the Respondents

S. No.	Educational Qualification	No. of Respondents	Percentage
1.	Uneducated	7	7.78
2.	Primary School Pass	10	11.11
3.	Senior Secondary Pass	16	17.78
4.	Higher Senior Secondary Pass	24	26.67
5.	Graduate	25	27.77
6.	Post-graduate	08	8.89
		90	100

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

- Occupation:** Occupation of a person usually affects his choices, tastes, preferences and the purchasing power. An analysis of the occupations of the respondents was carried out and the results so obtained are shown in Table B:

TABLE B: Analysis of the Occupation of the Respondents

S. No.	Occupation	No. of Respondents	Percentage
1.	Business	23	25.55
2.	Service	34	37.78
3.	Housemaker	33	6.67
		90	100

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

It was also found that all 90 respondents were key decision makers in their respective families which meant that they had the maximum say in the purchase decisions of their homes.

- Income:** The income levels of the people usually determine the amount and the type of products and services they purchase. Therefore, an analysis of the income of the respondents was also carried out and the results so obtained are shown in Table C:

TABLE C: Analysis of the Income of the Respondents

S. No.	Monthly Income of Respondents	No. of Respondents	Percentage
1.	₹ 0 – 1000	14	15.56
2.	₹ 1000 – 5000	30	33.33
3.	₹ 5000 – 20000	26	28.89
4.	₹ 20,000 – Above	20	22.22
		90	100

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

4. **Sources of finance:** The consumers make purchases using various sources of finance. An analysis of the sources of finance of the respondents was also carried out and the results so obtained are shown in Table D:

TABLE D: Analysis of the Sources of Finance of the Respondents

S. No.	Source	No. of Respondents	Percentage
1.	Self-generated income	90	100
2.	Bank loans	49	54
3.	Money taken from the private money-lenders	18	20
4.	Money taken from relatives/friends	16	17.78
5.	Other sources	20	22.22

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

The analysis showed that 100% of respondents used their self-generated income as the primary source. Apart from this, 54.44% of the respondents also borrowed from banks. 20% of the respondents borrowed money from the private moneylenders. 17.78% of the respondents borrowed money from their relatives/friends. 22.22% of the respondents sought credit from sources, such as credit co-operative society or chit funds.

5. **Consumer awareness:** The level of consumer awareness was assessed in all 90 respondents by thorough discussions. The views of respondents with respect to products are shown in Table E:

TABLE E: Analysis of the Views of the Respondents w.r.t. products

S. No.	Source	No. of Respondents	Percentage
1.	Knowledge of consumer protection laws	40	44.44
2.	Prepared monthly budget	35	38.88
3.	Enquired before purchasing	71	78.88
4.	Goods were observed and duly checked	46	51.12
5.	Relied solely on the seller	25	27.77
6.	Purchase receipts were taken and read out	35	38.88
7.	Did not take purchase receipt	55	61.12
8.	Returned/Replaced goods when they were not as per the expectations	31	34.34
9.	Purchased only branched goods	67	74.44
10.	Used unbranded goods	23	25.56

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

The views of respondents with respect to the availability of services are shown in Table F:

TABLE F: Analysis of the Views of the Respondents w.r.t. Availability OD Services

S. No.	Source	No. of Respondents who think that Services were Adequate	Percentage
1.	Education	36	40.00
2.	Health	41	45.55
3.	Banking	45	50.00
4.	Telephone	38	42.22
5.	Insurance	60	66.67
6.	Electricity	32	35.55
7.	Drinking water	35	38.89
8.	Entertainment	40	44.44

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

The views of the respondents with respect to the unfair trade practices are shown in Table G:

TABLE G: Analysis of the Experiences of the Respondents w.r.t. Unfair Trade Practices

S. No.	Source	No. of Respondents	Percentage
1.	Inferior Quality	56	62.62
2.	Less quantity	14	15.56
3.	Look-alikes	28	31.11
4.	Adulteration	30	33.33
5.	Exorbitant price	35	38.89
6.	False guarantee	20	22.22

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

When the respondents were asked about the kind of action they had taken against the sellers who were at fault or had cheated them, approximately 63.33% of them had not lodged any formal complaint even after knowing that they were cheated. Only 27.78% of the respondents had complained to grahak panchayat and only 8.89% of the people had complained to the district forum. Nobody complained to the state or national level commissions. These are shown in Table H as follows:

TABLE H: Analysis of the Reactions of the Respondents w.r.t. Unfair Trade Practices

S. No.	Reaction Type	No. of Respondents	Percentage
1.	Complaint to grahak panchayat	25	27.78
2.	Complaint to district forum	8	8.89
3.	Complaint to state commission	0	0

S. No.	Reaction Type	No. of Respondents	Percentage
4.	Complaint to national commission	0	0
5.	No complaint	57	63.33
		90	100

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

The overall findings and the suggestions of this study are as follows:

- Only 55.56% of the respondents of Jalna were aware of the Consumer Protection Act and the redressal mechanism.
- Consumer awareness is essential for curbing any type of unfair practice or cheating.
- Audio-visual media should be used by the authorities to educate the consumers about their rights as a customer and what are the options available to them in case of fraud or cheating.
- Most of the people were in a habit of enquiring before purchasing anything.
- Consumers must take precaution while making purchases because the consumers are themselves responsible for any loss that is caused by their negligence.
- Majority of the customers received inferior goods.
- Consumers must take and retain the proof of purchase such as the bill and the warranty cards.

Source: https://www.researchgate.net/publication/267429905_Consumer_Awareness_-_A_Case_Study_of_Jalna_City

QUESTIONS

1. What percentage of the sample population purchased only branded products?
(Hint: 74.44%)
2. Comment on the reactions of consumers in cases where they were cheated.
(Hint: Majority of the consumers refrained from filing any formal complaint and were indifferent towards such behaviour of sellers.)

8.9 SHORT ANSWER QUESTIONS



1. A _____ can be held liable if he consciously withholds any information due to which harm was caused.
2. Each mediation cell has to submit a report with respect to its functioning on a _____ basis with the District, State or National Commission to which it is attached.
3. The Central Council will be an advisory council and the chairperson of this council is the Minister in-charge of the _____.

4. Under the Consumer Protection Act, 2019, an application is deemed to be accepted in _____ days.
5. The right to be assured of access to a variety of goods and services at competitive prices is called the right to _____.
6. In the last two decades, there has been a tremendous increase in the _____ transactions.
7. Product liability cannot be granted if the complainant suffers harm due to his/her failure to take care of the precautions that are commonly known to the users of such products. (True/False)
8. The National Commission also has an administrative control over all the State Commissions. (True/False)
9. The State Commission can entertain appeals that have been filed against the orders of the National Commission. (True/False)
10. Under CCPA, the Investigation Wing will be headed by an Inspector-General for conducting enquiry and investigation in matters that are brought to it. (True/False)
11. In case the Director-General engages in vexatious search, he can be fined a maximum amount of _____.
 - a. ₹ 1,00,000
 - b. ₹ 10,000
 - c. ₹ 50,000
 - d. ₹ 5,00,000
12. Which of the following bodies can take *suo motu* cognizance of the irregularities or the unfair trade practices?
 - a. National Commission
 - b. Supreme Court
 - c. National Council
 - d. Controlling Authority
13. The Meat Inspection Act, 1906 and the Federal Trade Commission Act, 1914 were some of the initial laws meant to protect the consumer rights of consumers residing in _____.
 - a. USA
 - b. UK
 - c. India
 - d. None of these
14. Areeb and Asha Manufacturers is found engaging in misleading advertisements that can harm the interest of consumers. This was proved in the district consumer court. The owners of Areeba and Asha Manufacturers will most probably be imprisoned for up to _____ years.
 - a. 1
 - b. 2
 - c. 5
 - d. 10
15. Which of the following Acts is meant to protect consumers from hoarding and profiteering of essential commodities by traders?
 - a. Standards of Weights and Measures (Enforcement) Act, 1985
 - b. The Essential Commodities Act, 1955
 - c. The Essential Commodities (Special Provisions) Act, 1981
 - d. All of these

16. Choose the odd one out.
- The right to live
 - The right to a healthy environment
 - The right to redressal
 - The right to satisfaction of basic needs
17. Which of the following is not an objective of the Consumer Protection Act, 2019?
- Helping in disposing off the already existing and pending cases in the consumer courts throughout India
 - Deploying a grievance redressal mechanism in a manner as to dispose off consumer complaints swiftly
 - Simplifying the consumer grievance redressal process
 - To administer all manufacturers
18. Which of the following is not true in the context of the Consumer Protection Act, 2019?
- Provisions for misleading advertisements
 - Complex products and services
 - Inclusion of e-commerce
 - Purely physical transactions
19. A seller discloses personal information given by his customer to him (in confidence). She is indulging in _____.
- Unfair trade practice
 - Monopolistic practice
 - Restrictive practice
 - None of these
20. In this new Act, the CPCs have been made as advisory bodies for promotion and protection of consumer rights. In CPC, the second C stands for
- Consumer
 - Complaint
 - Council
 - Commission
21. Which of the following is the correct pecuniary jurisdiction of the State Commission?
- ₹ 1 crore – ₹ 10 crores
 - ₹ 1 lakh – ₹ 10 lakhs
 - ₹ 10 lakhs – ₹ 1 crore
 - ₹ 10 crores – ₹ 100 crores
22. In case a spurious drug results in the death of a consumer, the manufacturer will be imprisoned for a term not less than _____.
- 1 year
 - 5 years
 - 10 years
 - 2 years
23. Which provision of the new Consumer Protection Act discourages the providers of the goods and services from selling and delivering defective or deficient products or services?
- E-commerce
 - Product liability
 - Mediation
 - Dispute resolution

24. If any party is aggrieved by an order made by the National Commission, it may file an appeal against such order in which of the following bodies?
 - a. No appeal can be filed after order of National Commission
 - b. Supreme Court of India
 - c. Any State Commission
 - d. International Court of Justice
25. Who selects the members of the mediation cell of the National Commission?
 - a. President of Commission
 - b. Vice President of India
 - c. President of India
 - d. Prime Minister of India

8.10 DESCRIPTIVE QUESTIONS



1. What are the major laws that have been created in India for the protection of consumers?
2. List and explain various rights that are enjoyed by Indian consumers.
3. Describe objectives, scope and features of the Consumer Protection Act, 2019.
4. Explain at least five key differences between 1986 and 2019 versions of the Consumer Protection Act.
5. Explain the role of various bodies under the Consumer Protection Act, 2019.
6. Explain the concept of mediation and product liability.

8.11 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Major Laws Concerning Consumer Protection	1.	spurious drugs
	2.	True
Rights of Consumers	3.	right to consumer education
	4.	False
Consumer Protection Act, 2019	5.	consumers as a class
	6.	Above ₹ 10 crores
Consumer Disputes Redressal Mechanism Under Consumer Protection Act, 2019	7.	Central Consumer Protection Authority (CCPA)
	8.	True

B. | SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	product service provider
2.	quarterly
3.	Department of Consumer Affairs
4.	21
5.	choose
6.	digital
7.	True
8.	True
9.	False
10.	False
11.	b. ₹ 10,000
12.	d. Controlling Authority
13.	a. USA
14.	c. 5
15.	b. The Essential Commodities Act, 1955
16.	a. The right to live
17.	d. To administer all manufacturers
18.	d. Purely physical transactions
19.	a. Unfair trade practice
20.	c. Council
21.	a. ₹ 1crore – ₹ 10 crores
22.	c. 10 years
23.	b. Product liability
24.	b. Supreme Court of India
25.	a. President of Commission

8.12 SUGGESTED BOOKS AND E-REFERENCES**SUGGESTED BOOKS**

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NOT

INTELLECTUAL PROPERTY RIGHTS IN INDIA

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Explain the concept of Intellectual Property Rights
- ▶▶ Elaborate on the legal environment surrounding Intellectual Property Rights (IPR)
- ▶▶ List and differentiate different types of IPR
- ▶▶ Describe various laws concerning IPR in India
- ▶▶ Discuss the alternate dispute resolution procedures for IPR related conflicts

9.1 INTRODUCTION



Read

Pre-read Connect

In the previous chapter, the various laws concerning consumer protection in India. The chapter also discussed the rights of consumers in India along with a detailed explanation of the Consumer Protection Act, 2019.

In the recent decades, the role of intellectual assets of businesses has become strategically important. This is especially from the perspective of international trade and dissemination of new technology from developed nations to other countries. Owing to the globalisation and emergence of multinational corporations in recent decades, the concept of Intellectual Property Rights (IPR) had acquired much greater significance and importance from the perspective of both the domestic and international businesses. This is why one of the major international and multilateral agreements reached by member countries after the formation of World Trade Organization (WTO) pertains to intellectual property resulting into the TRIPS (Trade Related Aspects of Intellectual Property Rights) agreement.

In this chapter, you will study how to protect the Intellectual Property Rights (IPR) of Business. Next, you will study about alternate dispute resolution. Towards the end of the chapter, you will be acquainted with the global IPR challenges.

9.2 PROTECTING THE INTELLECTUAL PROPERTY RIGHTS (IPRs) OF BUSINESS



NOTE

The World Intellectual Property Organization (WIPO) was established in 1970 to protect the Intellectual Property Rights (IPRs).

With regard to the laws that define and protect IPR, we should consider both the national and international laws. There is no universal definition of what is patentable or one law that governs patents across all countries. Every country has its own definitions of what is patentable and the regulatory laws governing the patents. However, an international organisation called World Intellectual Property Organisation (WIPO) meant for international cooperation between various countries with regard to patent laws is a specialised agency of the United Nations dealing with international treaties pertaining to intellectual property rights. There are two major conventions or treaties which are administered by WIPO. These treaties include Paris Convention and Berne Convention respectively for industrial inventions and copyrights. WIPO has also created an international treaty through which a single patent filed with WIPO by any company belonging to member countries can be directly processed with patent authorities of other countries.



STUDY HINT

According to **Bainbridge**, the subject matter of intellectual property is very wide and includes literary and artistic works, films, computer programs, inventions, designs and marks used by traders for their goods or services

In order to facilitate international trade, the World Trade Organisation has facilitated an international agreement termed “Trade Related Aspects of Intellectual Property Rights (TRIPS)” for its member countries. The TRIPS agreement makes the international trade involving IPR simpler and safer by ensuring its member countries to adhere to some minimum standards with regard to their IPR laws. With TRIPS in place, multinational companies can sell/market their new products with exclusive intellectual rights in other markets and countries without being afraid of patent infringement and legal protection.

India is a signatory of TRIPS agreement and had accordingly amended the various laws pertaining to patents since 1999. The amendments include the various provisions relating to definitions of patentable intellectual properties, the nature of exclusive rights and related elements.

There are two main branches of the Intellectual Property (IP) as follows:

- **Industrial property:** These include inventions, trademarks and industrial designs.
- **Copyright:** These include copyrights related to the literary, musical, artistic, photographic and cinematographic works.

9.2.1 | PATENTS

A 'Patent' is a document representing rights issued by a country (or a regional office acting for several countries), upon application, to the owner of an invention, to have exclusive right to make, use, manufacture and market the invention, provided the invention satisfies certain conditions stipulated in the relevant law. The patent offers exclusive rights which mean no one else can exploit the invention without the authorisation of the owner of the patent. Invention means a solution to a technical problem in the field of technology. The protection offered by the patent is limited in time which is generally 20 years. A patent in the law is a property right that can be gifted, inherited, assigned, sold or licensed. The patent right is territorial in nature and the inventors will have to file separate patent applications in countries of their interest.

 **Quick TIP**

Every patent is registered for 20 years from the filing date of the patent application.

There are two types of patents:

- **Utility patent (invention):** A utility patent prohibits other individuals or company from using, making or selling the invention without authorisation. It is also known as "patent for invention". Microwave ovens, networking method, online payment system, electronic cash, e-commerce, cash management account are some examples of utility patent.
- **Design patent (manufactured articles):** A design patent is a legal protection given to the unique visual qualities of a manufactured item. Some examples of design patent include the sole of running shoes, design of a water fountain, etc.

Conditions of Patentability

The conditions of patentability are (1) Novelty, (2) Inventive step, and (3) Industrial applicability. Novelty implies something new and which is not published, presented or otherwise disclosed (or not available in the 'prior art') to the public as on the date of the patent. The second condition 'inventive step' means non-obviousness. It implies that the invention involves technical advance as compared to existing knowledge and/or has economic significance making the invention obvious to a person skilled in the art.

'Industrial applicability' means the invention is capable of being made for industrial application, can be used in at least one field of activity and can be reproduced with the same characteristics as many times as necessary. However, it is possible that an invention may satisfy the three conditions stated above, but still may not qualify for a patent as per the Patents Act, 1970. These are listed in the Act. For example, following are some important things that are not patentable as per the Act:

- If the invention leads to a commercial exploitation that is contrary to the public order or morality or which causes serious prejudice to human, animal, plant, health or the environment

- A mere discovery of a scientific principle or the formulation of an abstract theory or discovery of any living or non-living substances occurring in nature
- Mere arrangement or re-arrangement or duplication of known devices each functioning independently of one another in a known way
- A method of agriculture or horticulture



NOTE

The Patent Act, 1970, is amended by the Patent (Amendment) Act, 2002.

As per the Supreme Court of India, the object of the patent law is to encourage scientific research, new technology, and industrial progress as exclusive rights offer privilege to own and use the product for a limited period stimulating further new inventions. The price of the grant of the patent to the company is the disclosure of invention at the patent office, which after the expiry of the fixed period of monopoly, passes into public domain.

The patent provides incentives to individuals by offering them recognition for their creativity and material reward (through commercialisation or licensing of the invention) for their intellectual efforts. There is also a public good in patenting new inventions as it allows others to gain the new knowledge and can further develop the technology. The disclosure of the invention is an essential consideration in any patent granting procedure.

The patents are governed by the Indian Patents Act, 1970 in India which came into existence in 1970. The first amendment was enacted through the Patent (Amendment) Act, 1999 as India was put under the contractual obligation to amend its Patents Act in compliance with the provisions of the TRIPS. The amendment provided for the filing of applications for product patents in the areas of drugs, pharmaceuticals and agrochemicals, which were not allowed earlier (though these applications were to be examined only from 2005). It allowed applicants to have exclusive marketing rights to sell or distribute products in India, subject to conditions. The Act was amended again in 2002 through the Patents (Amendment) Act, 2002 which, for the first time, increased the term of the patent to 20 years. A third amendment was introduced in 2004 incorporating provisions for product patent in the fields of technology including chemicals, food, drugs, and agrochemicals.

Patents Cooperation Treaty

With regard to international patents, India became the 98th member of the Patent Cooperation Treaty (PCT) in 1998, administered by WIPO. Under PCT, it is possible to file a patent application for simultaneous protection of the patent in all the countries that are participants of the PCT. However, after filing a patent with WIPO under PCT, the companies should also process the patent with the patent authorities of respective countries as per their interests as discussed earlier. Once a patent is filed under PCT, a product can be introduced in any part of the world without losing the right to obtain the patent in the designated countries. The companies can later decide regarding which of the countries to introduce the product based on test marketing exercises.



EXHIBIT

PROCESS OF ONLINE REGISTRATION FOR PATENT

1. Collect information about your invention, ideas or concepts, such as:
 - Area of information
 - About the invention

- Function of invention
 - Advantage of the invention
2. Design the drawing and diagram for explaining the functioning of invention.
 3. Ensure that the invention is not patent.
 4. (a) Find out whether invention meets all the patentability criteria as per Indian Patent Act, 2016
(b) Decide whether to go further with patent.
 5. Write a provisional application in case you are at a starting level of research and development of your invention. It provides you with the following benefits:
 - Secures filing date
 - Provides 12 months of time to file complete specification
 - Offers low cost

After filing a complete specification (along with application for patent), the application is published after 18 months of the first filing. After this, the applicant sends a request for examination to the controller. After receiving the request, the patent application is transferred to the examiner from the controller (who examines the patent application on the different patentability criteria). The patentability criteria are as follows:

- | | |
|--------------------------------|--------------------------|
| ○ Patentability subject matter | ○ Inventive step |
| ○ Novelty | ○ Industrial application |
| ○ Non-obviousness | ○ Enabling |

Most patent applications receive different types of objections based on the examination report. The best part is to analyse the examination report with the help of patent professional and respond to controller regarding the novelty of their invention.

All objections regarding patent application in the examination report can be clarified by developing a communication between the controller and the patent applicant. After meeting patentability requirement, the application is placed order for grant.

9.2.2 | COPYRIGHTS



NOTE

Generally, copyrights are registered for a period of 60 years.

Copyright is a right given by the law to creators of literary, dramatic, musical and artistic works and producers of cinematograph films and sound recordings. It is a bundle of rights that include rights of reproduction, communication to the public, adaptation and translation of the work. It offers a sole right to the author to produce or reproduce his intellectual work.

Copyright protection is available only for the works of original creation. However, the ideas in the work need not be new but the form in which they are expressed must be an original creation of the author. In other words, copyright

is not applicable to the ideas themselves but are applicable only to the form of expression of ideas. For example, if you write a book on the epic Mahabharata or a commentary on the scripture like Bhagavad Gita or an academic book on the subject of financial management, though the story of Mahabharata or the scriptural truths of Bhagavad Gita or the financial management concepts already exist, you will acquire copyrights over your own form of expression of the ideas in your book as long as it is original and does not infringe on the copyrights of any already existing works on the topic. Also, the copyright protection has nothing to do with the quality or the value attached to the work or the purpose for which it is intended. The copyrights are temporal (applicable to a limited period of time), geographic (applicable to particular territory), have permitted use (restrictions), and may or may not pertain to non-material works (some countries require the work to be fixed in some material form).

Copyright is an intellectual property right that has its roots in the common law system and is now governed by the national laws in each country. Copyrights are governed by the Copyrights Act, 1957 in India. Several amendments have been made to the Act, for example, computer programs were introduced within the definition of literary works in 1984 as they were considered to be the products of intellectual skills like any other literary works. In 1999, the Act was amended to give effect to the provisions of the TRIPS agreement.

Scope of Copyright

Examples of copyrightable objects are as given below:

- **Literary works:** Books including novels, short stories, poems, dramatic works, fictions, and non-fiction etc., and computer programs.
- **Artistic works:** A painting, a sculpture, a drawing, an engraving or a photograph whether or not such work possesses artistic quality, a work of architecture and any other work of artistic craftsmanship.
- **Musical works:** Works consisting of music and includes any graphical notation of such works but does not include any words or any action intended to be sung, spoken or performed with the music. Musical works need not be written down to acquire copyright protection
- **Sound recordings:** A recording of sounds from which sounds may be produced regardless of the medium e.g. a phonogram or a CD-ROM.
- **Cinematograph film:** Any work of visual recording on any medium produced through a process from which a moving image may be produced by any means and includes a sound recording associated with it.

The Copyright protects the rights of the authors who are the creators of the intellectual property in the above forms. Copyright protection is conferred on all original works that have not been copied from any other source. The owner of the copyright may assign his rights to any other person either wholly or partially. The copyright terms vary according to the class of works.

It is, however, not necessary to register a work to claim copyright. Acquisition of copyright is automatic and it comes into existence as soon as a work is created and does not require any formality. However, a certificate of registration of copyright and the entries made therein can serve as the evidence in a court of law when

disputes arise. The copyrights are protected only for a limited period of time. In general, a copyright can last for 60 years from the year following the death of the author.

The copyright Act offers two types of protection – economic right and moral rights. The economic rights refer to the rights for reproducing the work, performing the work in public or communicating it to the public, etc. The moral rights refer to rights to restrain or claim damages in respect of any distortion or mutilation of the works or any other action in relation to the said works which would be prejudicial to the honour or reputation of the author. These rights are available even after assignment of the copyright.

The copyrights are not governed by any special courts but are tried in regular courts. In this regard, the Copyright Act provides for the establishment of the Copyright Board which is a quasi-judicial body which can adjudicate certain cases pertaining to copyright. It has powers to adjudicate upon disputes on the assignment of copyright, hear appeals against the orders of the registrar of copyright, grant compulsory licenses in certain circumstances, etc.

The Copyright Act applies only to the works first published in India irrespective of the nationality of the author. The multilateral agreement on copyright, the Berne Convention, administered by WIPO, provides copyright protection to literary and artistic works at the international level. All countries that had joined the convention should provide copyright protection to literary and artistic works of member countries in their own territories and enjoy reciprocal protection from others. The Indian government has passed the International Copyright Order, 1958 according to which any work first published in any country which is a member of Berne Convention will be accorded the same treatment as it was first published in India.



EXHIBIT

PROCESS OF ONLINE REGISTRATION OF COPYRIGHT

1. File an application form of your work along with the requisite fees. There should be a separate application form for different works. After filing of application form, diary number is generated and issued to the applicant.
2. Now, an application form will be examined by the examiner. It takes minimum 30 days' time for recording and analysing the objection included in the examination report of the copyright application form.
 - a. In the case of no objection: The application goes further for scrutiny by the examiner. The scrutiny results in two options:
 - ✓ In the case of discrepancy found during scrutiny: The letter of discrepancy is sent to the applicant.
 - ✓ In the case of zero discrepancy found during scrutiny: The application can go ahead with the registration process of the same work.
 - b. In the case of an objection: In case if someone faced an objection in the application form, authorities send a letter to the concerned parties and try to convince them to take back the objection.
3. Once everything is cleared from the registrar end, the applicant receives the copyright of particular work, which he/she can use it legally.

9.2.3 TRADEMARKS

Quick TIP

Trademarks are symbols or signs that distinguish the goods and services of one organisation from those of others or competitors.

Historians have found that as long as 3,000 years ago, Indian craftsmen used to engrave their signatures on their artistic creations before sending them to Iran. Such signatures are meant to connote the unique trademark of Indian craftsmen. Similarly, the use of signs to distinguish the goods of merchants and manufacturers had been in vogue from ancient days. In the market-oriented economy, manufacturers compete with each other offering a variety of goods in the same category. Even though such goods may actually differ in quality, price and other characteristics, there may not be any apparent differences for the consumers. Trademarks allow manufacturers and traders to distinguish their offerings and provide guidance to consumers towards considering alternatives and in making their choice between competing goods. Trademarks are valuable marketing tools that communicate the origin and quality of products, promote goodwill with consumer, and protect original manufacturers from unfair and counterfeit competitors.

Concept of Trademark

A trademark can be defined as any sign that individualises the goods of a given enterprise and distinguishes them from the goods of its competitors. The trademark must indicate a source in order to individualise the product and also distinguish the product from the goods of other enterprises offered in the market. A trademark could be a brand name, a visual symbol that indicates the source of goods, a signature, name, label, packaging, logo, picture, a combination of any of these or other articles of commerce that perform the above two functions of individualisation and distinguishing. As per WIPO, types and categories of trademark signs could include words, letters and numerals, devices, coloured marks, three-dimensional signs, audible signs (sound marks), olfactory marks and invisible signs like those that can be recognised by touch. There are two requirements with regards to accepting a trademark under the law: first, the trademarks should be meant for its basic function of distinguishing products or services and second, it should not give rise to harmful effects in terms of a misleading character or violating public order or morality. The trademark should also be of distinctive character.



Examples of Trademarks

The trademarks provide protection to the owner by ensuring an exclusive right to use it. Trademark rights can extend for indefinite period unlike patents and copyrights as it can be renewed every ten years. Similar to trademarks, there is

also the concept of service marks that are used in services to enable the consumers to distinguish between different services, like banking services, insurance services etc. The same regulations and laws govern the service marks.

Similar to copyrights, registration of a trademark is not compulsory and the trademark rights arise automatically as a result of using a mark on the goods or services. However, it is advisable to register trademarks to ensure protection against misrepresentation. In the absence of registration, any dispute has to be contended under other laws like unfair trade practices which could be time consuming and expensive. Another problem with non-registration of trademarks is that owner's automatic rights are limited to the geographic area in which the mark has actually been used. Another party can simultaneously use the same mark for the same goods in different parts of the country without infringing each other's rights.

The laws pertaining to trademarks are governed by the Trademarks Act, 1999 in India. The objective of the Act is to confer protection on the user of the trademark, prescribe conditions for acquisition, and provide legal remedies for the enforcement of trademark rights. The definition of a trademark as per the Act is "any registered trademark or mark used to identify the origin and manufacture of the goods". The Controller-General of Patents, Designs and Trademarks is the central government appointed agency that functions as registrar of Trade Marks under the Act.

Following are the advantages of registering a trademark under trademark Act:

- Confers exclusive rights on the registered proprietor to use the trademark
- Prevents any competitor from using the mark for similar goods
- Provides legal protection under the trademarks law
- Registration gives nationwide priority rights to use the trademark
- Allows filing of civil suits by any aggrieved person before a district court
- Provides criminal remedies in case of falsification of trademarks in case of delay

Certification Mark and Collective Mark

Two other important terms related to trademarks are "certification trademark" and "collective mark". The function of a certification trademark is to indicate that the goods or services comply with certain objective standards in respect of origin, material, mode of manufacture of goods or performance of services as certified by a competent person. A certification mark is any word, name, symbol, device or any combination, used or intended to be used in commerce with the owner's permission by someone other than its owner, to certify regional or other geographic origin, material, mode of manufacture, quality etc. Examples of certification marks are ISI mark, FPO mark and BIS Hallmark.

A collective mark is a trademark or service mark used or intended to be used in commerce by the members of a cooperative, an association, or other collective group or organization, including a mark, which indicates membership in a union, an association or other organisation. The function of a collective mark is to indicate a trade connection with the Association or Organisation. For example, NASSCOM representing the "National Association of Software and Services Companies" and CA mark used by Institute of Chartered Accountants are collective trademarks.

The international registration of trademarks is governed by the Madrid Agreement and the Protocol relating to that agreement. These are open to any countries who are party to the Paris Convention for the Protection of Industrial Property. The international registration of trademarks removes the need for filing many national applications in all the countries of interest in accordance with different national procedures.



EXHIBIT

PROCESS OF ONLINE REGISTRATION FOR TRADEMARK

1. Select trademark.
2. File the application form of trademark. If the registration of trademark is done in two or more categories, there would be different application forms for each category.
3. Receive acknowledgement immediately containing details such as the date of application and application number. This will take 2 or more days to obtain the online registration sheet. Now, you can use the mark, but the use of symbol would take up to 2 years if everything goes smoothly.
4. Get your trademark examined. Firstly, the government verifies the application form and raises objections, if any. If no objection against application is made then the letter of acceptance known as TLA is issued.
5. The trademark will be advertised in the journal as the application form is accepted.
6. Approximately, 9 months' time period is required to issue trademark certificate after the publication of advertisement.

9.2.4 | TRADE SECRETS

The strength of the leading successful and innovative companies depends many times on the innovative techniques and accompanying know-how employed in their businesses. Though these may be their unique competitive strength and weapon in the market competition, such techniques and know-how may not always be protectable under the patent law. Patents are available only for inventions in the field of technology and not for innovations concerning the conduct of business. These technical know-hows are usually termed as 'trade secrets', may also lack the novelty or other requirements that need to be met for patentability. However, companies do require protection under the law against unfair competition in terms of stealing their trade secrets by competitors. Hence, trade secrets are also a kind of intellectual properties of companies, so it is necessary that IPR laws take them into consideration. The legal provisions for the protection of trade secrets vary across countries. Some countries have separate laws meant for protecting trade secrets, while others have provisions under laws meant for preventing unfair competition. In some countries, it may also be treated as an aspect of tort law or as part of other civil or criminal law provisions depending on the legal structure and practices of the country.

Trade secrets can belong to any of these two broad categories viz., manufacturing or industrial secrets and commercial secrets. Industrial secrets are information of purely technical character like production methods, chemical formulae, blueprints,

prototypes etc. which does not satisfy by the patentability requirements. Commercial secrets could be sales methods, distribution methods, contract forms, business schedules, price agreements, consumer profiles, advertising strategies, supplier lists, etc. Patentable inventions that are yet to be granted with a patent by the authorities can also be treated as a trade secret in the intervening period.

The characteristics that determine whether an item is a trade secret are:

- the extent to which the trade information is known to the public or within a particular trade or industry
- the amount of money and effort spent in developing the secret information
- the extent of measures taken by the trader to guard the secrecy of the information
- the ease or difficulty with which the information could be acquired by others

The characteristic of intention and extent of measures taken by the company in terms of treating a particular information as a trade secret is considered by courts, in several countries, to be of primary importance in determining whether the information constitutes a trade secret. In general, companies include provisions in the employment contracts to reinforce and supplement the protection afforded to trade secrets under the law. Employment contracts may incorporate specific provisions prohibiting the disclosure of business or trade secrets. Employees have a duty during the period of employment to act with good faith towards his employer and after the employment has come to an end, not to use or disclose any confidential information about his employer's affairs that may have come to his notice during his employment.

Unlike intellectual properties like inventions and copyrightable material, the trade secret is not strictly a property that the possessor has exclusive right to use. In other words, there is no legal remedy if the trade secret leaks out to competitors and if they could reverse engineer the secret, say a formula. If the dispute arises, the determination of unfair competition by stealing of trade secret is based on the means with which the information has been acquired by the competitor.

In India, trade secrets are not protected by any law in the same manner as patents or trademarks but the protection can be on the basis of common law.

Under the TRIPS agreement, trade secrets are referred to as "Undisclosed information". TRIPS agreement requires member countries to provide effective remedies for trade secret misrepresentation including injunctive relief, damages, and provisional relief to prevent infringement and to preserve evidence.

9.2.5 | GEOGRAPHICAL INDICATIONS

Geographical indications are the indications that identify a goods as originating from a particular geographical territory. For such goods, the quality, reputation or other characteristics of the goods are essentially attributable to that particular geographical origin. For example, the Geographical Indications (GI) tag is issued to the Indian basmati rice variety. Basmati is special long grain aromatic rice grown in a particular Indo-Gangetic Plains (IGP) geographical region of the Indian sub-continent and covers seven states of India. Since India is the largest producer and

exporter of basmati rice, the GI tag assigned to basmati rice will help preserve the unique identity of India's aromatic basmati rice in the international markets. Other examples of goods that are known for their geographical origin are Champagne, Tequila, Darjeeling, Kanchivaram Silk, Alphonso mangoes, etc., all of which have their names based on the places of their origin, though consumers think of the products themselves instead of their names.

The Geographical Indications is a new addition to the various types of Intellectual Property Rights (IPRs). As per WIPO, the GI protection is applicable regardless of whether the qualities of a given product are due to its geographical origin or they merely indicate the place of origin of a product. Geographical indications may consist of names or symbols. For example, a symbol of Eiffel Tower can be used to indicate the place of origin as Paris. When goods acquire high reputation based on their geographical origin, making them valuable commercial assets, they get exposed to misappropriation, counterfeiting or forgery and, hence, their protection becomes important. The GI protection is not, however, available, as per TRIPS regulation, if the geographical name had become generic over a period of time.

An example of GI tag meant for protecting another Indian origin product is the traditional tie-and-dye fabric based Pochampally sarees of Andhra Pradesh. There are around one lakh weavers in Andhra Pradesh who produce these handloom based sarees which are famous and well known by the place of their origin. With the design now winning the GI protection, it will ensure that these handloom weavers are protected from unfair competition and from counterfeit sarees sold in that name.

An important difference between Trademarks and GI tags is that whereas a trademark identifies a single enterprise which offers certain goods in the market to differentiate them from offerings of others, a GI tag identifies a geographical area in which *one or several enterprises* are located which produce the kind of product for which the geographical indication is used. Hence, there is no concept of ownership of geographical indication. Each and every enterprise located in that geographical area has the right to use the GI tag for the products originating in that area *but subject to certain quality requirements as may be prescribed*. Protection of geographical indication means the right to prevent unauthorized persons from using geographical indications, either for products that do not originate from the geographical place, or not complying with the prescribed quality standards.

In India, the protection of geographical indications is governed by Geographical Indications of Goods (Registration and Protection) Act, 1999. The objective of the Act is to facilitate registration and protection of geographical indications related to goods in India. The Act is administered by the Controller General of Patents, Designs and Trademarks who will be the Registrar for GI also. The Act provides for the establishment of a geographical indications registry which is currently located in Chennai. The registration under the Act confers legal protection and prevents unauthorised use of a registered GI by others.

9.2.6 | INDUSTRIAL DESIGNS

The next major important intellectual property that can be protected under law is the industrial designs. Industrial designs refer to visual and aesthetic design that

makes a product attractive, appealing and adds to the commercial value of the product.

As per WIPO, industrial designs refer to 'the creative activity of achieving a formal or ornamental appearance for mass-produced items that, within the available cost constraints, satisfies both the need for the item to appeal visually to potential customers, and the need for the item to perform its intended function efficiently'. Protection of industrial design refers to the rights granted pursuant to a registration system, to protect the original ornamental and non-functional features of an industrial article or product that result from design activity. The design should not be related to any technical features of the product. The subject matter of the legal protection is not products or even functional design of the product but the visual design which is applied to or embodied in those products. In other words, if a manufacturer protects the IPR rights of a product under industrial design law, this does not prevent another manufacturer from producing the same product but only prevents him from copying the design which can lead to counterfeit products.

An important point with regard to industrial designs that can be protected under the law is that it refers to the 'creative activity of achieving formal or ornamental appearance and does not refer to the 'functional design' of the product. In other words, industrial designs in the context of IPR do not refer to engineering design or manufacturing design of products. The design of any product includes both design for function and the design for visual aspects. The IPR law for industrial design pertains only to design for the visual aspect. As you would remember now, the "design for function" of a product, if it is novel and satisfies attributes of patentable invention, can anyway be patented under the "Patent Law" and hence, industrial design law is not applicable. Some examples of designs that can be protected as intellectual property are jewellery designs, the design of housewares, the design of electrical appliances, the design of automobile shapes, the design of textile garments etc.

The legal protection of industrial design serves the important function of protecting one of the distinctive elements by which manufacturers achieve market success. In some cases, like jewellery, the design could be the most important factor. The legal protection serves as an incentive to the investment of resources in fostering the design element of production.

An important requirement for a design to be protected as intellectual property under industrial design law is that the design should be novel and original.

In India, the intellectual property rights for industrial design are protected by Designs Act, 2000. As per the Act, the design means only the features of shape, configuration, pattern or ornament or composition of lines or colour or combination thereof applied to any article whether two dimensional or three dimensional or in both forms, by any industrial process or means whether manual, mechanical, chemical, separate or combined which in the finished article appeal to and are judged solely by the eye, but does not include any mode or principle or construction or anything which is in substance a mere mechanical devise, and does not include any trademark.

The industrial design protectable under the Designs Act cannot include any trademark, any property mark, any artistic works. Note that the artistic works

is not included as it can be protected under the copyright law. As per the Act, the following things are not protectable under the Act: book jackets, calendars, certificates, greeting cards, post cards, medals, mere change in size of article, flags, emblems and layout design of Integrated Circuit (ICs are dealt with in separate law), design of industrial plants and layouts etc. The protection available for registered design under the Indian Act is for a period of 10 years.

Protection under Industrial Designs Act vs. Copyrights Act

Products that qualify under the law of industrial designs might equally qualify for protection under the law of copyright. If the product embodies features that qualify under both the laws, the protection could be cumulative (i.e. simultaneous depending on the country's laws. Cumulation of protection means that the design is protected simultaneously and concurrently by both the laws and the creator can invoke the protection of either or both as he chooses. If he has failed to obtain the protection under the industrial design law, he can claim protection under copyright law.

Alternatively, the protection could be on 'co-existent' basis as per some country laws. Co-existence of protection means that the creator may choose to be protected either by the industrial design law or by the copyright law. If he has chosen the one, he can no longer invoke the other. If he has registered under Design Act, at the expiration of such registration, he can no longer claim protection under the copyright law. The system of cumulative protection exists in countries like France and Germany while the system of co-existence is applicable in most of the other countries.

In India, as per Section 15 of the Copyright Act, 1957, there is a special provision regarding copyright in design registered or capable of being registered under the Designs Act, 2000. The copyright shall not subsist in any design which is registered under the Designs Act, 2000. As per Indian Designs Act, 2000, even if the design was originally created as a work of art and protected automatically under the Copyright Act, once it is intended to be used as a model or pattern to produce more than 50 single useful articles or sets of articles, it is usually considered to be an industrial design which can only be protected under the Designs Act. This means if the manufacturer fails to register his design under the Designs Act and manufactures more than 50 pieces of the article with that design, then he foregoes protection under both the Designs Act and the Copyright Act.



SELF ASSESSMENT QUESTIONS

1. Three important conditions for patentability are _____, _____ and _____
2. Which of the following is patentable under the Indian Patent Act?
 - a. Discovery of a new scientific principle.
 - b. A new product created by an arrangement of known existing products each functioning independently of one another in a known way.
 - c. Method of horticulture.
 - d. None of these

3. An Indian company that has a patentable invention desires to export its products to two foreign countries. In this case, select the correct statement that offers a proper solution.
 - a. It is sufficient if the company files its patent in India and gets approval from the Indian patent authorities as India is a signatory to TRIPS.
 - b. The company has to get its invention patented in all the three countries separately.
 - c. It is enough if the company files a single patent with WIPO under PCT (assuming the foreign countries are members of PCT) and then follows it up with patent authorities of the respective countries.
 - d. None of these
4. Copyrights for creative works of the mind is a natural right and accrues automatically once created. It is not necessary to register under any law to acquire rights. (True/False)
5. One difference with regard to IPR protection between copyrights and trademarks is that the period of rights is limited in the case of copyrights while it is indefinite in the case of trademarks. (True/False)
6. Unlike other IPR categories, Geographical Indications (GI) does not have any ownership concept associated with it. (True/False)
7. Which of the following are patentable under the Industrial Designs Act of India?
 - a. Visual design and aesthetic appearance of a smart watch.
 - b. The circuit board design of the smart watch.
 - c. Innovative functions of the smart watch.
 - d. All of these



ACTIVITY 1

Download the IPR related laws of WIPO, TRIPS and Indian IPR laws. Compare and contrast the features and provide your opinion on the protection offered by Indian laws.

9.3 WIPO AND THE ALTERNATE DISPUTE RESOLUTION



NOTE

In 1975, India joined WIPO.

The World Intellectual Property Organisation (WIPO) is a specialised agency or organ of the United Nations (UN). The WIPO was established in 1967 with an object to *encourage creative activity, to promote the protection of intellectual property throughout the world*. The headquarters of WIPO are located in Geneva, Switzerland. WIPO offers dispute resolution services for cross-border IPR disputes.

Some of the objectives and work of the WIPO are as follows:

- Developing a balanced, accessible and international Intellectual Property (IP) system

- Providing means through which countries can stimulate the process of innovation and creativity required for their economic development which is achieved by patents, copyrights and industrial design
- Establishing order in market by removing as far as possible, any confusion, uncertainty and fraud which is achieved through competition laws and trademarks
- Acting as an international forum for negotiating international standards and treaties
- Helping governments in using the IP in their developmental strategies
- Providing IP training to the target groups
- Delivering commercial IP services to the private sector
- Protecting the IP throughout the world by ensuring cooperation among different countries and by any possible collaborations with other international organisations

**NOTE**

The World Intellectual Property Day is celebrated on 26th April each year.

All the members of the United Nations are eligible to become the members of the WIPO. Currently, there are 191 member countries in the WIPO. The WIPO administers 26 international treaties.

In spite of several well-established laws and regulations, both domestic and international, governing various rights of parties concerning intellectual properties, there is always a possibility of disputes between parties. Conflicts and disputes are an inevitable part of business activities. Such disputes can be expensive and time-consuming depending on the efficiency with which IPR laws are governed and enforced in different countries, which may involve conflicting interpretations and complex procedures for resolution of disputes. Usually, conflicts can be resolved in two ways. First, where both parties to a dispute approach the concerned court of law. Second, where both the parties to a dispute aim to resolve their conflicts outside the court. The process or procedure of settling disputes without going in for any litigation is known as Alternate Dispute Resolution (ADR). The ADR usually involves procedures such as arbitration, mediation, negotiation, conciliation, etc. Most of the businesses prefer ADR procedures because they are less expensive and can be completed in a short period of time.

Arbitration is a process in which an impartial and non-biased third-party (arbitrator) hears both the parties to a dispute and issues a decision accordingly. However, the decision of the arbitrator(s) may be binding or non-binding. A binding decision means that both parties agree to and must adhere to the decision that is passed by the arbitrator. In case of a non-binding decision, one or both the parties may choose to ignore the decision and may thereafter pursue the usual course of court litigation. Mediation is also used for ADR. This term is used interchangeably with arbitration. However, these two are quite different. In mediation, a mediator collaborates with both the parties in order to reach a conclusion or settlement. Usually, the decisions of mediation are non-binding in nature. The process of ADR has been traditionally used in litigations all over the world. However, the use of ADR in the context of Intellectual Property Rights (IPRs) is a relatively new phenomenon.

In 1994, WIPO established the WIPO Arbitration and Mediation Center. This is an international, neutral and not-for-profit dispute resolution provider. It provides ADR services for Intellectual Property disputes in a time-efficient and cost-efficient manner. It also enables private parties to settle their domestic or cross-border IP and technology disputes efficiently out of the court. The WIPO center offers four different forms/types/procedures of ADR in line with the WIPO rules as follows:

- **Mediation:** As per WIPO, mediation is an informal and consensual process under which a mediator helps both the parties in settling their disputes mutually in an amicable manner. The work of the mediator is to assist parties based on their interests and act only as a neutral intermediary. No mediator can impose any settlement. However, if parties agree on the terms and are able to reach a settlement agreement, it might have the force of a contract. If settlement is not reached using mediation, the parties always have the option to go for arbitration or litigation in the court of law.
- **Arbitration:** As per WIPO, arbitration is also a consensual procedure wherein parties to a dispute submit their arbitration application to one or more arbitrators of their choice for settling their dispute. The decision of arbitrators is considered as final and binding upon both the parties. Usually, arbitration rules out the possibility of any litigation options.
- **Expedited arbitration:** As per WIPO, expedited arbitration is a type of arbitration that involves a single arbitrator and can be concluded speedily and at less cost. This type of arbitration is suitable in those dispute cases that are of low value or are simplistic in nature or where speedy resolution is required.
- **Expert determination:** As per WIPO, expert determination is an ADR procedure wherein parties to a dispute jointly submit an application for resolving their dispute by involving one or more experts. The experts so selected are agreed upon by both the parties. These experts have to hear the matter referred to them and award a decision accordingly. Usually, the decision of experts is considered as final and binding unless parties to a dispute agree not to.



NOTE

The WIPO center is a leading administrator for various Internet domain disputes.

Till the end of 2018, WIPO center had administered more than 560 dispute cases; the total value of which amounts to several hundred million of USD. The ADR services of the WIPO have been used by organisations of more than 60 countries. The WIPO center also collaborates with several other Intellectual Property Organisations (IPOs) to promote awareness with respect to how the ADR can be used to resolve IP and technology disputes without going into litigation. The WIPO Center has also helped various IPOs such as those belonging to Singapore, Korea and Poland in establishing the joint dispute resolution procedures. In addition, the WIPO Center has also developed customised dispute resolution procedures for certain specific industries such as fashion, film and media, franchising, life sciences, Information and Communication Technology (ICT), etc. The WIPO center also provides training to mediators and arbitrators.

The WIPO's Alternative Dispute Resolution (ADR) procedures offer following advantages:

- Using a single procedure, parties can resolve disputes involving intellectual property that is protected in a number of different countries saving time and cost.

- Owing to private nature, affords parties the opportunity to exercise greater control over the way their dispute is resolved compared to court litigations.
- ADR can be neutral to the law, language and institutional culture of the parties which prevents some parties getting home court advantage when compared to court-based litigation in respective countries.
- ADR proceedings are private and hence guarantee confidentiality.
- Unlike court decisions, arbitral awards are not normally subject to appeal.
- Both the parties maintain their autonomy
- ADR procedures are simple and flexible
- ADR procedures save a lot of time as compared to the court-based litigation methods
- ADR procedures are way less expensive than traditional method
- Results of the ADR procedures are usually final and binding, unless mentioned otherwise
- Decisions made by arbitrators, mediators or experts are enforceable

**NOTE**

The United Nations Convention for the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the New York Convention) provides for the recognition of arbitral awards on par with domestic court judgments.

**SELF****ASSESSMENT
QUESTIONS**

8. The Alternate Dispute Resolution (ADR) is managed and administered by:
 - a. Indian controller-general of patents, design and trademarks
 - b. An agency of WTO and TRIPS
 - c. An agency of WIPO
 - d. None of these
9. The WIPO has Arbitration and Mediation Centre located in Geneva that offers dispute resolution services for cross-border _____ disputes.

**ACTIVITY 2**

Write a brief report on an important case that has been recently resolved using ADR method.

9.4 GLOBAL CHALLENGES IN IPR

Ever since, the concepts related to Intellectual Property Rights and their protection have been developed, there is a simultaneous rise in challenges related to them. Every organisation and individual wants to protect their IPR so that they may be credited solely for their creations and inventions. The rise of IPR is accompanied by the rise of challenges that face the IPR.

Some of the key challenges related to the IPR internationally are as follows:

- **Global nature of innovations:** Nowadays, the IP is created collectively by a team of different actors belonging to different specialisations, countries,

organisations. Under such circumstances, it is difficult to manage the IP rights in multiple jurisdictions and with varying approach to IPR. Such global IPR can be effectively managed by harmonising various standards and procedures, ensuring cooperation among IP offices, establishing specialised jurisdictions to resolve any IP disputes.

- **New technologies impact IP management and enforcement:** There are certain innovations such as robots which themselves are capable of producing IP assets which leads to questions of creation, invention and ownership. Information is a resource and innovation which can be transferred and propagated very quickly and it is very difficult to control the distribution of such assets. There are technologies such as 3D printing which can produce goods on the basis of IP-protected knowledge and designs. There is no designated way to protect IPR from such technologies.
- **Increased importance of the data and trade secrets:** Today, information, knowledge assets and trade secrets are the most valuable assets of a company. These have become all the more important due to globalisation and interconnected supply chains. It has become important to protect confidential and critical business information in the digital world. The entire databases of organisations need to be protected. Such database protections are not available in various jurisdictions.

India has also faced various challenges related to IPR and it continues to face IPR challenges with respect to various IP matters. For instance, India and the United States share a strategic partnership and they share a strategic cooperation in various fields such as defence, countering terrorism, trade, science and technology, etc. In 2016, India was the ninth biggest single-country trading partner for the US. However, if there is one area that has proved to be a great dampener in the relationship between two countries, it is related to IPR.

Though the objective of multilateral agreements like TRIPS is to prevent such frictions and though both the US and India are signatories to TRIPS agreement, various issues persist with regard to the protection of IPR. Pursuant to TRIPS, India has amended its patent laws and has even introduced product patents for various industries including pharmaceuticals. Similarly, US had also amended its patent laws towards compliance with its obligations under TRIPS. However, there were differing views on the approach to IPR protection between the two countries that led to the US alleging that the IPR protection in India was inadequate in several areas like pharmaceuticals, IT and publishing. The IPR issues between India and the US have been identified as most crucial for their bilateral trade relations.

The US blames India and China as countries with poor IPR protection that has led to the export of counterfeit pharmaceuticals to the US. Since, India is one of the largest countries that export generic drugs globally, the allegations by the US could adversely affect its image. US had kept India on the 'Priority Watch List' since 2005 in its annual special 301 report on IPRs alleging that India lacks measurable improvements to its IPR regime.

Following are some of the reasons stated in its latest report:

- Lack of sufficient measurable improvements in India's IP framework.

- The difficulty of US innovators in getting and maintaining patents in India particularly in pharmaceuticals.
- Enforcement of action and policies are insufficient.
- Copyright policies do not properly incentivise the creation and commercialisation of content.
- Outdated and insufficient trade secrets legal framework.

Though India was not designated as a 'priority watch country' (which would have led to penal action against India). The Pharmaceuticals Research and Manufacturers of America (PhRMA) claims that India's IPR laws do not comply with the TRIPS agreement.

The major problem between the US and India regarding IPR protection is in the pharmaceuticals sector. India had either denied or revoked patents for certain foreign drugs which failed to meet its "enhanced efficiency" requirement for patentability. This requirement is crucial for protecting against the companies that seek to extend the life of their patents by making minor modifications of their patentable products, a practice termed 'evergreening'. The US, however, believes that the requirement of "enhanced efficiency" is likely to have the effect of limiting the "patentability of potentially beneficial innovations". Hence, the Section 3(d) of India's Patent Law which denies patents for incremental innovations to avoid evergreening of patents had become a contentious bilateral IPR issue. Other areas where IPR related disputes had arisen between India and US are copyright violations in publishing and cinema industry and software piracy. A Business Software Alliance (BSA) report estimated that India's piracy level stood at 60% with country recording installation of \$2.9 billion worth of unlicensed software in 2013.

US claims that revenues of US companies were adversely affected as a result of such volumes of piracy. There has been a continuing dialogue between India and the US towards resolving the above IPR related issues.

Apart from these, there are a lot of IPR issues between China and the US. The US and China have various copyright issues. Along with India, China is also on the US's priority watch list for IPR violations even in 2019.

The most critical IPR challenges in India are as follows:

- **Process to product patent:** Developed countries such as US want India to move from process patents to product patents.
- **Section 3(d) of Indian Patent Act:** Section 3 (d) of the Indian Patent Act disallows multinational companies from 'evergreening' their patents by making minor changes. A considerable therapeutic efficiency needs to be added to an already existing patent in order to acquire a new patent.
- **Compulsory licensing:** Using the provision of compulsory licensing, the Government of India can order the patent holding company or any other company to produce a particular drug in mass quantity. It means that any pharma company irrespective of whether or not it holds a patent can be order to produce a certain drug in certain emergency situations.

- **Drug price control order:** Government of India has issued instructions that the price of the drugs must be just and fair. In case, of any unfair pricing, the Government has the right to intervene.
- **Food security and IPR:** Under TRIPS, the Government of India has to reduce or eliminate subsidies that are being given to farmers in the form of minimum support price, electricity, fertilisers, etc. These have not been implemented so far and Government is struggling to create a balance.
- **Intellectual Property Rights (IPRs), Community Property Rights (CPRs) and Indigenous Knowledge:** A lot of traditional knowledge exists in India. Pharma companies could use these traditional leads and may create formulations and get them patented. In order to protect the rich source of traditional knowledge, the Government of India disallows the multinational pharma companies to get patents based on traditional knowledge. This move is opposed by the multinationals.

Apart from these, certain other IPR challenges facing India are as follows:

- Insufficient regulations
- Low level of awareness w.r.t IPRs
- Low level of respect for IPRs
- Formulating IPR policies
- Training IPR personnel



**SELF
ASSESSMENT
QUESTIONS**

10. The IPR disputes between US and India pertain to
 - a. Copyrights in the publishing industry
 - b. Software piracy
 - c. Pharmaceutical product patents
 - d. All of the above
11. The Pharmaceuticals Research and Manufacturers of America (PhRMA) claims that India's IPR laws do not comply with the _____.
12. Which of the following is not necessarily true in the context of IPRs in India?
 - a. Insufficient regulation
 - b. Drug price control
 - c. India's IPR laws do not comply with TRIPS
 - d. Conserves Community Property Rights (CPRs)



ACTIVITY 3

Based on your desk research, write a report on measures taken by India towards addressing IPR challenges.

9.5 SUMMARY



- Intellectual property pertains to intangible properties that are creations arising out of the intellectual effort of its creator. There are two broad categories of IPR viz., industrial inventions and artistic creations.
- The major types of intellectual property categories that can be protected against infringement under the law are patents, copyrights, trademarks, geographical indications and designs. Apart from these, there are other items like layout designs of integrated circuits, plant varieties, etc., which can also be protected under IPR laws.
- The TRIPS agreement facilitated by WTO is the most comprehensive international multilateral agreement that allows international cooperation between member countries on IPR related regulations. The international IPR related cooperation through several treaties, agreements and conventions is administered and managed WIPO, a specialised agency of UN.
- India had become a member country of TRIPS agreement and has accordingly amended its patent laws.
- A patent provides exclusive rights to the owner of an invention to make, use, manufacture and market the invention provided it satisfies the required patentability conditions. Three important conditions are novelty, inventive step and industrial applicability. The Patents Act, 1970 governs the patent-related laws in India.
- Copyright is a bundle of rights given by law to the creators of literary, dramatic, musical and artistic works. Though copyright is a natural right that accrues automatically, a registration under the law (Copyright Act, 1957) can facilitate better protection and easier dispute resolution. Copyrights are applicable for a limited duration only.
- Trademarks are signs that individualise the goods of a given enterprise and distinguishes them from its competitors. It could be a brand name, visual symbol, label, logo etc. which can be protected under law for exclusive usage and to protect counterfeit products. The Trademarks Act, 1999 confers protection for trademarks in India.
- The trade secrets are also a kind of intellectual properties which can be protected under law. They include technical know-how and other kinds of business information that may lack the novelty or other requirements for patentability but nevertheless constitute important intellectual assets of a company for its success requiring prevention of unauthorised usage and unfair competition in the market. At present, there is no specific law that governs trade secrets in India but can be protected under common law.
- Geographical Indications identify goods that owe their quality and reputation to the particular geographical territory from which they originate. Such goods can be protected against counterfeit products under IPR laws. In India, the protection of geographical indications is governed by the Geographical Indications of Goods (Registration and Protection) Act, 1999.
- The industrial designs that refer to the visual and aesthetic design of a product adding commercial value to the product can be protected under

IPR laws. They refer to the creative and aesthetic design and do not govern the functional or technical design of a product. These are governed by the Designs Act, 2000 in India.

- Other major IP assets that can be protected under the law are layout designs of integrated circuits and plant varieties. These are also governed by separate laws in India.
- The WIPO has an Arbitration and Mediation Center that offers dispute resolution services for cross-border disputes.
- Though India and US have become major trade partners with growing strategic partnership in several fields, the field of IPR protection continues to remain as an important dampener. The major issue pertains to IPR laws, protection and enforcement in the case of pharmaceutical products.

9.6 KEY WORDS



- **Assignment:** Transfer or sale of a patent by an instrument in writing to transfer the entire interest in the patent to the assignee by the assignor (i.e. patent holder)
- **Infringement:** The practice of making, using or selling a patented product or process without permission
- **Intellectual Property:** An intangible property created out of intellectual effort like inventions, know-how, processes, methods, materials, artistic works, etc., which are protectable by legislation through patents, copyrights, trademarks, trade secrets, etc.
- **Invention:** A new product or process involving an inventive step and capable of industrial application
- **Novelty:** An invention that is new, original, unusual and does not form part of any existing state of the art, and not published or available in public domain

9.7 CASE STUDY: TOYOTA LOSES TRADEMARK BATTLE AGAINST A SMALL INDIAN MANUFACTURER



Suppose an international company that has built a global reputation for its products and trademarks seeks to expand into a new country. Let us assume that there exists another manufacturer in that country that is already using that trademark independently and had also registered it with the country's authorities. Can the MNC's entry be blocked by that small business player already trading under the same name whose scale of operation is minuscule compared to the MNC? What if small players around the world choose to register well known global trademarks in their countries for the purpose of blocking anticipated expansion by the MNC, hoping to be bought for a large sum? On the other hand, what if that small player had genuinely built a good business using that trademark without ever using the reputation of the global MNC in any way?

Alternatively, what if bona fide domestic companies, that have established a great reputation with their trademarks in the country find themselves open to litigation at the suit of unknown or barely known claimants from almost anywhere in the world, who have barely used that trademark though have registered prior hand?

This case study deals with the above scenarios.

Toyota and its Prius Trademark

Toyota launched the world's first commercial hybrid car called "Prius" in Japan in 1997. Later, it introduced Prius in other countries like UK, USA, Australia, etc., in 2001. Toyota first registered the trademark "Prius" in Japan in 1990 and subsequently in several other countries all over the globe and it had become the registered proprietor of the trademark in as many as 28 countries. Toyota did not introduce the car till 2009 in India and hence had not obtained the trademark registration in India. Toyota believed that the trademark "Prius" is well known across the globe and it has built a global reputation for the brand and had hence automatically acquired natural rights over the trademark across the globe.

In 2009, Toyota discovered that the trademark "Prius" has already been registered in India by a small auto-parts manufacturer. The auto-supplier had got the trademark registered in his name in 2001 itself and had built a successful business, having become a supplier to major automobile manufacturers like Hyundai, GM etc. including Toyota. The supplier claimed that they got the Latin word "Prius" from English Dictionary as a substitute for the Sanskrit phrase "pehla prayas" meaning "to come first" which they wanted to use a trademark for their new product "Add-On Chrome Plated Accessories" and it had nothing to do with the launch of Toyota's Prius launch in Japan. The supplier has been manufacturing spare parts for Toyota Cars and selling it using brand names like Toyota, Toyota Innova etc. as being genuine spare parts pertaining to those cars.

Toyota approached the Indian trademarks registration authorities for cancellation of the registered trademark given to the auto-supplier claiming that Toyota has been using the trademark since 1990 and has built a global reputation for the trademark and was a legitimate owner of the trademark in 28 countries.

The issue went to the courts with the auto-supplier arguing that he is the legal owner of the trademark in India as the Toyota's Prius brand name was unknown in India when it initially registered with the trademark authorities in India in 2001 and Toyota has introduced its Prius car only in 2009 in India when it has built a strong business under the trademark.

Before we go over the case and its final conclusions which were reached in 2017, let us review some legal concepts regarding trademark protection.

Impact of Not Registering Trademarks

One important characteristic of trademarks, as a class of intellectual property rights, is that the rights accrue to the owner even if it is not registered with the government authorities, similar to copyrights. However, there are several disadvantages to

not registering trademarks. First and foremost, even highly successful trademark owners cannot protect their trademarks if the name becomes generic in the public mind over a period of time. For example, when Microsoft tried to register the name “Windows” as its own trademark with US Patent authorities, it was refused on the grounds that the name had already become generic with the public. Secondly, even though ownership accrues naturally, it is difficult to protect any infringement of trademarks by competitors using other laws like those meant for unfair trade practices. The third important disadvantage, which is relevant for this case study, is that natural ownership rights accrue to him only in the particular territory in which he sells his goods.

For example, if a manufacturer manufactures and sells his goods with a successful but unregistered trademark in New Delhi, nothing prevents another manufacturer in Chennai to use the same trademark for his own goods. The idea is that the Delhi based manufacturer’s reputation in terms of his established trademark is not relevant in Chennai where any other manufacturer can build his own reputation using the same trademark though independently and without using the reputation of the Delhi manufacturer.

Concept of Passing-Off

Another concept with regard to unregistered trademarks is “Passing-Off”. Suppose one manufacturer has successfully built a reputation over a period of time with a well-known trademark but has not got it registered. If another manufacturer tries to sell his own goods using the reputation of the first manufacturer built on that unregistered trademark, the second manufacturer is said to be passing off his goods using a trademark which does not belong to him. The concept of “infringement” is applicable only in the case of registered trademarks and the statutory right for an action against infringement is not applicable in the case of “Passing-Off”. In a passing off action, the registration of the trade name has no meaning (as neither manufacturer has registered it) and the priority in adoption and use of the trademark is superior to the priority in registration.

The legal situation becomes difficult if the second manufacturer chooses to register the trademark while the original natural owner has not. In this case, according to various case laws, it is now a well-settled fact that a prior *unregistered user* of the trademark has rights even over a later *registered user*.

Territorial Rights: Global Trademarks

The trademarks are territorial by nature (similar to the other IPR properties) and there is no concept of “global trademark”. Companies need to register their trademarks in each and every country they propose to sell their goods. Though as in the case of patents, WIPO provides the international registration system wherein a single application with WIPO can be used to process registration in each and every country one requires the protection.

However, the protection afforded to unregistered trademarks is also available for foreign trademarks which have built a reputation in a particular country through

extensive advertisements and publicity. The trans-border reputation can enable a global manufacturer to obtain an injunction in the courts of the country in which he is not trading. Indian courts have recognized the existence of trans-border reputation and granted an injunction in several cases in the past.

The Verdict of Delhi High Court

The Delhi High Court, in an order passed in 2009, granted an injunction restraining the auto spare parts supplier from using the registered trademarks of Toyota. However, the order was vacated in 2010 on the basis of the application filed by the defendants (auto spare parts supplier). Toyota (the plaintiff) filed an appeal before the Division Bench of the High Court which permitted the defendant to use the registered as well as unregistered trademarks of Toyota subject to the condition that they use the trademarks only for the purpose of identifying that the defendants' products can be used in Toyota's cars. Defendants were also required not to use the logos of Toyota. Toyota again approached the court for infringement of the order as the defendants continued to use Toyota trademarks.

At the conclusion of the trial, the court held that the acts of defendants constituted an infringement of the trademarks "Toyota" and "Toyota Innova" and "Passing-Off" of the defendant's goods under the trademark of "Prius". Though the defendant had registered the trademark in 2001 itself in India, the plaintiff is the first user having marketed hybrid car all over the globe under the name "Prius" from 1997 onwards. The court restrained defendants from using the registered trademarks of Toyota while also granting the rights for "Prius" trademark to Toyota based on the contention that Toyota has already built goodwill and reputation all over the globe and which had also permeated to the Indian jurisdiction. Punitive damages of ₹ 10 lakhs were also awarded in favour of Plaintiff for the years during which they illegally used Toyota's trademark.

The above verdict was reversed in an order by Division Bench of the High Court in 2016 wherein the defendant appealed that the order restricting them to use the Prius trademark is unjustified. The court set aside the earlier order and even dismissed the punitive damages granted earlier to Toyota. The reason cited was that the trans-border reputation of the mark "Prius" had not been correctly arrived at by the trial judge as the proof of Toyota's reputation in this regard belonged to a period later than 2001, while the defendants were using the trademark ever since they registered it in 2001.

Supreme Court's Final Verdict

The Supreme Court took a position that the case depends mainly on whether there had been a spillover of the reputation and goodwill of the trademark of Toyota in India. It held that since Prius car was launched in India only in 2009 and since the brand name had not acquired the degree of goodwill, reputation and market popularity in the Indian market "so as to vest in the plaintiff the necessary attributes of the right of a prior use so as to successfully maintain an action of passing off even against the registered owner". The court also observed that the delayed action by Toyota (Prius got registered in India in 2001 even while Toyota

was already in the Indian market in 2000 itself) in safeguarding its trademark is unexplainable. It upheld the Delhi High Court order and granted the rights for usage of the trademark "Prius" to the defendant as there were not sufficient enough proof of reputation of "Prius" in the Indian market. It observed that the news item relating to the launch of Prius in Japan in 1997 in major newspapers like Economic Times in India do not firmly establish the acquisition and existence of goodwill and reputation of the brand name in India.

QUESTIONS

1. The Supreme Court did not get into the question of the honesty of the Indian manufacturer who claimed that they were unaware of the globally well-known trademark of "Prius" but they independently arrived at the name from English dictionary while they built a reputation using the trademark and were able to supply even to majors like Hyundai etc. including Toyota. It only focused on the proof for the trans-border reputation of Prius in India when it got registered in 2001. Do you agree with this stand of Supreme Court?

(Hint: On the issue of honesty, the case would have gone in favour of Toyota. The court rather decided to focus on interpreting the related trademark laws. The interpretation of laws would be the same irrespective of the fact that the defendant is honest or not as future cases will also rely on this judicial interpretation.

2. The only way Toyota would have succeeded in this court battle going by the Supreme Court judgment is if they have got their trademark established in India in 1990 even while launching it in Japan or before 2001 (though the Indian market is not ready even now for hybrid cars). Is it practical for global majors to establish trademarks this way?

(Hint: Though it is possible to register trademarks globally using WIPO mechanism as Toyota had done in 28 countries before, it is impractical to process registration even for countries where they have got no future plans. We can surmise that this judicial precedent could be overridden by the Supreme Court in the future as dishonest small domestic players can easily mimic and register global trademarks at the behest of no trans-border reputation as yet in the market.)

9.8 SHORT ANSWER QUESTIONS



1. The _____ agreement facilitated by the WTO is the most comprehensive international multilateral agreement that allows international cooperation between member countries on IPR related regulations.
2. A _____ can be defined as any sign that individualises the goods of a given enterprise and distinguishes them from the goods of its competitors.
3. "Patent for invention" is called _____ patent.

4. ISI mark, FPO mark and BIS Hallmark are examples of _____ marks.
5. Under the TRIPS agreement, _____ are referred to as “Undisclosed information”.
6. _____ are the indications that identify a goods as originating from a particular geographical territory.
7. In order to facilitate international trade, the World Trade Organization has facilitated an international agreement termed “Trade Related Aspects of Intellectual Property Rights (TRIPS)” for its member countries. (True/False)
8. Patent and copyrights can extend for an indefinite period. (True/False)
9. The registration of a trademark is compulsory. (True/False)
10. A collective mark is used to show the trade connection to the organisation. (True/False)
11. Which of the following types of protection is provided by the Copyright Act?
 - a. Economic rights
 - b. Moral rights
 - c. Both a and b
 - d. None of these
12. Which of the following options is an advantage of registering a trademark under trademark Act?
 - a. Prevents any competitor from using the mark for similar goods
 - b. Provides legal protection under the trademarks law
 - c. Registration gives nationwide priority rights to use the trademark
 - d. All of these
13. Which of the following is defined as the visual and aesthetic design that makes a product attractive, appealing and adds to the commercial value of the product?
 - a. Industrial design
 - b. Geographical indications
 - c. Trademarks
 - d. None of these
14. In which of the following sectors has a major issue between India and the US with regard to protect of Intellectual Property Rights (IPRs)?
 - a. Pharmaceuticals
 - b. Health
 - c. Education
 - d. None of these

15. Which of the following Acts protects the Intellectual Property Rights for industrial design?
 - a. Designs Act, 2000
 - b. Trademarks Act, 1999
 - c. Copyrights Act, 1957
 - d. None of these
16. Which one of the followings is not an example of copyrightable objects?
 - a. Literary work
 - b. Artistic work
 - c. Musical work
 - d. Labour work
17. Which of the following laws provide protection to trade secrets?
 - a. Common law
 - b. Civil law
 - c. Trademarks Act, 1999
 - d. None of these
18. Which of the following is an advantage of Alternative Dispute Resolution (ADR)?
 - a. Fosters confidentiality
 - b. Saves cost and time
 - c. Both a and b
 - d. None of these
19. Which of the following does not have any specific Act as a legal remedy?
 - a. Trade secrets
 - b. Patents
 - c. Trademarks
 - d. None of these
20. Do layout designs of integrated circuits and plant varieties get protection under the IPR law?
 - a. Yes
 - b. No
 - c. May be
 - d. None of these
21. Which of the following characteristics determine whether an item is a trade secret?
 - a. The extent to which the trade information is known to the public or within a particular trade or industry

- b. The amount of money and effort spent in developing the secret information
 - c. The extent of measures taken by the trader to guard the secrecy of the information
 - d. All of these
22. Which of the following is not a condition for patentability?
- a. Inventive step
 - b. Industrial applicability
 - c. Inventive step
 - d. A method of agriculture or horticulture
23. Which of the following rights is given by the law to creators of literary, dramatic, musical and artistic works and producers of cinematograph films and sound recordings?
- a. Copyrights
 - b. Patents
 - c. Trademarks
 - d. None of these
24. Which of the following could be a brand name, a visual symbol that indicates the source of goods, a signature, name, label, packaging, logo, picture, a combination of any of these or other articles of commerce that perform the functions of individualisation and distinguishing?
- a. Copyrights
 - b. Patents
 - c. Trademarks
 - d. None of these
25. The protection for registered design under the Indian Act is available for a period of _____ years.
- a. 10
 - b. 20
 - c. 5
 - d. 15

9.9 DESCRIPTIVE QUESTIONS



1. Explain the term 'Intellectual Property Rights' and how they differ from tangible assets of an organisation. What are the different types of IPRs that are protected under law?
2. What are the intellectual assets that can be patented? What are the criteria for granting patents? Differentiate patents with copyrights.

3. Explain the role of trademarks in marketing and legal provisions regarding their registration.
4. Discuss with examples the concept of geographical indications as intellectual property rights and the associated laws in India.
5. Differentiate between designs that can be protected under copyright law vs. Designs Act in India and the legal provisions regarding the same. What kind of items can be protected under Designs Act, 2000?

9.10 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Protecting the Intellectual Property Rights (IPRs) of Business	1.	novelty, inventive step and Industrial applicability
	2.	d. None of these
	3.	c. It is enough if the company files a single patent with WIPO under PCT (assuming the foreign countries are members of PCT) and then follows it up with patent authorities of the respective countries.
	4.	True
	5.	False
	6.	True
	7.	a. Visual design and aesthetic appearance of a smart watch.
Wipo and the Alternate Dispute Resolution	8.	c. An agency of WIPO
	9.	IPR
Global Challenges in IPR	10.	d. All of these
	11.	TRIPS agreement
	12.	c. India's IPR laws do not comply with TRIPS

B. SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	TRIPS
2.	trademark
3.	Utility
4.	certification

Q. No.	Answer
5.	trade secrets
6.	Geographical indications
7.	True
8.	False
9.	False
10.	True
11.	c. Both a and b
12.	d. All of these
13.	a. Industrial design
14.	a. Pharmaceuticals
15.	a. Designs Act, 2000
16.	d. Labour work
17.	a. Common law
18.	c. Both a and b
19.	a. Trade secrets
20.	a. Yes
21.	d. All of these
22.	d. A method of agriculture or horticulture
23.	a. Copyrights
24.	c. Trademarks
25.	a. 10

9.11 SUGGESTED BOOKS AND E-REFERENCES



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COMPANY LAW

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶ Explain the concept of a Company and its legal characteristics
- ▶ Describe the legal provisions regarding the formation and incorporation of a company
- ▶ Elaborate on the purpose and regulations concerning memorandum of association and articles of association
- ▶ Describe the concept of the prospectus and its purpose
- ▶ Explain various aspects of memberships
- ▶ Explain the concept of shares and describe various types of equity and debt instruments

10.1 INTRODUCTION



Read
Pre-read Connect

In the previous chapter, you studied about the Intellectual Property Rights related to businesses and the global challenges related to the IPR. The chapter also discussed the concept of Alternate Dispute Resolution.

The company law in India is presently governed by the Companies Act, 2013. The company law in India followed British law on companies till Companies Act, 1913 before independence. After independence, the Act underwent several amendments and in 1956, the act was fully revised and re-enacted as Companies Act, 1956 with several major changes. The Companies Act, 1956 was the law governing companies until 2013. The Act, after undergoing several amendments based on the requirements of changing the business environment, was recently replaced with the new Companies Act, 2013 which received president's assent on 29th August, 2013, and became applicable from the financial year 2014-15. The new Act has several major changes including higher power for shareholders, provisions for corporate social responsibility, and the establishment of national company law tribunal among others. Subsequently, the government had amended the Company Law in 2017.

In this chapter, you will be introduced to the Companies Act, 2013 along with the concept of company formation and incorporation of a company, memorandum and articles of association. In addition, the chapter discusses the prospectus and membership. Towards the end, the chapter elaborates on borrowings, loans, debentures and investments.

10.2 COMPANIES ACT, 2013

The Companies Act, 2013 governs all listed and unlisted companies in India. It is applicable all over India. It is divided into 470 sections, 7 schedules and 29 chapters. In this Act, various new sections have been inserted in comparison to the older version of the Companies Act, 1956 which contained 658 sections.

The emphasis of the new Companies Act, 2013 is more on e-management, compliance and enforcement, disclosure norms, auditors, mergers, and acquisitions and governance practices. The new Companies Act has introduced the norms of disclosures, corporate social responsibility, etc.

10.2.1 OBJECTIVES

The Companies Act, 2013 was enacted to regulate companies and protect the interests of shareholders and other stakeholders. The new Companies Act, 2013 is implemented for achieving the following objectives:

- To make the key managerial personnel and directors accountable by defining their duties
- To make more stringent norms for the disclosure of various information at periodic intervals
- To make norms wherein, in many of the cases, the prior approval from the shareholders of the company is required

- To make a mandatory contribution towards corporate social responsibility
- To develop an economy by encouraging entrepreneurship
- To ensure that the formation and maintenance of companies is flexible and simple
- To ensure high standards of corporate governance
- To encourage transparency
- To ensure strict action against frauds
- To ensure timely approvals

The Companies Act, 2013 introduced a new type of business entity (or company) to the existing list, including the public and private limited companies. This new business entity is termed as One-Person Company (OPC). According to the **Companies Act, 2013**, an OPC means a company with only one person as its member [Section 3(1) of 2013 Act]. The draft rules state that only a natural person who is an Indian citizen and resident in India can incorporate an OPC or be a nominee for the sole member of an OPC.

Certain provisions under the new Companies Act, 2013 are as follows:

- Mandatory auditor rotation and provision of joint auditors
- Any services to be rendered by the auditor should be approved by the board of directors or the audit committee
- The standards on auditing have been accorded legal sanctity in the Companies Act, 2013 and would be subject to notification by the National Financial Reporting Authority (NFRA)
- The Companies Act, 2013, in several sections, has given cognizance to the Indian Accounting Standards, which are standards converged with the International Financial Reporting Standards, for their applicability in the future.
- Secretarial audits are compulsory for every public company with the paid-up share capital > ₹ 100 crores.
- The Companies Act, 2013 requires every company to observe secretarial standards specified by the Institute of Company Secretaries of India (ICSI) with respect to general and board meetings.
- Companies must conduct an internal audit and the auditor of a company is required to comment on the fact that the internal audit system of the company is commensurate with the nature and size of the company's operations. The Companies Act, 2013 mandates that a chartered accountant or a cost accountant or such other professional, as may be decided by the board to conduct, would be appointed as the internal auditor of the company. The companies that shall be required to appoint an internal auditor mandatorily as per the draft rules are as follows:
 - Every listed company
 - Every public company having the paid-up share capital of more than ₹ 10 crores

- Every other public company that has any outstanding loans or borrowings of more than ₹ 25 crores from banks or public financial institutions or has accepted deposits of more than ₹ 25 crores at any point of time during the last financial year.

10.2.2 | SCOPE AND MAJOR PROVISIONS

The Companies Act, 2013 is applicable to all companies registered and incorporated in India. Its major provisions are as follows:

- It lays down the procedure for incorporating a new company.
- It lays down the procedure for making changes in the chartered documents of a company, such as the Memorandum of Association (MoA) and Articles of Association (AoA).
- It lays down the procedure for conducting meetings of the Board of Directors.
- It lays down the procedure for conducting the meetings of the members.
- It lays down the procedure for voting in the matters of the decision to be passed at the meeting of the Board of Directors or the members.
- It lays down the procedure for appointing Directors and Managing Directors.
- It lays down the procedure for appointing other key managerial persons, such as the Chief Executive Officer, the Company Secretary and the Chief Financial Officer.
- It lays down the procedure for signing financial accounts and presenting the same to the members.
- It lays down procedures for prosecuting and punishing the key managerial personnel and Directors in case of default.



SELF ASSESSMENT QUESTIONS

1. Every public company having the paid-up share capital of more than ₹ _____ shall be required to appoint an internal auditor.
2. The Companies Act, 2013 introduced the norms for corporate social responsibility (CSR). (True/False)

10.3 CONCEPT OF COMPANY

The term 'company' means an association of persons for some purpose. Suppose you, along with your friends and alumni of your college, form a group of around 100 people and decide to perform some activities on the lines of self-employment to earn some monthly income. You call your group 'an association for social good' and split the profit achieved between yourselves.

Let us say your activities are completely within laws and you are able to earn little more than your expenses as you work only part-time. If you think there is nothing wrong in such an endeavour, you are wrong. As per the Companies Act, your association of friends will be considered as illegal under the law and you are liable to prosecution and penalties by government authorities, even though none

**NOTE**

Rule 10 of the Companies (Miscellaneous) Rules, 2014 prescribes that an unincorporated company, association or partnership consisting of more than 50 persons is illegal.

Important Concept

According to the Companies Act, 2013 of India, a company is a 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.

of your activities is wrong and may even be meant for social good. This is because 'any such association of more than 100 people which is formed with the intent of making profits' must be registered under the appropriate law. In this case, you should convert your association (conducting activities with the intent of making profits) as a partnership and adhere to the provisions of the Partnership Act or register the group as a company under the Companies Act, 2013 in order to avoid running an 'illegal association' under the law.

Let us now focus on the company form of business. Suppose you start a business along with your friends with initial capital contributed by all of you. Along with this initial capital, you are also able to get some bank loans. Two years after starting the business, in spite of your best and sincere efforts to run your business profitably, your business has to be wound up due to huge losses. Let us say, you initially contributed ₹ 40 lakhs and your friend ₹ 10 lakhs with a bank loan of ₹ 10 lakhs. You earned profits over the first year which you distributed to yourself and your friend. However, in the second year, losses were incurred and when you sold all the assets of the business, it came up to only ₹ 5 lakhs. Now, your bank wants the remaining ₹ 5 lakhs while your friend also demands his ₹ 10 lakhs. Both of them know that you are otherwise rich with inherited wealth. In the above scenario, are you liable to repay ₹ 10 lakhs to your friend and remaining ₹ 5 lakhs to the bank from your personal wealth which is in no way concerned with the business?

In the above example, your liability to pay depends on the legal form of the business entity under which business was operating. If you have registered your business as a sole proprietorship or as a partnership, then you are personally liable to pay the remaining ₹ 5 lakhs to the bank from your personal wealth. If your friend has given his ₹ 10 lakhs as a loan (not being a partner), then you are liable to repay his money too.

Suppose you have registered your business as a limited company under the Companies Act. In this case, you are not personally liable to pay except the proceeds of the sale of assets of the business on winding up. The bank cannot claim your personal property for the repayment of the loan. This is because the company is regarded as a legal entity under the law. In the case of a company, your liability is limited to the amount you have contributed as share capital to the company so that neither the bank nor your friend can have any claim on your personal properties.

10.3.1 | CHARACTERISTICS OF A COMPANY

The concept of 'limited liability' is one of the important features and advantages of the company as a legal entity. A bank cannot claim on your personal property because the bank gave a loan to your company and not to you. Similarly, your friend contributed equity to the company and not to you even if you were the one running the company. All this simply means that once you form and register a company, 'a new legal entity' is created under the law. No physical person in the name of the company comes into existence, but a new invisible legal person is said to have come into existence in the eyes of law.

The personal liability of a business owner and also that of any other equity shareholder is limited to the initial capital contributed to the company. As long as there is no fraudulence on your part or on managers, and business losses are

natural occurrence owing to the external economy and market-based reasons, those who are affected by the losses have recourse only to the company as a legal person and not shareholders.

Apart from the concept of limited liability, there are several other aspects of a company which are important from the perspective of the conduct of business and the Companies Act. These are discussed below:

- **Definition:** A company is an association of many persons who contribute money or money's worth and employ the collected amount for a common purpose. The persons who contribute such money are called 'members'. The proportion of the contribution of each member is called his 'share' in the capital of the company.
- **Incorporation:** A company needs to be registered under the Companies Act with the Registrar of Companies (ROC) according to the procedures prescribed. A minimum of seven persons are required to form a public limited company, while at least two persons are required for a private company formation.
- **Artificial legal entity:** In the eyes of the Act, the company is an artificial, invisible person who exists only in the eyes of the law. Since a company is only a creature made by law, it possesses only those properties that have been conferred upon it by its charter of creation.
- **Distinct legal entity:** The Company is a legal entity separate from its promoters or shareholders. It is an autonomous body self-controlling and self-governing. The ownership of assets of the company belongs to the company as a legal entity and not to the shareholders. In the eyes of law, the company is a different entity from its shareholders.
- **Distinct legal person:** Similar to persons who can purchase or sell goods or properties, enter into a contract with another person, obtain a loan from the bank, sue another person in court, companies also have similar rights and perform all those functions in their own names.
- **Perpetual existence:** Similar to the limited liability feature of companies, the concept of perpetual existence is the next major and important feature of companies. A company once incorporated by registration is said to exist forever until it is explicitly dissolved for any reason. The lifespan of a company goes beyond the lifespan of any of its promoters, managers or shareholders. These entities keep changing, but the company retains its identity and is said to have perpetual existence.
- **Transferability of shares:** The shares of a company are freely transferable. The shareholders of the company are free to sell their shares to others for due consideration in financial markets. Hence, the ownership of shares could be completely different at different points of time and so are those who run the company. The perpetual existence is facilitated by the concept of transferability of shares (and separation of ownership discussed next).
- **Separation of ownership and management:** This is the third major advantage of the companies as legal entities. Though the company is owned by the shareholders, they are not involved in the management of its business. Shareholders, as principals, set the objectives and goals for the company, through their agents in terms of their representatives. The representatives



NOTE

If a person has 5 shares, he will have 5 votes in a company. Therefore, the principle of voting in a company is 'one share one vote'.

are the directors of the company, who, in turn, appoint managers to run the company. This separation of ownership from management allows businesses to be run by professionals who are remunerated for their expertise while the profits are shared by the owners who contribute only capital.

- **Common seal:** Since companies are artificial legal persons, distinct from shareholders who contributed capital or managers who run it, the business transactions and contracts cannot be signed by these people. Hence, every company is required to have a common seal for authorising its transaction which is considered as the official signature of the company as a legal entity.

Table 1 shows the major differences between the partnership form of business and companies:

TABLE 1: Partnership vs. Company

S. No.	Basis	Company	Partnership
1.	Law and creation	Governed by the Companies Act, 2013. It is mandatory to register under the Companies Act.	Governed by the Partnership Act. Registration is not mandatory.
2.	Legal status	Incorporation of a company creates a new artificial legal entity	Partners and the firm are not separate.
3.	Liability	No personal liability. Limited to capital contributed.	Unlimited liability of partners.
4.	Legal formalities	Statutory books should be maintained. Financial statements should be audited, published and filed with authorities.	No such legal requirements.
5.	Resources	No limit for the number of shareholders and capital that can be raised.	Resources depend on the personal wealth of partners (maximum number of partners is limited).

10.3.2 | KINDS OF COMPANIES

Two major kinds of companies are: 1. Statutory Companies; and 2. Registered Companies. The statutory companies are companies formed by special Acts of the parliament, such as the State Bank of India. The other government and non-government companies that are governed only by the Companies Act, 2013 are called Registered Companies.

The next major classification of companies is public limited companies and private limited companies. The main difference is the membership. While public limited companies can freely invite the public for subscribing and contributing to its equity capital, private limited companies have restricted membership.

The registered public and private limited companies can further be classified as per the following characteristics:

- **Limited or unlimited liability:** We discussed limited liability companies above. It is theoretically possible to register companies with unlimited liability,

but such companies are not incorporated for profit-making businesses and usually have other objectives, like religion, scientific development, etc.

- **Limited by shares or guarantee:** Apart from companies limited by liability to the extent of shares contributed, it is also possible to create companies 'limited by guarantee'. In such companies, members of the company may 'guarantee' certain amount which is an additional liability taken by them voluntarily apart for share capital contributed, which can be invoked when the company is wound up. Such companies limited by guarantee are created for the formation of the sports club, trade associations, NGOs, etc.
- **Unlimited liability:** Companies incorporated with unlimited liability may or may not have share capital contributed (owing to the nature of their activity). Similarly, companies incorporated with limited guarantee may or may not have share capital contributed.

10.3.3 | DISTINCTION BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY



NOTE

The minimum number of directors in a public, private and OPC companies is 3 (three), 2 (two) and 1 (one), respectively.

As per the Companies Act, 2013, the public company means a company which is not a private company or a private company which is a subsidiary of a non-private company. A public company must have a minimum of seven members. The shares of a public company are freely transferable and there is no limit to the maximum number of members.

The main difference between a public limited company and a private limited company is in terms of the members or shareholders. While public limited companies can have unlimited shareholder members, private limited companies are restricted to few members. Since one of the major reasons for many of provisions of the Companies Act is to protect the interests of shareholders, and since the members of private limited companies are restricted, the Companies Act provisions governing private limited companies are less strict. The second major difference in the case of a private company is that it restricts the right of its members from freely transferring their shares.

The major differences between a public limited company and a private limited company are given in Table 2 as follows:

TABLE 2: Public Limited Company vs. Private Limited Company

S. No.	Feature	Public Limited Company	Private Limited Company
1.	Members	Unlimited number of shareholders with a minimum of seven members.	Shareholders limited to a maximum of 200 and a minimum of 2.
2.	Raising capital	Public invitation for the subscription to capital can be made.	Public invitation to subscribe for any securities of the company is prohibited.
3.	Transferability of shares	Freely transferable.	Right to transfer shares is restricted by Articles.

S. No.	Feature	Public Limited Company	Private Limited Company
4.	Privileges	All relevant provisions of the Companies Act need to be complied with.	As there is no involvement of public funds, the private limited companies are exempted from several provisions of the Companies Act and several others are less stringent.

Some important exemptions and privileges granted to private limited companies are as follows:

- Two persons are sufficient to start a private company
- Exempted from complying with provisions of the Act regarding the issue of a prospectus
- Exempted from restrictions placed on public companies with regard to kinds of share capital, voting rights, issue of shares with disproportionate voting rights
- Several exemptions are given with respect to the appointment of directors. For example, there is no need for the appointment of mandatory independent directors
- Exemptions regarding provisions pertaining to managerial remuneration
- No need to constitute an audit committee of the board

10.3.4 | LIFTING THE CORPORATE VEIL

Since a company is a legal entity separate from persons owning its share capital or running its management, a veil is said to be created between the promoters, managers and shareholders, and the external world once incorporation is done as a company under the Act. This corporate veil hides the persons behind the company.



Quick TIP

Section 135 of the Companies Act, 2013 deals with Corporate Social Responsibility (CSR), which means a company should spend a certain amount of money on CSR activities.

External parties transact business with the company rather than the persons behind the company. This is the reason due to which banks give loan to the company as an artificial legal person and not to the persons running the company. The liabilities of the company are different from those of its shareholders. It means that in case of any business dispute, courts treat the company as an artificial legal person that transacts with the external world and do not look into the persons behind the corporate veil.

Although courts usually regard the company as an artificial legal person and not its owners-promoters-shareholders, but there are certain cases when the courts are allowed to lift the corporate veil and probe the activities of the aforementioned persons. For example, we discussed in an earlier example that a company with excess liability over assets of ₹ 5 lakhs to the bank was dissolved, and it was stated that the bank had recourse only to the company to which it has given loan and not the promoters, owners and shareholders. In this case, if it had so happened that the business loss was not due to natural business and economic circumstances, but due to fraudulent activities of the promoter (such as diverting loan amount for

personal wealth creation), the bank will have recourse to the personal properties of the promoter or manager concerned.

Whenever courts find that the notion of legal entity is used to defeat public convenience, they are allowed to lift the corporate veil and regard the company as an association of persons. This is termed as the 'doctrine of lifting the corporate veil'. The doctrine is applicable in the following two cases:

1. Cases under judicial interpretation
2. Cases under statutory provisions

The various instances that are applicable under each of the above categories are listed in Table 3:

TABLE 3: Lifting the Corporate Veil

Cases under Judicial Interpretation	Cases under Statutory Provisions
<p>Courts can lift the corporate veil during the following instances:</p> <ol style="list-style-type: none"> 1. To investigate the character of the company 2. When the company acts as an agent of shareholders 3. When the company is formed <ul style="list-style-type: none"> - To evade taxes or against revenue interests of the government - To evade personal and statutory obligations - To avoid welfare legislation - To divert business opportunity to another company 4. When the company is used as a facade to cover fraudulent and illegal activities 5. When courts want to determine the expertise of the company 	<p>Statutory provisions of the Companies Act pertaining to the following instances allow lifting of the corporate veil and investigation of the persons behind the company:</p> <ol style="list-style-type: none"> 1. Define the relationship between holding and subsidiary companies 2. Investigate the affairs of the company 3. Investigate ownership of the company 4. When articles provide for directors with unlimited liability 5. Wind up proceedings throw up fraudulent activities 6. Misrepresentation in the prospectus 7. Ultra Vires act (beyond one's legal power or authority) 8. Several other statutory provisions that allow lifting of the veil

Important Concept
 Incorporation of a company is the process of company registration into a limited company and a separate legal entity at the Registrar of Companies (RoC).


SELF ASSESSMENT QUESTIONS

3. A technology company that raised huge capital with the promise of changing people's lives with innovative technical solutions went bankrupt due to faulty technology, which was unearthed much later. Customers suffered huge personal losses and damages due to faulty products produced by the company. Customers sued the company for getting compensation for damages suffered. In this case,

- a. The shareholders who were instrumental in setting up the company were also liable to pay for damages, if any, awarded by courts.
- b. Promoter shareholders are liable to compensate monetarily the affected consumers.

- c. Compensation cannot go beyond the proceeds of the sale of assets of the company after paying creditors and shareholders are not liable in any way.
 - d. All of these
4. The term 'corporate veil' means:
- a. Separate personality of the company as a distinct legal entity than that of persons behind it
 - b. The protection offered to consumers dealing with the company
 - c. Perpetual existence of the company
 - d. None of these
5. The partnership form of business can lead to unlimited liability for partners. (True/False)
6. The legal provisions regarding private limited companies are less strict than public limited companies. Choose the best reason from the choices below:
- a. Private limited companies have a limited number of shareholders.
 - b. Private limited companies cannot raise capital from the general public.
 - c. Private limited companies tend to be family businesses.
 - d. None of these.
7. Courts can look into the persons behind a company, like promoters, directors or managers in the following cases:
- a. Courts can always probe into persons behind the company as a company is an invisible artificial person in the eyes of the law.
 - b. Courts can probe into the persons behind the company under some specific statutory provisions.
 - c. Courts have to treat a company as an artificial legal person and can probe into the persons behind the company only in case of fraudulent or illegal activities, and misdeeds.
 - d. Both b and c

10.4 FORMATION AND INCORPORATION OF A COMPANY

The Companies Act regulates the formation and incorporation of a company. There are several provisions that stipulate requirements and procedures that should be adhered to in the process of the creation of a new company. In general, the company formation consists of two stages: 1. Promotion stage; and 2. Incorporation stage.

10.4.1 PROMOTION

It is the stage prior to the incorporation and commencement of the business company. Before a company can be formed, somebody conceives the idea of the

business and works on that idea. The person who initiates the formation of the company with the intention of starting his business based on his idea is termed as the 'Promoter'. The promoter may also take help from the external entities, like functional experts in the field, managerial experts, legal experts, technical experts, etc., towards starting the business. Since the concept of a promoter is important in companies act, Section 2(69) defines the term 'promoter' as follows:

1. The person who is identified as the promoter in the prospectus or in its annual return; or
2. The person who has control over the affairs of the company, directly or indirectly, whether as a shareholder, director or otherwise; or
3. The person under whose instructions and advice the Board of Directors is accustomed to act



STUDY HINT

Company formation is also known as company registration or company incorporation.

Functions of the promoter include conceiving the business idea; undertaking the detailed technical, economic and commercial feasibility of the project idea; conducting negotiation with suppliers for business contracts; deciding on the name, location, scope of business, etc., of the company; getting the memorandum and articles of associated drafted and printed; arranging for the preparation of the prospectus, raising funds for the company and to pay preliminary expenses

As per the Companies Act, the promoter has a fiduciary (relationship involving trust) obligations or duties to the company as follows:

- Duty as not to make secret personal profit or aggrandisement during the promotion of the company; and
- Duty to disclose material facts regarding the formation of the company

When a promoter spends his personal money in promoting the company which will become a separate entity after incorporation, he has legitimate rights to claim reimbursement of such expenses as well as remuneration for doing activities of promoting the company. The Act provides various means by which remuneration can be given, e.g., a lump sum remuneration in terms of cash, shares or debentures.

10.4.2 | INCORPORATION

Incorporation refers to the process of bringing the company into existence as a separate corporate legal entity. Steps involved in the process of incorporation of a company are as follows:

1. The promoter should apply to Registrar of Companies (RoC) to ascertain the availability of company name (Form 1A with six suggested names should be filed).
2. The process requires legal expertise and, hence, promoter should appoint chartered accountants, lawyers, etc., to prepare various legal documents.
3. Draft the Memorandum of Association and Articles of Association by solicitors and vet the same with RoC.
4. Within 60 days of approval of the name, the promoter can apply for registration of the company.

5. After submission of all relevant documents and information required under the Act, the Registrar shall register the details in the register and issue a "Certificate of Incorporation" (with an allotment of corporate identity number) to the effect that the proposed company has been incorporated under the Act.

**NOTE**

The prospectus is issued by a company as a legal document which discloses the securities offered for sale to the public or investors.

Online registration of companies is also possible following similar steps. The registration of the company should be done with the Registrar situated in the State in which the registered office is located with the following documents and information:

- Memorandum of Association and Articles of Association duly signed by all the subscribers as prescribed
- A declaration by a qualified person (like an advocate, chartered accountant etc., involved in the formation of the company) and a person named in articles as director, manager or secretary that all the requirements as per law for the incorporation of the company have been complied with
- An affidavit by members subscribing to the memorandum and first directors named in the articles that they are not convicted in any offense or any fraud or any breach of duty under the Act and that all the information given in the documents are true to their knowledge
- Address for correspondence till registered office is established
- Particulars of personal details of subscribing members who have signed the memorandum and the personal details and interests of first directors named in the articles

The 'Certificate of Incorporation' is the legal document that brings the company into existence from the date mentioned thereto and grants legal personality, corporate existence and perpetual succession to the company. The memorandum and articles of association become binding upon the members and the company as if they have been signed by the company and the members.

**NOTE**

In the Companies Act, 1956, there was a requirement to obtain a 'Certificate of Commencement of Business' for public companies before the start of business which has been deleted in the new Companies Act, 2013.

10.4.3 | FLOATATION/RAISING OF CAPITAL

A new public company or a company with no track record of profits and not meeting the other similar eligibility conditions as prescribed by regulations of Securities and Exchange Board of India (SEBI) cannot raise equity capital from the public by floatation of equity shares in the capital market. For such newly formed companies, the common sources of capital are the capital brought by the promoters and his friends and family circle, the venture capital firms, private equity funds and other such special avenues available for entrepreneurs.

A public limited company that meets the eligibility conditions of SEBI can raise capital through any of the following methods: 1. Public Offer; 2. Offer for Sale; 3. Rights Issue; and 4. Private Placement. A private limited company can raise equity capital through Rights Issue or Private Placement.

A public offer may be an Initial Public Offer (IPO) made when the company raises capital for the first time from the capital markets or a follow-on public offer (FPO). It is an offer for the general public to subscribe to the shares of the company in the primary market made through the issue of a 'Prospectus'. There

are several methods of raising such capital from the public – Offer for sale, Book building method, Fixed price issue method, etc., all of which involve employing an investment banker for the purpose as per the SEBI regulations. The term ‘Offer for Sale’ may involve offloading the existing shares of promoters and venture capital funds who have initially invested during the start-up of the company to the general public (with a premium over par value). No new or fresh equity shares are created in the case of an Offer for Sale method.

Companies which have already raised equity capital from the public before, and intends to raise further equity capital with FPO, should first mandatorily offer its existing shareholders an opportunity to subscribe to the newly issued shares. This is a right granted by the Companies Act to the existing shareholders in order to ensure that their existing proportion of the share capital with the company is not diluted. Such an issue of new shares made to the existing shareholders is called the ‘Rights Issue’. It is mandatory for the companies to make ‘Rights Issue Offer’ to the existing shareholders before they can raise further capital from the general public.

The method of private placement involves raising equity capital from friends and relatives of promoters or from qualified institutional investors in compliance with the regulations of SEBI. No public offer is made in the case of private placement of equity shares.



**SELF
ASSESSMENT
QUESTIONS**

8. Tick the wrong statement with regard to the term ‘promoter’ of a company:
 - a. A promoter is a person who is identified so in the prospectus.
 - b. A promoter is a person who has control over the affairs of the company.
 - c. A promoter is a person who instructs and advises the board of directors.
 - d. A promoter of the company cannot reimburse or remunerate himself once the company is incorporated.
9. Which of the following documents should be registered with the Registrar of Companies during the incorporation of a company?
 - a. Prospectus
 - b. Memorandum of Association
 - c. Articles of Association
 - d. Both b and c

10.5 MEMORANDUM OF ASSOCIATION

The Memorandum of Association is the legal document that defines the objects of the company, functions as the charter or constitution of the company that governs the relationship of the company with the rest of the world and lays down fundamental conditions upon which alone the company is formed. It is a public document available for inspection at the Registrar’s office and anybody dealing with a company is expected to have sufficient knowledge of its contents.



STUDY HINT

Sections 2(56), 4 and 399 of the Companies Act, 2013 define memorandum of association (MoA) as a public document which means if a person is entering into a contract with a company, then he/she is supposed to have a knowledge of the company's MoA.

The Memorandum allows anyone to know the field of activity of a company. This makes possible for shareholders to know for sure in what kind of businesses will their money be deployed by the company. A company that raises equity capital for the business of making automobiles cannot decide to deploy the money to start an IT company or real estate business (unless their memorandum permits those businesses also). Similarly, anybody else dealing with the company, for example, the suppliers can know whether their transaction is legally allowed as per the objects of the company.

The important clauses of a memorandum are briefly explained below:

- **Name and situation clauses:** Name of the company registered with the RoC should mandatorily end with the term 'Limited'. The situation clause should provide the address details of the registered office of the company.
- **Objects clause:** This is the most important purpose of the memorandum as this clause states the objects of the company, beyond which the company cannot do any activity. Any business done outside the objects of the memorandum will be considered illegal and void.
- **Liability clause:** This clause mentions the liability of the members. This depends on the type of company and relevant provisions of the Act applicable to them. For a public limited company, the liability of the members is limited to the share capital subscribed by them.
- **Capital clause:** This clause states the amount of share capital with which the company is initially registered, usually termed as 'authorised share capital' or 'nominal capital'.
- **Association clause:** This clause states that the persons subscribing their signatures at the end of the memorandum are desirous of forming themselves into an association. A minimum of seven persons should sign the memorandum along with a witness signature for a public limited company.

10.5.1 | DOCTRINE OF 'ULTRA VIRES'

The term 'ultra vires' means 'beyond powers'. Any activity done by a company that is contrary to the objects or beyond the scope of the objects stated in the memorandum of association will be treated as 'ultra vires' or 'beyond the legal powers and authority of the company'. Following are the ramifications of such acts:

- Such acts will be considered as wholly void and not binding on the company
- Such acts cannot be legalised or ratified even with the unanimous consent of all the members of the company
- Any member of the company can bring an injunction to restrain a company from doing ultra vires activities
- Directors of the company are personally liable for funds used ultra vires
- Contracts entered by the company that are ultra vires will be considered void
- Banks that lend money to a company for activities that are ultra vires cannot recover the money under that loan agreement

- If the company lends money ultra vires, the contract will be considered void
- A company can be made liable for the torts (civil misconduct) of its employees only for activities that are not ultra vires.

10.5.2 | ALTERATION OF MEMORANDUM

Since the memorandum of association is one of the most important documents that functions as the charter or constitution for the company, the alterations to the document are strictly regulated by the provisions of the Act. Though any of the clauses of the memorandum can be altered, several restrictions have been put in place. Some of the alterations require a general resolution, some alterations require special resolution and others require central government approval in addition to a resolution. The provisions for change in the MoA are given in Table 4 as follows:

TABLE 4: Provisions for Change in the MoA

S. No.	MoA Clause	Provisions for Change
1.	Name Clause	The company name can be changed by passing a special resolution and getting approval from the central government
2.	Situation Clause	Shifting registered office from the location of one registrar office to another requires passing special resolution and approval by the regional director. Shifting to another state requires both special resolution and central government approval
3.	Objects Clause	Objects can be changed by passing a special resolution
4.	Liability Clause	Liability clause can be altered by passing a special resolution with the authority of articles of association
5.	Capital Clause	Increase in share capital – By passing an ordinary resolution Reduction of share capital – Through special resolution under the authority of articles along with approval from Tribunal Rights of shareholders – Special resolution is required. In some cases, approval from Tribunal is also required



**SELF
ASSESSMENT
QUESTIONS**

10. Which of the following statements is true with regard to the memorandum of association?
- a. A company is not restricted to the scope of activities mentioned in the memorandum.
 - b. The law does not require anyone dealing with the company to know the contents of the memorandum beforehand.
 - c. Liability clause of the memorandum states the nature of liability of members.
 - d. The doctrine of indoor management requires external people to be aware of the internal management of the company before entering into any contract.

11. Which of the following clauses of a memorandum can be altered with an ordinary resolution?
- Name Clause
 - Objects Clause
 - Increase in authorised share capital
 - Change in scope of business activities

10.6 ARTICLES OF ASSOCIATION



Quick TIP

Articles of Association contain information in relation to the board of directors, general meetings, voting rights, board proceedings, etc.

The Articles of Association is an important document of a company that specifies rules, regulations, and bye-laws for the internal administration of the company. It governs the relationship between the company and its constituent members by prescribing their rights and obligations. However, it does not have the force of a statute and the doctrine of ultra vires cannot be used to test the validity of an action under the Articles.

The contents of the Articles pertain to the following subject matter:

- Definitions of important terms and phrases
- Share capital and rights attached to different classes
- Procedures regarding making calls and forfeitures of shares
- Appointment of managerial personnel, their power, rotation, duties, etc.
- Rules regarding matters, such as transfer of shares, issue of shares, general meetings, common seal, dividend and reserves, accounts and audits, remuneration of managers, issue of redeemable preference shares, a lien on shares, paying commissions and fixing rate thereof, and winding up of the company

10.6.1 ALTERATION OF ARTICLES

The subject of the alteration of articles is an important one. This is because the articles specify several important rules and regulations regarding the conduct of the affairs of the company and any changes can easily affect or benefit the company or others related to the company. As per the Companies Act, a company has the power to alter its articles even with retrospective effect. Articles can be changed by passing a special resolution. Following are some important Companies Act provisions with regard to the alteration of articles:

- Articles can be altered only through a special resolution (articles cannot contain any rule that state that alteration can be done through ordinary resolution). Articles cannot also restrict alteration (amounting to taking away powers of the company)
- Alterations in Articles cannot go beyond any provisions of the memorandum
- Articles cannot be illegal, contrary to any statute or public policy
- The power to alter articles should be exercised in good faith for the benefit of the company as a whole

10.6.2 | BINDING FORCE OF MEMORANDUM AND ARTICLES

The memorandum and articles bind the company and the members thereof to the same extent as if they respectively had been signed by the company and each member to observe all the provisions of the memorandum and the articles. The articles of association bind the company to its members, the members to the company and the members to each other. The articles constitute a contract between a company and its members in respect of rights and liabilities as members. The salient features of the Act in this regard are:

- The company is bound to the members to observe and follow the articles. In case of a breach, members can restrain the company by bringing an injunction.
- The articles are binding on the members and the company can sue its members in case of any breach.
- The articles are also binding between members of the company subject to the relevant provisions of the Act.
- The memorandum and articles do not constitute a contract between the company and any third party. Neither the company nor its members are bound to the outsiders to give effect to the provisions of the memorandum and articles. This ensures that no outsider can take advantage of articles to found a claim thereon against the company.

10.6.3 | DIFFERENCE BETWEEN MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION

The differences between articles and memorandum are given in Table 5 as follows:

TABLE 5: Memorandum of Association vs. Articles of Association

S. No.	Feature	Memorandum of Association	Articles of Association
1.	Purpose	Stipulates the scope of business activities that can be undertaken by the company	Stipulates the rules and regulations to manage company affairs
2.	Authority	It is subordinate to the Companies Act, 2013	Articles are subordinate to the provisions of the Memorandum
3.	Nature	Specifies conditions that creditors, shareholders and the outside public must keep in mind while dealing with the company	Constitute a contract between the company and its members
4.	Changes	Alterations are difficult to achieve and involve stricter conditions like approval from central government or tribunal	Can be easily altered by passing a special resolution
5.	Ratification	Acts beyond the scope of memorandum are null and void and cannot be ratified by any means	Acts beyond the articles are considered as irregular and can be ratified later by shareholders

10.6.4 | DOCTRINE OF CONSTRUCTIVE NOTICE



NOTE

The doctrine of indoor management and the doctrine of constructive notice are opposite and exceptional to each other.

The memorandum and articles of association specify the scope of objects of the company and the rules and regulations pertaining to those objects. Considering the doctrine of ultra vires, and binding force of memorandum and articles, it is necessary that a person dealing with a company know the contents of those documents prior to their dealings with the company. Since these documents are public documents available for inspection for anybody at the Registrar office, it becomes the duty of the persons to inspect those documents and make sure that their contracts with the company are in conformity with the memorandum and articles. Hence, as per the 'Doctrine of Constructive Notice', a person dealing with a company is deemed to know the contents of the company's memorandum of association and articles of association. Under the Act, every person is presumed to know the contents of the documents and they cannot declare ignorance later. The doctrine of constructive notice is also applicable for other documents like special resolutions and particulars of charges which are required to be registered with the RoC by the Act.

However, the doctrine is considered unreal when it comes to the practical world as it does not take notice of the realities of business life. People know the company through its officers and not through its documents. Hence, courts in India do not take the doctrine very seriously as per current judicial precedents.

10.6.5 | DOCTRINE OF INDOOR MANAGEMENT

A person can read the memorandum and article to understand the permitted scope of business activities of a company and the bye-laws of its management. However, it is not possible for him to know the internal management of the company. The doctrine of indoor management says that though a person is presumed to have the knowledge of memorandum and articles, it is not required of him to enquire into the regularity of the indoor proceedings. As per the doctrine, a person will not be affected by any irregularity in the internal management of the company. The doctrine provides protection to the outsiders by requiring the management of the company to do all things according to the procedure prescribed by the Articles. The duty of observing internal management procedures prescribed, such as the constitution of the board, quorum, voting, internal regulations, and resolutions etc., has been imposed upon those who are responsible for the management affairs of the company.

It is important to note that the people will be reluctant to deal freely with all companies in the absence of such protection. Hence, the Act provides for the doctrine of indoor management.



SELF ASSESSMENT QUESTIONS

12. The main purpose of the Articles of Association is
 - a. To define the scope of business activities of the company
 - b. To define the organisational structure of the company
 - c. To stipulate the rules, regulations, and bye-laws regarding internal management
 - d. None of these

13. It is more difficult to alter the articles of association than the clauses of the memorandum of association. (True/False)
14. The memorandum of association and articles of association bind the company and its members as if the company and the members have signed a contract to observe the clauses of these documents. (True/False)
15. The doctrine of constructive notice is not strictly followed by courts in India. (True/False)

10.7 PROSPECTUS

In the earlier section, we studied briefly about the methods of floatation and raising of capital. Companies need to raise capital from primary markets as and when they require additional funds for new projects and for expansion of business activities. Investors will be willing to subscribe to the fresh equity shares if they are convinced that the company will continue to grow and make profits. Hence, they would be interested in knowing why the company is raising capital and the expected future growth trajectory of the company before they decide to invest in the company by subscribing to new shares. Hence, the companies need to publish the required information for investors when they invite the public for subscribing to additional capital. The 'prospectus' is the public document inviting the general public to subscribe to the share capital of a public company. Thus, the prospectus is the document that makes an offer for sale of equities to the public with all the requisite information that may be required for the investors in their decision making.

The Companies Act and SEBI regulations stipulate the following requirements with regard to prospectus with the objective of safeguarding the investor interests:

- The raising of capital and the issuing of prospectus should comply with the obligations stated in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. The SEBI regulations stipulate various conditions, like the mandatory appointment of a lead merchant banker, Bankers to the issue, Registrar to the issue, etc.
- The prospectus should be registered with the RoC. There are several other documents that should be filed along with the prospectus as stipulated in the Act.
- The company should file the prospectus with the RoC through the lead merchant banker. SEBI provides detailed guidelines regarding the content of the prospectus, like mandatory disclosures required, pricing of securities, etc.
- The prospectus should not contain statements of experts who are in any way connected with the formation, promotion or management of the company. Any expert views should be published only with the consent of the person who must be competent to make such statements.
- The prospectus must state the matters and contain reports specified in Section 26 of the Act.
- Every application form for subscribing shares or debentures of a company shall not be issued unless it is accompanied by a prospectus or an abridged prospectus.

10.7.1 | CONTENTS OF PROSPECTUS

The prospectus generally consists of information like:

- Names and addresses of the registered office of the company
- Date of opening and closing of the issue
- Details about the underwriting of the issue
- Authority for the issue and the details of the resolution passed therefor
- Capital structure of the company
- Main objects of the public offer
- Terms of the present issue and such other particulars
- Main objects and present business of the company
- Schedule of implementation of the project
- Particulars relating to management perception of risk factors specific to the project
- Gestation period of the project
- Extent of progress made in the project
- Deadlines for completion of the project and any litigation or legal action pending
- Disclosures about the source of promoter's contribution
- Reports by the auditor of the company with respect to its profit and losses and assets and liabilities, etc.

Section 26 of the Companies Act contains the information to be provided in the prospectus.

10.7.2 | GOLDEN RULE OF PROSPECTUS

The prospectus should contain all information required as per laws and regulations in this context and must make all statements with scrupulous accuracy and not state facts that are not strictly correct. The golden rule to be followed while framing the prospectus states that the prospectus should disclose the true nature of the company's venture. Since the public is invited to take shares on the faith of the representation made in the prospectus, nothing should be stated as a fact which is not so, and no fact should be omitted, the existence of which might, in any degree, affect the nature or quality of the privileges and advantages which act as an inducement to take shares.

10.7.3 | MIS-STATEMENTS IN PROSPECTUS AND LIABILITY

If the prospectus contains misleading information, false statements, or omits material facts, then shareholders have remedies against the company and its directors. The directors, promoters, and others responsible for such misleading information are liable for their mistakes under civil laws, criminal laws, and general contract law. The shareholders also have rights of rescission and rights of action for damages against the company.

10.7.4 | DEEMED PROSPECTUS

In the offer for sale method of issuing the shares, the entire share capital is allotted to an intermediary called 'Issue house'. The House then offers the shares to the public by means of an advertisement on its own. As per Section 25, where a company allots shares with a view to these being offered by the allottees for further sale to the public, the document by which such an offer for sale is made to the public shall be taken as 'the prospectus by implication' (or deemed prospectus) issued by the company subject to provisions in this regard. This is basically meant to provide an exception to the issue of the prospectus in the case of the method of an offer for sale.

10.7.5 | PRIVATE PLACEMENT

According to Section 42 of the Companies Act, 2013 as amended by the Companies (Amendment) Act, 2017, a company can make an offer for private placement and application in a form and manner as may be prescribed to the persons identified by the board. The private placement shall be made only to a select group of persons whose number shall not exceed fifty or such higher number as may be prescribed (excluding the qualified institutional buyers and employees of the company).



Quick TIP

A private placement is also known as a non-public offering where securities are sold to a small number of selected investors.

10.7.6 | SHELF PROSPECTUS AND INFORMATION MEMORANDUM

A shelf prospectus means a prospectus issued for one or more issues of the securities or class of securities specified in the prospectus. In order to avoid unnecessary repetition of issuing of prospectus for a company that wishes to make more than one offer of securities in a year, the Companies Act provides for issuing 'shelf prospectus' which remains valid (on the shelf) for a specified period of time during which more than one offer of securities can be made.

A company filing a shelf prospectus is required to file an information memorandum containing all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities, and the succeeding offer of securities and such other changes as may be prescribed with the registrar within the prescribed time.

10.7.7 | RED HERRING PROSPECTUS

Red Herring Prospectus is a prospectus that does not specify the complete particulars regarding the quantum or price of the securities being offered. A company can issue a red herring prospectus prior to the issue of the prospectus. The red herring prospectus is used in cases like book building method of raising funds where the price is not fixed prior hand. It should be filed with the registrar at least three days before the opening of the offer. Once the price and quantum of capital raised are fixed, the final prospectus will be issued.



SELF ASSESSMENT QUESTIONS

16. Which of the following statements is true with regard to the prospectus?
- It is a document meant to invite the general public to subscribe to the new issue of shares.
 - It should be filed with the Registrar through a lead merchant banker.

- c. The content of the prospectus should follow the relevant provisions of the Companies Act and SEBI regulations.
 - d. All of these
17. The golden rule of prospectus states that:
- a. The pricing of shares should always be at a discount to fair value.
 - b. It should contain only minimal information as required by law.
 - c. It should make statements with scrupulous accuracy and avoid statements which are not strictly correct and thereby reflect the true nature of the company's venture.
 - d. None of these

10.8 MEMBERSHIP

According to Section 2(55) of the Companies Act, 2013, a member of a company means:

- (a) subscriber to the memorandum of the company
- (b) every other person who agrees in writing to become a member of the company and whose name is entered in the register of members of the company
- (c) every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository

Important Concept

A part of the profit which is paid to the shareholders of the company is called dividend.

10.8.1 RIGHTS OF MEMBERS

The shareholders have several rights under the Companies Act, 2013 as listed below:

- Any amendments to memorandum or articles of association can be done only in a general meeting of a company by giving sufficient notice to all shareholders. The shareholders have voting rights in accepting or rejecting the resolutions passed in such general meetings.
- There are several other cases which require voting of shareholders in a general meeting or in an extraordinary general meeting convened for the purpose. The shareholders have the right to attend and vote in such meetings.
- Shareholders have the right to transfer shares freely.
- Shareholders have the right to receive dividends. The declaration of dividends is subject to shareholders' approval at an annual general meeting (However, it is not mandatory for a company to distribute dividends every year, in comparison to preference share dividends which is mandatory, as the company may choose to reinvest the profits in expansion projects).
- The Companies Act, 2013 also provides provisions for the protection of minority shareholders in the case of oppression or mismanagement of the affairs of the company by majority shareholders.

10.8.2 REGISTER OF MEMBERS

Companies are required under the Act to keep and maintain the following registers in such a form and in such a manner as may be prescribed namely, a. register of members indicating shares held by each member; b. register of debenture holders; and c. register of other security holders.

It is important, however, to note that the debenture holders are not members of the company. The term 'members' of a company, in general, refers only to the shareholders of the company.



EXHIBIT

SHAREHOLDER VS. MEMBER OF A COMPANY

A member is different from a shareholder in the following ways:

1. A company is registered with the RoC that has no share capital but the members are registered under the memorandum of association. In such a case, there are only members because there is no share capital of the company.
2. Certain persons may hold share warrants or debentures. Such persons are shareholders but not members of the company.
3. In the case of demise of a member of a company, his/her legal representative is only a shareholder but not a member.



SELF ASSESSMENT QUESTIONS

18. Choose the right statement(s) with regard to members of a public limited company:
 - a. All the shareholders of a public limited company are its members.
 - b. Those who are listed as members in the memorandum can only be termed as its members and not all shareholders.
 - c. Those who are registered as members (or beneficial owners in depositories) with the registrar of companies are its members.
 - d. Both a and c

10.9 CONCEPT OF SHARES

Shares refer to the share of equity capital contributed by a member to the share capital of a company represented by the certificate of shares (which may be in the physical or dematerialised form). The equity share represents the interest of a shareholder in the company measured by the sum of money it represents for the purpose of his liability and interests thereto. A person holding a share is entitled to enjoy not only the contractual rights but also those rights, which have been granted to him by the Companies Act. The share represents the right to receive a proportionate share of profits, if any, and proportionate part of the assets of the company upon liquidation. According to Section 43 of the Companies Act, 2013, there are the two types of the share capital of a company: (1) Equity shares; and (2) Preference shares.

10.9.1 | EQUITY SHARES



NOTE

Equity shares are also called ordinary shares.

Apart from the rights mentioned herewith, equity shareholders also enjoy the right to vote on resolutions passed in company general meetings, thereby giving him the right to participate in the decision making of the management. Other characteristics of ordinary equity shares are:

- Owners of equity shares are entitled to dividends declared out of profits
- Dividends are paid to ordinary shareholders only after the dividends have been paid to preference shareholders
- The Companies Act also allows for the issue of equity shares with differential rights with regard to dividend and voting rights.

10.9.2 | PREFERENCE SHARES

Preference shares are shares which carry a preferential right over other classes of shares with respect to the payment of dividend every year and repayment of capital (if and when the company is wound up). In general, preference shares require a fixed amount of dividend to be paid every year (unlike ordinary equity shares where the dividend may be higher, lower or nil depending on profits made). There are different types of preference shares depending on how the dividend is paid over the years as follows:

- **Non-cumulative preference shares:** If the company does not make a profit in any year, no preference dividend will be declared
- **Cumulative preference shares:** If the dividend is not paid in any year, it will be paid in the subsequent years as the unpaid dividends are cumulated over years.
- **Participating preference shares:** These shares allow preference shareholder to participate in surplus profits made by the company beyond fixed preference dividend based on the limits specified after payment of dividend to ordinary shareholders.
- **Convertible preference shares:** The holders of these shares have the right to convert the preference shares into ordinary equity shares after the stipulated period of time.
- **Redeemable preference shares:** These preference shares can be redeemed (i.e., capital is repaid to shareholders and shares extinguish) after a certain period of time stipulated or at the will of the company by giving notice.

10.9.3 | SHARE WARRANT AND SHARE CERTIFICATE

The share certificate refers to the certificate issued by the company under its common seal specifying the shares held by any member. Shares are not negotiable instruments and should be registered in the owner's name with the registrar. At present, all shares are issued and transacted in dematerialised form and no physical shares exist. The depositories hold the shares in dematerialised form as the beneficial owner of the shareholders.

Share warrants are options issued by a company giving the warrant holder a right to subscribe to equity shares at a pre-determined price on or after a pre-determined

period of time. Section 2(81) defines securities as securities defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 which includes share warrants.

10.9.4 | TRANSFER OF SHARES

Shares of a public limited company are freely transferable and Articles cannot put any restrictions. Restrictions can be placed in articles for the transfer of shares in the case of private limited companies. Since all shares in the Indian capital market are now issued and traded in dematerialised form, it is now possible to transfer shares electronically and the procedures laid down in the Companies Act for physical shares are not applicable to non-physical shares.

10.9.5 | TRANSMISSION OF SHARES

Transfer of shares on account of the operation of law is termed as transmission of shares. It is applicable in case of death, insanity or insolvency of an individual member or liquidation of a company member. The person claiming title should apply to the company for transmission of shares in his name and no formal instrument or stamp duty is required for such transmission.



Quick TIP

Transfer of shares is voluntary, whereas transmission of shares involves an operation of law.

10.9.6 | NOMINATION OF SHARES

Every holder of securities of a company can nominate a person with whom the securities shall vest in the event of his death, as per procedures prescribed. It is also possible to nominate shares held jointly by more than one person.

10.9.7 | FORFEITURE OF SHARES

It is possible that companies do not require investors to pay the entire amount related to the subscription of equity shares during the initial subscription. Such unpaid amount on the partially paid-up shares may be called for payment later by the company. If a member fails to pay any call, or instalment of call, on the day appointed for payment of partly paid equity shares, the board may serve a notice on him requiring payment of the amount unpaid together with any interest that may have accrued failing which the company may forfeit the shares. If the payment is not made within the period specified in the notice, the shares are liable to be forfeited. The forfeited share may be sold or otherwise disposed of on such terms and in such a manner as the board may think fit.



Important Concept

Forfeiture of shares is the cancellation of share allotment due to the non-payment of call money by the member or shareholder.



SELF ASSESSMENT QUESTIONS

19. Which of the following statements is true with regard to dividends?
- Preference dividends are fixed and do not vary with the profits of the company.
 - It is mandatory to pay the dividend for ordinary equity shares if the company makes profits.
 - Cumulative preference equity shares only state a minimum dividend rate to be paid. Companies can make higher dividends if profits allow and if they so desire.
 - Participatory preference shares allow voting rights.

10.10 BORROWINGS, LOANS, DEBENTURES AND INVESTMENTS

Apart from equity capital, companies can also raise debt capital. The debt capital can be raised through borrowings from commercial banks or through public issue of debentures (i.e., bond instruments). Companies can also lend to other entities or invest in other companies subject to company law provisions in this regard which are as follows:

- The board of directors has the power to borrow, lend or invest money in accordance with the provisions of the Act in this regard, which they can delegate to other managerial personnel. In accordance with this power, the company can make an arrangement with bankers to borrow money by way of overdraft, cash credit and other types of loans.
- The board of directors can exercise the power to borrow only with the consent of the company by a special resolution if the borrowed money, together with money already borrowed, exceeds the aggregate of its paid-up share capital and free reserves.
- Companies can issue secured debentures subject to such terms and conditions as may be prescribed. They have to create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised except for redemption of debentures. The company shall pay interest and redeem debentures in accordance with the term of conditions for their issue.
- If the prospectus issued for subscribing to debentures invites members exceeding 500, then the company should appoint one or more debenture trustees before making such an offer. The debenture trustee shall take steps to protect the interests of debentureholders and redress their grievances.
- A company can make investments through not more than two layers of investment companies (investment companies are companies whose principal business is the acquisition of shares, debentures, and other securities).
- No company can give a loan to any person or body corporate exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.



SELF ASSESSMENT QUESTIONS

20. The Companies Act, 2013 has completely done away with the requirement of appointing one or more debenture trustees before making a public issue of debentures. (True/False)

10.11 SUMMARY



- The Companies Act governs the businesses in India. The latest legislation in force is the Companies Act, 2013 (Act) as amended by the Companies (Amendment) Act, 2019.
- The Act defines the concept of the company, legal procedures for incorporation of the company, the method of establishing the charter and bye-laws of the

company through memorandum and articles of association, and the several legal provisions to be adhered to in respect of establishment and conduct of companies in India.

- A company is an artificial legal person with distinct legal entity status, separate from the association of people who form the company to undertake the business activity.
- Some important characteristics applicable for a company include limited liability, perpetual existence, separation of ownership and management, common seal as the signature of the company, transferability of the ownership of shares etc.
- Companies can be classified into statutory and registered companies. Companies can be limited by shares or guarantee. Companies can also be formed with or without share capital. Registered companies are classified as private limited and public limited companies. Private limited companies have restricted membership and cannot raise equity capital from the general public.
- At times, courts may look into the persons behind the corporate veil of separate legal status. This is referred to as the doctrine of lifting the corporate veil.
- Incorporation of the company requires registration of the company with the Registrar of Companies by filing appropriate forms, the Memorandum of Association and the Articles of Association.
- Memorandum of Association is the legal document that defines the objects of the company and functions as the charter or constitution of the company governing the relationship between the company and the rest of the world.
- Articles of Association specifies the bye-laws of carrying out the business activities in terms of rules, regulations and procedures regarding internal administration of the company.
- People dealing with a company are presumed to have the knowledge of the contents of the MoA and AoA. This is called the doctrine of constructive notice. As per the doctrine of indoor management, a person will not be affected by any irregularities in the internal management of the company.
- The prospectus is the document issued inviting the general public for subscribing to the additional capital. A prospectus should be filed with the Registrar by the lead merchant banker before any public issue can be made.
- The concept of share refers to the share of equity capital contributed by a member to the share capital of the company. Two major categories of shares are the ordinary equity shares and the preference equity shares.

10.12 KEY WORDS



- **Abridged prospectus:** A brief version of the prospectus
- **Board of directors:** The collective body of directors of the company

- **Debentures:** The Companies Act, 2013 defines debentures as instruments of a company evidencing a debt, whether constituting a charge on the assets of the company or not
- **Voting right:** The Companies Act, 2013 defines voting right as the right of a member of a company to vote in any meeting of the company or by means of postal ballot

10.13 CASE STUDY: LIFTING THE CORPORATE VEIL – CONTRACTUAL OBLIGATIONS OF THE COMPANY



The Indira Gandhi National Open University (IGNOU), which conducts distance learning programmes, has an education model of working with private partners, franchisees and collaboration with multiple agencies to deliver its multitude of programmes. It also conducts programmes for students in foreign countries. In 2005, IGNOU entered into an agreement with Universal Empire Institute of Technology (UEIT) to act as a partner institute and run a centre in Dubai. Later, a dispute between them led IGNOU terminating the agreement and invoking the arbitration clause of the agreement. It claimed USD 14,48,046 as damages including USD 5,00,001 as loss of goodwill.

In the arbitral tribunal proceedings, Sudhir Gopi, the managing director of the UEIT, was the petitioner who signed all the papers in his name. The tribunal directed UEIT to file a statement clarifying the nature and character of UEIT and whether he was authorised to represent UEIT. UEIT clarified that Sudhir Gopi represented the company, as its managing director, based on a resolution passed by UEIT authorising him to do so and that the replies of the Sudhir Gopi were filed in his capacity as a managing director and not in his personal capacity. The arbitral tribunal held that the petitioner and UEIT are jointly and severally liable, and directed them to pay USD 6,64,070 to IGNOU with the interest of 12% per annum along with the cost of proceedings. The decision of the tribunal to make the managing director personally liable for the damages and including him as jointly and severally liable to IGNOU amounted to 'lifting the corporate veil' and making the persons behind the company liable for the faults of the company.

Does the case deserve lifting of the corporate veil?

The award of the tribunal was challenged by the petitioner before the Delhi High Court. The petitioner contended that the arbitral award holding the petitioner and UEIT jointly and severally liable is not legally sustainable in view of the fact that the petitioner was not a signatory to the arbitration agreement.

The petitioner contended that even though he is a principal shareholder as well as the chairman and managing director of UEIT, he is not personally liable for the contractual liability of the UEIT and hence the arbitral award holding him liable to pay the amount to IGNOU is without any legal jurisdiction. Though the replies to the statement of claims were filed under his signature, it was done on behalf of UEIT in his capacity as managing director and not in his personal capacity.

Moreover, the arbitration agreement pertains only to IGNOU and UEIT, and the petitioner cannot be made a party to the arbitration proceedings. The petitioner

also contended that the arbitration tribunal, in any case, does not have the power to proceed against any person who was not a signatory to the arbitration agreement. IGNOU contends that UEIT is a Company with just One Person. IGNOU asserted that the case is fit for lifting the corporate veil as the petitioner was running the business under the facade of UEIT, and there was no difference between the petitioner and UEIT. IGNOU pointed out that UEIT had just 100 equity shares subscribed and the managing director of the company held 99 equity shares and he was also the sole in-charge of running the business. It also contended that the conduct of the petitioner showed no distinction between himself and UEIT. The cheques issued to IGNOU in discharge of UEIT's obligations were issued by the petitioner and he also replied to all legal notices issued by IGNOU.

With regard to the petitioner's contention that he was not a party to the arbitration agreement, IGNOU countered that it was the petitioner who participated in the arbitration proceedings and cannot challenge the jurisdiction of the tribunal at a subsequent stage.

High Court: Arbitration Tribunal Wrong in Lifting the Corporate Veil

In its judgement, the Delhi High Court held that the arbitration agreement was between UEIT and IGNOU, and the agreement was not signed by the petitioner in his personal capacity. There was no record to the effect that the agreement was between the petitioner and IGNOU. Since the petitioner is not part of the arbitration agreement, the tribunal has no power to extend the scope of the arbitral proceedings to include persons who have not consented to arbitrate. The Court also held that arbitration tribunals have no power to lift the corporate veil even if the case deserves lifting the corporate veil and hence there is no requirement to get into the merits of the dispute. Notwithstanding the above, the court examined the facts and circumstances of the case and held that the decision of the arbitration tribunal to lift the corporate veil was wrong. Since the petitioner was not a party to the arbitration agreement in person and was acting only on behalf of the company, making him personally liable for acts of the company amounts to lifting the corporate veil. The court observed that "the corporate personality may be disregarded only when the corporate form is used to perpetuate a fraud, to circumvent a statute or other misdeeds". The court observed that the tribunal lifted the corporate veil for the reason that UEIT's business was being conducted by the petitioner who was also the sole beneficiary of its business being the absolute shareholder of UEIT. However, the mere failure of a corporate entity to meet its contractual obligations is no ground for piercing the corporate veil. It held that there was no foundation to decide that UEIT was used for improper use. It also observed that it was never IGNOU's case that UEIT was set up or used to perpetuate a fraud on IGNOU and it had not pleaded to set up a case of fraud. The court held that the decision of the arbitral tribunal to pierce the corporate veil is fundamentally flawed, and falls foul of the fundamental tenets of the company laws in India.

Conclusion

The above case clearly illustrates and explains the significance of the doctrine of lifting the corporate veil. Even though UEIT was practically a one-person company, the court concluded that there were no legally valid reasons to lift the corporate

veil and make the owner-shareholder, who was also running the company as managing director, to be liable for the contractual obligations of the company.

(**Note:** Later, in another unrelated case involving disputes related to arbitration proceedings (GMR Energy Limited vs Doosan Power), Delhi High Court observed that the arbitration tribunals do have the power to pierce the corporate veil. However, as the judgment in the present case discussed above clearly indicates, even if considering that the arbitration tribunals have the power to lift the corporate veil, there were no sufficient reasons for lifting the corporate veil in the case of UEIT vs. IGNOU, and the petitioner could not be made personally liable for the contractual obligations of UEIT though he was the only absolute shareholder and also the managing director running the affairs of the company.)

QUESTIONS

1. In the above case, for all practical purposes, the company and the association of persons behind the company are one and the same, as there was only one person holding 99% shares having absolute control over the management of the company. Given this fact, how can you justify that he is not personally liable?

(**Hint:** If UEIT was a partnership or sole proprietorship, then the petitioner could have been made personally liable. Since UEIT was incorporated as a company, the company became a separate legal entity with which only IGNOU had transacted. Any contractual obligation and liability will fall only on the company and only the company's assets can be used to pay for the liability.)

2. In the given case, what could be the instances in which the tribunal could have legally lifted the corporate veil?

(**Hint:** In case, the dispute between UEIT and IGNOU was that the UEIT had deliberately defrauded IGNOU leading to the present claim of damages and that the company was used only as a facade to hide behind the fraudulent activities of the petitioner, etc., or that the petitioner had appropriated the profits and assets of the company arising out of the business deal with IGNOU while inflicting losses to IGNOU and its business prospects, then lifting the corporate veil can be legally valid.)

10.14 SHORT ANSWER QUESTIONS



1. A public limited company has minimum _____ members and a private limited company has minimum _____ members.
2. The _____ regulates the formation and incorporation of a company.
3. In the _____ stage of a company formation, somebody gets the idea of the business and start working on that idea.
4. _____ refers to the process of bringing the company into existence as a separate legal entity.
5. The memorandum and the _____ become binding upon the members and the company.

6. _____ is an offer for the general public to subscribe to the shares of the company.
7. The prospectus is issued by a company as a legal document which discloses the securities offered for sale to the public or investors. (True/False)
8. The term 'Ultra vires' means beyond the legal powers and the authority of the company. (True/False)
9. Memorandum of Association specifies the rules, regulations and bye-laws for the internal administration of the company. (True/False)
10. Equity shares give voting rights to the shareholders and the right to receive dividends. (True/False)
11. In a public limited company, the minimum number of directors is _____. Choose the correct option:
 - a. 1
 - b. 2
 - c. 3
 - d. 4
12. In reference to a public company, which one of the following options is correct regarding the transfer of shares?
 - a. Prohibited
 - b. Freely transferable
 - c. Restricted
 - d. None of these
13. As per the doctrine of _____, a person will not be affected by any irregularity in the internal management of the company.
 - a. Intra virus
 - b. Ultra virus
 - c. Constructive notice
 - d. Indoor management
14. Which one of the following options decides the nationality of the company?
 - a. Place where books of accounts are kept
 - b. Registered office
 - c. Shareholders
 - d. None of these
15. When is a company said to have been registered? Choose the correct option:
 - a. It gets a certificate for the commencement of business.
 - b. It files the memorandum of association and the articles of association.
 - c. It actually starts its business.
 - d. It gets an incorporation certificate with the Registrar of Companies.
16. Which among the following is the by-law for the internal administration of the company?
 - a. Certificate of Incorporation
 - b. Articles of Association
 - c. Memorandum of Association
 - d. None of these

17. Bharat Heavy Electricals Ltd. (BHEL) is which type of a company? Choose the correct option:
- a. Chartered Company
 - b. Public Limited Company
 - c. Statutory Company
 - d. Private Limited Company
18. Which of the following statements is incorrect w.r.t. Companies Act, 2013?
- a. Mandatory auditor rotations
 - b. No joint auditors
 - c. Secretarial audits are compulsory for every public company with the paid-up share capital > ₹ 100 crores
 - d. None of these
19. Which among the following is a type of prospectus that does not specify the complete particulars regarding the quantum or the price of the securities being offered?
- a. Red herring prospectus
 - b. Shelf prospectus
 - c. Deemed prospectus
 - d. None of these
20. Which of the following refers to the certificate issued by the company under its common seal specifying the shares held by any members?
- a. Incorporation certificate
 - b. Share certificate
 - c. Issuance certificate
 - d. None of these
21. Which among the following gets dividend on priority basis at the time of dividend distribution?
- a. Debentureholder
 - b. Equity shareholder
 - c. Preferential shareholder
 - d. None of these
22. Which among the following defines the objective of the company?
- a. Memorandum of Association
 - b. Articles of Association
 - c. Share certificate
 - d. None of these
23. Which type of companies are the companies formed under the Special Act of the Parliament? Choose from the given options.
- a. Statutory companies
 - b. Registered companies
 - c. Both a and b
 - d. None of these
24. From the given option, which one method is used to change the name of a company?
- a. An ordinary resolution
 - b. A special resolution
 - c. An approval of the Central government
 - d. A special resolution and with the approval of the Central government

25. How can a company change its Articles of Association? Choose the correct option.
- A resolution of the Board of Directors.
 - A special resolution.
 - An ordinary resolution in the Annual General Meeting by the shareholders.
 - Obtaining permission from the National Company Law Tribunal.

10.15 DESCRIPTIVE QUESTIONS



- Discuss the Companies Act, 2013 in detail.
- Explain the concept of limited liability and perpetual existence of companies.
- What are different kinds of companies possible under the Companies Act, 2013? Explain the difference between public limited companies and private limited companies.
- What are the steps involved in incorporating a company?
- Explain the purpose and contents of the memorandum of association and articles of association of a company.
- Explain the concept of shares, the different types of shares and the rights of shareholders.

10.16 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Companies Act, 2013	1.	10 crores
	2.	True
Concept of Company	3.	c. Compensation cannot go beyond the proceeds of the sale of assets of the company after paying creditors, and shareholders are not liable in any way.
	4.	a. Separate personality of the company as a distinct legal entity than that of persons behind it.
	5.	True
Formation and Incorporation of a Company	6.	b. Private limited companies cannot raise capital from the general public.
	7.	d. Both b and c
	8.	d. A promoter of the company cannot reimburse or remunerate himself once the company is incorporated.
	9.	d. Both b and c

Topic	Q. No.	Answer
Memorandum of Association	10.	c. Liability clause of the memorandum states the nature of liability of members.
	11.	c. Increase in authorised share capital
Articles of Association	12.	c. To stipulate the rules, regulations, and bylaws regarding internal management
	13.	False
	14.	True
Prospectus	15.	True
	16.	d. All of these
	17.	c. It should make statements with scrupulous accuracy and avoid statements which are not strictly correct and thereby reflect the true nature of the company's venture.
Membership	18.	d. Both a and c
Concept of Shares	19.	a. Preference dividends are fixed and do not vary with the profits of the company.
Borrowings, Loans, Debentures and Investments	20.	False

B. | SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	seven; two
2.	Companies Act
3.	promotion
4.	Incorporation
5.	Articles of Association
6.	Initial Public Offer
7.	True
8.	True
9.	False
10.	True
11.	c. 3 (three)
12.	b. Freely transferable
13.	d. Indoor management
14.	b. Registered office
15.	d. It gets an incorporation certificate with the Registrar of Companies.
16.	b. Articles of Association
17.	b. Public Limited Company
18.	b. No joint auditors
19.	a. Red herring prospectus
20.	b. Share certificate
21.	c. Preferential shareholders

Q. No.	Answer
22.	a. Memorandum of Association
23.	a. Statutory companies
24.	d. A special resolution and with approval of the Central
25.	b. A special resolution

10.17 SUGGESTED BOOKS AND E-REFERENCES



SUGGESTED BOOKS

- Taxmann. (2019). *Company Law Manual - A Compendium of Companies Act 2013 along with Relevant Rules* (11th ed.). New Delhi.
- Davies, P. L., & Worthington, S. (2012). *Gower and Davies' Principles of Modern Company Law*. Sweet & Maxwell.
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- Ramaiya (Revised by Arvind P Datar, S. Balasubramanian), 2014. *A Ramaiya Guide to the Companies Act*, 18th Edition. LexisNexis.

E-REFERENCES

- Arbitrator Cannot Lift The Corporate Veil - Delhi High Court - Corporate/Commercial Law - India. (2018). Retrieved from <http://www.mondaq.com/india/x/602586/Corporate+Commercial+Law/Arbitrator+Cannot+Lift+The+Corporate+Veil+Delhi+High+Court>
- Nishith Desai Associates: Delhi High Court: Failure to meet the contractual obligations is no ground for lifting the corporate veil. (2018). Retrieved from <http://www.nishithdesai.com/information/news-storage/news-details/article/delhi-high-court-failure-to-meet-the-contractual-obligations-is-noground-for-lifting-the-corporate.html>
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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Discuss the salient features of the Right to Information Act, 2005
- ▶▶ Explain the objectives of public authorities and their obligations
- ▶▶ Discuss the designation of Public Information Authority
- ▶▶ Explain the duties of a public information officer
- ▶▶ Describe the procedure for requests for obtaining information
- ▶▶ Describe the Central and State Information Commission

11.1 INTRODUCTION

 **Read**
Pre-read Connect

In the previous chapter, you studied about various aspects of the Company Law, such as the formation of a company, Memorandum of Association, Articles of Association (AOA), etc.

The Right to Information Act, 2005, which gave a powerful tool to the Indian citizens to get information from the government as a matter of right. RTI Act, 2005 is a comprehensive Act that covers almost all matters of governance and has the widest possible reach, being applicable to the government at all levels: Central, State and Local as well as recipients of government grants. The Right to Information Act, 2005 has marked in a new dawn in the era of the Indian History. RTI Act, 2005 provides for setting out the practical regime of right to information for citizens to secure access to information under the control of public authorities, in order to promote transparency and accountability in the working of every public authority, the constitution of a Central Information Commission and State Information Commissions and for matters connected therewith or incidental thereto. In this chapter, you will study about the Right to Information Act, 2005 in detail.

As per the Act, an information is any material form and includes records, documents, memos, e-mails, opinions, advice, press releases, circulars, orders, logbooks, contracts, reports, papers, samples, models and data material held in any electronic form. It also includes information relating to any private body which can be accessed by the public authority under any law for the time being in force.

11.2 SALIENT FEATURES OF THE RIGHT TO INFORMATION ACT, 2005

Important Concept
The Right to Information Act mandates that timely response be given to any citizen who asks for it. The Ministry of Personnel, Public Grievances and Pensions initiated to launch a portal for the citizen. The portal facilitates the citizen to search for the needed information.

The main aim of the Act is to provide secure access to information for promoting transparency and accountability.

As per the preamble, the RTI Act is designed to achieve the following objectives:

- Securing the access to information under the control of public authorities
- Promoting transparency and accountability in the work place
- Constituting a Central Information Commission and State Information Commissions

The salient features of the RTI Act are as follows:

- A citizen has the right to seek information from any public authority.
- This right includes the inspection of documents, records, notes and other certified samples held by the public authority.
- Public information authorities and assistant public information officers are appointed within 100 days of the enactment.
- The Act makes it obligatory for every public authority to make suo-motu disclosure in respect of the particulars of its organisation, functions, duties etc. as provided in section 4 of the Act.
- To seek information, a written application has to be made to the State public information officer who deals with requests of information.

**NOTE**

The Right to Information Act was passed by Parliament on 15th June 2005 but it came into effect on 12th October 2005.

- The application should be accompanied by demand draft/banker cheque/ Indian Postal Order of ₹10 payable to the Accounts Officer of public authority.
- There is no fee for making an appeal.
- It is not compulsory to provide reasons for seeking the information.
- No prescribed form of application is there for seeking information. Plain paper can be used.
- An appeal to the first Appellate Authority can be made if the information is not provided within time. A second appeal with the State Information Commission is made if the first appeal is not accepted.
- The Commission decides the appeals and conveys its decision to the Appellant/Complainant and First Appellant Authority.

**SELF****ASSESSMENT QUESTIONS**

1. It is not compulsory to provide reasons for seeking information. (True/ False)
2. The main aim of RTI is to promote _____ and _____.

**ACTIVITY 1**

Discuss a few incidences where RTI Act, 2005 has helped citizens to obtain information.

11.3 OBJECTIVES, PUBLIC AUTHORITIES AND THEIR OBLIGATIONS

The basic object of the Right to Information Act is to authorise citizens, promote transparency and accountability in the working of the government, discourage corruption, and make democracy work for the people in real sense. An informed citizen could keep necessary vigil on the instruments of governance and make governments more accountable to the governed. The Act is a big step towards making citizens informed about the activities of the Government. The objectives of the Right to Information Act are as follows:

- a. To encourage accountability and transparency in the performance of public duty by the public bodies.
- b. To set up a system wherein the citizens have a right to access the information under the control of public authorities.
- c. To allow the government bodies (public authorities) to take decisions as per the prescribed laws and contain corruption.
- d. To bring forward the irregularity of the public authorities into the public domain.

**NOTE**

The authority will be under no obligation to provide such information that might hurt the sovereignty and integrity of India

A "Public Authority" is any authority, body or institution of self-government. These bodies or institutions are constituted by or under the constitution or by another law made by the parliament or the state legislature. The state government or the Central Government may by issuing the notification declare any body or institution as the public authority. The bodies owned or substantially financed

by the Central or State Government authorities are also recognised as public authorities. The non-financial bodies that are substantially financed by either the State Government or the Central Government also come under the definition of the Public Authority. The various obligations of a Public Authority are as follows:

- a. Maintain all records duly catalogued and indexed in a manner and the form which facilitates the right to information under this Act and ensure that all records that are appropriate to be computerised are, within a reasonable time and subject to availability of resources, computerised and connected through a network all over the country on different systems so that access to such records is facilitated.
- b. Publish within one hundred and twenty days from the enactment of this Act, details of particulars of its organisation, functions and duties, powers of officials, the procedures, regulations, etc.
- c. Publish all relevant facts while formulating important policies on announcing the decisions that may affect the general public.
- d. Provide reasons for its administrative or quasi-judicial decisions to affected persons.



**SELF
ASSESSMENT
QUESTIONS**

3. A “Public Authority” is any authority, body or institution of self government. (True/False)
4. The non-financial bodies which are substantially financed by either the State Government or the Central Government do not come under the definition of the Public Authority. (True/False)



ACTIVITY 2

Make a list of bodies that could be included under the head of Public Authority.

11.4 DESIGNATION OF THE PUBLIC INFORMATION AUTHORITY

Important Concept
The Central Public Information Officer or State Public Information Officer may seek the assistance of any other officer as he or she considers it necessary for the proper discharge of his or her duties.

A public authority, within 100 days of enactment, is required to designate the Central Public Information Officers or the State Public Information Officers in respective public offices or the administrative offices. These designated officers have to provide the necessary information to the public. At every sub-divisional level and other sub-district level, Central Assistant Public Information Officer or the State Assistant Public Information Officer, as applicable, will be designated to receive the request of the information and submit the information.

The Central Public Information Officer or the State Public Information officer provides reasonable help to the persons who seek information from these officers in the form of Appellate Authorities. The Central Public Information Officer or the State Public Information Officer shall take reasonable help from any officer. Any officer whose assistance is required by the above officer shall render the reasonable assistance at a reasonable time.



**SELF
ASSESSMENT
QUESTIONS**

5. The public and state public officers are appointed within:
 - a. 100 days
 - b. 200 days
 - c. 50 days
 - d. None of the above
6. The designated officers shall provide the necessary information to the public. (True/False)



ACTIVITY 3

Make a list of bodies that could be included under the head of Public Authority.

11.5 PUBLIC INFORMATION OFFICERS AND THEIR DUTIES

Every public authority in compliance with the Act is required to designate officers as public information officers. They are required to furnish the necessary information as demanded by the public. The public information officers are the officers who are required to furnish the necessary information as desired by the citizens under the Act. The various duties to be undertaken by the public information officers are as follows:

- Public information officers shall deal with the applications or request of information of the citizens demanding the information, and if the information cannot be provided, an explanation should be provided for the same.
- If the information demanded for is related to the other public authority office, the public information officer shall transfer the same within 5 days of the request to that concerned officer and shall inform the applicant accordingly.
- The public information officer can seek the information from any other officer as he deems fit for the discharge of its duties.
- The public information officer within 30 days of the receipt of the request shall provide the desired information to the applicant.
- If the information desired is for the liberty or life of a person, it shall be provided within 48 hours of the receipt of the information.
- If the public information officer fails to provide the information within the specified time, it is deemed that he had refused to supply the information.
- If the information desired cannot be provided in full, the public information officer shall inform the applicant stating the reasons for providing the partial information.
- If the information to be supplied is treated to be confidential by the third party, the public information officer shall take it into consideration within 5 days from the receipt of the request.
- Public information officer can issue a notice to the third party to present itself within 10 days of the receipt of the notice.



**SELF
ASSESSMENT
QUESTIONS**

7. The public information officer is required:
 - a. To deal with information request
 - b. To furnish information within the specified period
 - c. Both of these
 - d. None of these
8. Within how many days shall the public information officer furnish the required information?
 - a. 30 days
 - b. 45 days
 - c. 60 days
 - d. None of these



ACTIVITY 4

Describe the duties of a public information officer.

11.6 PROCEDURE FOR REQUESTS FOR OBTAINING INFORMATION

The procedure for the request for obtaining information involves four main steps, which are shown in Figure 1:



Quick TIP

The information provided to an applicant has to be in the form which is easily understandable to him or her.



FIGURE 1: Procedure for Request of Information

Let us discuss these steps in detail:

- **Application:** The request for getting the information is required to be submitted in writing or using the electronic means in English, Hindi or the official language of the area. The request should clearly state the information sought for. The reason for seeking the information is not required to be given while making the application. The prescribed fee shall be paid for obtaining the information.
- **Time Limit:** The time limit for obtaining information is as follows:
 - The time limit of supplying the information is 30 days.
 - If the information is regarding the life and liberty of a person, it shall be provided within 48 hours.
 - An additional 5 days should be given if the information is to be furnished by the Assistant Public Information Officer.

- If the interest of a third party is also included, then an additional 10 days are to be provided, which means a total of 40 days are to be given.
- The public information officer shall furnish the information free of cost if the above time limits are breached.
- **Fees:** Various fees applicable are prescribed in the following manner:
 - The application fee paid should be reasonable and prescribed through a notification from time-to-time.
 - People living below the poverty line should not be charged.
 - The information must be furnished free of cost if Public Information Officer fails to furnish information within the prescribed time.
- **Grounds for Rejection:** The grounds for rejection are as follows:
 - If the information is covered under the exemption from disclosure.
 - If the information infringes the copyright of any person other than the State.



SELF ASSESSMENT QUESTIONS

9. The information must be furnished free of cost if _____ fails to furnish information within the prescribed time.



ACTIVITY 5

Visit RTI Act's website to find the details of the fee applicable to people living below the poverty line.

11.7 EXEMPTION FROM DISCLOSURE

The following type of information is exempted to be provided to the public (as given by the RTI Act):

1. Information, disclosure of which would prejudicially affect the sovereignty and integrity of India, the security, strategic, scientific or economic interests of the State, relation with foreign State or lead to incitement of an offence;
2. Information which has been expressly forbidden to be published by any court of law or tribunal or the disclosure of which may constitute contempt of court;
3. Information, the disclosure of which would cause a breach of privilege of Parliament or the State Legislature;
4. Information including commercial confidence, trade secrets or intellectual property, the disclosure of which would harm the competitive position of a third party, unless the competent authority is satisfied that larger public interest warrants the disclosure of such information;
5. Information available to a person in his fiduciary relationship, unless the competent authority is satisfied that the larger public interest warrants the disclosure of such information;



STUDY HINT

Section 7 (1) requires that the information requested by an applicant to a PIO shall be furnished "as expeditiously as possible".

6. Information received in confidence from foreign Government;
7. Information, the disclosure of which would endanger the life or physical safety of any person or identify the source of information or assistance given in confidence for law enforcement or security purposes;
8. Information which would impede the process of investigation or apprehension or prosecution of offenders; cabinet papers including records of deliberations of the Council of Ministers, Secretaries and other officers;
9. Information which relates to personal information the disclosure of which has no relationship to any public activity or interest, or which would cause an unwarranted invasion of the privacy of the individual;
10. Notwithstanding any of the exemptions listed above, a public authority may allow access to information, if the public interest in disclosure outweighs the harm to the protected interests.



**SELF
ASSESSMENT
QUESTIONS**

10. The public information officer can reject the application:
- a. If it results in an unwarranted invasion on the privacy of the individual
 - b. If the information demanded has been received in confidence from foreign Government
 - c. If information disclosure would endanger the life or physical safety of any person
 - d. All of these



ACTIVITY 6

Give examples of information that is exempted from disclosure.

11.8 CENTRAL AND STATE INFORMATION COMMISSION

The Central Government shall by notification in the official Gazette constitute a body, which shall be known as Central Information Commission and it shall exercise the powers conferred upon it as prescribed under the Right to Information Act, 2005. Apart from this Commission, the State Government, by notification in the official gazette may constitute a body to be known as the State Information Commission that is vested to exercise prescribed rights under Right to Information Act, 2005. Let us discuss these two Commissions in detail in the following sections.

11.8.1 CENTRAL INFORMATION COMMISSION

The Central Information Commission (CIC) shall consist of the following members:

1. Chief Information Commissioner
2. Such number of Central Information Commissioners, not exceeding ten, as may be deemed necessary

**NOTE**

The Finance Ministry received the maximum 1.55 lakh RTI applications in 2016, whereas the ministry of Information and broadcasting got the second position with 1.11 lakh applications.

3. The Chief Information Commissioner and Information Commissioners shall be appointed by the President on the recommendation of a committee consisting of the following:
 - a. The Prime Minister, who shall be the Chairperson of the committee
 - b. The Leader of Opposition in the Lok Sabha
 - c. Union Cabinet Minister to be nominated by the Prime Minister

The Chief Information Commissioner and other commissioners appointed are required to be the persons having varied experience in areas of law, science, technology, social service, management, journalism, mass media or administration or governance. The Chief Information Commissioner or other commissioners appointed cannot be the members of Parliament or Legislature. They cannot hold any office of profit or be members of any political party.

The headquarters of the Central Information Commission shall be based in Delhi. The Central Information Commission may, with the prior approval of Central Government, establish its office at any other place.

The Chief Information Officer shall hold the office for a term as may be prescribed by the Central Government (amended in 2019) from resuming the office or till attaining the age of 65, whichever is earlier, and shall not be eligible for the re-appointment.

11.8.2 | STATE INFORMATION COMMISSION

The composition of the State Information Commission is as follows:

- a. The State Chief Information Commissioner
- b. Such numbers of State Information Commissioners which shall not exceed 10

The State Chief Information Commissioner and State Information Commissioners are appointed by the Governor of the State on the recommendation for their appointment by the Committee, which consists of the following:

- a. The Chief Minister, who shall be Chairperson of the Committee
- b. The leader of the opposition in Legislative Assembly
- c. The cabinet minister who shall be nominated by the Chief Minister

The State Information Commissioner and other Commissioners appointed are required to be the persons having varied experience in areas of law, science, technology, social service, management, journalism, mass media or administration or governance. The State Information Commissioner or other commissioners appointed cannot be the members of Parliament or Legislature. They cannot hold any office of profit of any political party.

The headquarters of the State Information Commission shall be based as per the notification in the official Gazette and the State Information Commission may, with the prior approval of State government, establish the office at any other place.

The State Information Officer shall hold the office for a term as may be prescribed by the Central Government (amended in 2019) from when he has entered his office and shall not be eligible for re-appointment.

11.8.3 | POWER OF INFORMATION COMMISSION

The powers of the Information Commission (i.e. both the Central Information Commission and the State Information Commission) are contained in Section 18 of the Right to Information Act, 2005. The powers of the Information Commission are as follows:

- To receive complaints
- To take disciplinary action against information officer
- To impose a monetary penalty
- To conduct an enquiry

The Central and State Information Commission are empowered to inquire into the complaint of any person:

- a. Who has not been able to submit a request to the Central Public Information Officer or State Public Information Officer either of the reason that no such officer has been appointed under the provisions of this Act or his application under this Act has been rejected for further forwarding.
- b. Who has been denied the access to the information requested under this Act.
- c. Who has been required to pay any fee which he or she feels is unreasonable.
- d. Who believes that he or she has been given information which is completely misleading.
- e. Who has not been given a response for the information enquired for.

The Central or the State Information Commissioner while enquiring into the matter shall have the same right as in the Civil Procedure Code, 1908 in respect of the following matters:

- Summoning or enforcing the attendance of persons and compelling them to give oral or written representation
- Receiving evidence on affidavits
- Issuing summons for the examination of witnesses
- Any other matter which may be prescribed



**SELF
ASSESSMENT
QUESTIONS**

11. The Central Information Commissioner shall have the same rights as specified in:
- a. Civil Procedure Code, 1908
 - b. India Evidence Act, 1972
 - c. Negotiable Instrument Act, 1996
 - d. All of these



ACTIVITY 7

Discuss and list down the powers enjoyed by the Information Commissioners.

11.9 APPELLATE AUTHORITIES



Quick TIP

If the Appellate Authority (AA) failed to satisfy the citizen, in this case, the citizen has right to make appeal to the Information Commission (IC).

It is the responsibility of the Public Information Officer of a public authority to supply correct and complete information within the specified time to any person seeking information under the RTI Act, 2005. There are possibilities that a Public Information Officer may not act as per provisions of the Act or an applicant may not otherwise be satisfied with the decision of the Public Information Officer. The Act contains the provision of two-tier appeals to tide over such situations.

The first appeal lies within the public authority itself which is made to an officer designated as the First Appellate Authority by the concerned public authority. The First Appellate Authority happens to be an officer senior in rank to the Public Information Officer.

The second appeal lies with the Information Commission. The Central Information Commission (Appeal Procedure) Rules, 2005 govern the procedure for deciding appeals by the Central Information Commission. Section 19 of the Right to Information Act, 2005 deals with appeals.

The Appellate Authorities under this Act are Central Public Information Officers, Central Commission or State Commission.

11.9.1 APPEAL

Any person who does not receive the decision within the time limit specified in the Act or who is aggrieved with any of the decisions of the State Public Information Officer or the Central Information Officer may file an appeal within 30 days from the expiry of such period or from the receipt of the decision to the officer who is senior in rank to the Central Public Information Officer or the State Public Information Officer as the case may be. However, the aggrieved party may appeal even after 30 days if there are sufficient grounds of filing an appeal.

The appeal by the concerned third party shall be made within 30 days, if it relates to the disclosure of the third party information against the order of the Central or the State Public Information Officer.

The second appeal against the above officer shall be made within 90 days from the date when the decision has been made or has been received.

- **Disposal of Appeal:** If an appellate authority while deciding an appeal comes to a conclusion that the appellant should be supplied information in addition to what has been supplied by the Public Information Officer, he/she may either:
 - a. Pass an order directing the Public Information Officer to give such information to the appellant; or
 - b. He himself may give information to the appellant. In the first case, the appellate authority should ensure that the information ordered by him to be supplied is supplied to the appellant immediately.

- **Time Limit of Appeal:** The first appellate authority should dispose-off the appeal within 30 days of receipt of the appeal. In exceptional cases, the Appellate Authority may take 45 days for its disposal. However, in cases where disposal of appeal takes more than 30 days, the Appellate Authority should record in writing the reasons for such delay.

 **Quick TIP**

RTI laws also have a provision to punish the public officials who provide either incorrect or misleading information and either delay or obstruct an application for information.

11.9.2 | PENALTIES

A penalty of ₹250 each day till the time of furnishing information can be imposed by the State Information Commission or the Central Information Commission at the time of deciding the complaint as the case may be on the Central or State Public Information Officer, as the case may be, who has not furnished the information or the information furnished is misleading. However, the total amount of penalty imposed shall in no case exceed ₹25,000. Further, if the Central Commission or the State Commission is of the opinion that the State Public Information Officer or the Central Information Officer, as the case may be, has not provided the requisite information or with the *mala fide* intentions has not supplied the requisite information, it shall recommend the disciplinary action against the Central or the State Public Information Officer as the case may be.

11.9.3 | BAR ON JURISDICTION OF COURTS

No court shall entertain any suit, application or any other proceeding with respect to any order made under this Act and besides that no order shall be called in question. The Supreme Court after the reference may remove the State Commissioner and Central Commissioner and thereafter the Governor or the President, as the case may be, may remove them from their office. However, the orders of the authorities under the Act or the denial of the information can be challenged by a Writ Petition before the High Court or Special Leave Petition before the Supreme Court.

11.9.4 | ROLE OF CENTRAL AND STATE GOVERNMENTS

The role of the Central Government or the State Government in the RTI Act, 2005 is as follows:

- a. To develop or organise the educational programme to advance the understanding of the public and making them clear about the relative provisions of the Act.
- b. To encourage the public authorities to participate in the development programs and to undertake such programs.
- c. To promote timely and effective dissemination of the information by public authorities about their activities.
- d. To train the Central Public Information Officers or State Public Information Officers and facilitate relevant training materials.

The appropriate government is required to compile a guide in its official language. The appropriate government may, if considered necessary, update the objects of the Act, postal address, email address, of the Central and State Public Information Officer.

- **Information:** Material in the form of documents, memos, mails, log books, contracts, etc.
- **Official gazette:** A public journal, which prints official notices from the government for imparting information
- **Public information officer:** An officer appointed at the state level or the central level, as the case may be, to provide the information required

11.12 CASE STUDY: RIGHT TO INFORMATION ACT



Mr. Laksh runs an NGO, where he provides free education to children and women living in villages. On 1st November 2012, he applies for monetary aid from the state government. The government, after hearing his case, agrees to provide aid for the schools run by the NGO.

After one year, someone enquires about the source and utilisation of funds for the schools run by Mr. Laksh, under the Right to Information Act, 2005.

Mr. Laksh refuses to provide this information, stating that as the NGO run by private people and is not a government organisation, it is not liable to disclose the information under the Right to Information Act, 2005.

In reply to this contention, the person who had requested for the information states that as the organisation is funded by the government, it falls under the purview of the Right to Information Act, 2005.

In reply, Mr. Laksh states that as the government has started providing him support recently, the organisation does not fall under the purview of the Right to Information Act, 2005.

QUESTIONS

1. Is the justification given by Mr. Laksh in the case maintainable?
(**Hint:** As Mr. Laksh's organisation is funded by the government, it will fall under the purview of the Right to Information Act, 2005.)
2. Is Mr. Laksh liable to provide all the information asked by the person in the case?
(**Hint:** Refer to the Right to Information Act, 2005.)

11.13 SHORT ANSWER QUESTIONS



1. The Right to Information Act came into effect on:
 - a. October 12, 2005
 - b. August 15, 2005
 - c. June 15, 2005
 - d. March 12, 2005

2. What is the time limit to get information concerning the liberty and life of a person?
 - a. 23 hours
 - b. 49 hours
 - c. 48 hours
 - d. 52 hours
3. What is the fee to obtain information under the RTI Act, 2005 ?
 - a. ₹ 30
 - b. ₹ 40
 - c. ₹ 70
 - d. ₹ 10
4. Which one of the following is not the basic objective of RTI Act, 2005?
 - a. Authorise citizens
 - b. Discourage transparency
 - c. Promote accountability in the working of government
 - d. Discourage corruption
5. The officer designated by the public authorities in all administrative units or offices to provide information to the citizens under the RTI Act, 2005 is known as:
 - a. Chief Information Commissioner
 - b. Appellate Authority
 - c. Assistant Public Information Officer
 - d. Public Information Officer
6. If the interest of a third party is also included in the information sought for, the maximum time limit to get the information will be:
 - a. 30 days
 - b. 50 days
 - c. 40 days
 - d. 90 days
7. The Chief Information Commissioner and Information Commissioner are appointed by the:
 - a. Vice President
 - b. President
 - c. Prime Minister
 - d. Railway Minister
8. The term of office of the Chief Information Commissioner is:
 - a. 4 years
 - b. 7 years
 - c. 10 years
 - d. 5 years
9. The Appointment Committee of Central Chief Information Commissioner (CIC) includes:
 - a. Prime Minister (Chair)
 - b. Leader of the opposition in Lok Sabha
 - c. Union Cabinet Minister
 - d. All of these

10. Which one of the following is not the power of the Chief Information Commissioner?
 - a. To receive complaints
 - b. To conduct inquiry
 - c. To take disciplinary action
 - d. To waive off monetary penalty
11. The public authority must appoint the Chief Information Commissioner within:
 - a. 50 days
 - b. 100 days
 - c. 70 days
 - d. None of these
12. Which one of the following is not required for obtaining information under the RTI Act, 2005?
 - a. Application
 - b. Time limit
 - c. Fee
 - d. Monitoring
13. The headquarter of the Chief Information Commission is based in:
 - a. Karnataka
 - b. Delhi
 - c. Rajasthan
 - d. Punjab
14. The first appeal shall be disposed of by the first appellate authority within:
 - a. 45 days
 - b. 30 days
 - c. 50 days
 - d. 60 days
15. Which one of the following does not come under the definition of information under the RTI Act, 2005?
 - a. Contracts
 - b. Reports
 - c. Logbooks
 - d. Case study
16. A citizen has the right to seek information from any _____.
17. The request for getting information is required to be submitted in _____.
18. The chief information officer shall hold office for a term of 5 years or till attaining the age of _____.
19. The public officers shall be appointed both at _____.
20. The state commission or central commission can recommend disciplinary action or monetary penalty of _____ per day.
21. The basic objective of the RTI Act is to promote _____.
22. There is no fee for making an appeal under the RTI Act, 2005. (True/False)
23. The objective of the RTI Act, 2005 is to bring forward the irregularity of the public authority. (True/False)
24. People living below the poverty line should be charged under the RTI Act, 2005. (True/False)
25. The time limit for supplying the information under the RTI Act is 45 days. (True/False)

11.14 DESCRIPTIVE QUESTIONS

1. What are the salient features of the Right to Information Act, 2005?
2. Explain public authorities. What are their obligations?
3. What are the duties of public information officers?
4. Explain the procedure of obtaining the information under the Right to Information Act, 2005.
5. Describe the composition of the Central Information Commission.
6. Describe the appeal procedures under the Right to Information Act, 2005.

11.15 ANSWER KEY**A. SELF ASSESSMENT QUESTIONS**

Topic	Q. No.	Answer
Salient Features of the Right to Information Act, 2005	1.	True
	2.	transparency and accountability
Objectives, Public Authorities and their Obligations	3.	True
	4.	False
Designation of the Public Information Authority	5.	a. 100 days
	6.	True
Public Information Officers and their Duties	7.	c. Both of these
	8.	a. 30 days
Procedure for Requests for Obtaining Information	9.	Public Information Officer
Exemption from Disclosure	10.	d. All of these
Central and State Information Commission	11.	a. Civil Procedure Code, 1908
Appellate Authorities	12.	a. 30 days
	13.	True
	14.	Central Public Information Officers, Central Commission or State Commission

B. SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	a. October 12, 2005
2.	c. 48 hours
3.	d. ₹ 10
4.	b. Discourage transparency
5.	d. Public Information Officer
6.	c. 40 days
7.	b. President
8.	d. 5 years
9.	d. All of these
10.	d. To waive off monetary penalty
11.	b. 100 days
12.	d. Monitoring
13.	b. Delhi
14.	b. 30 days
15.	d. Case study
16.	public authority
17.	writing
18.	65 years
19.	central level and state level
20.	₹ 250
21.	transparency
22.	True
23.	True
24.	False
25.	False

11.16 SUGGESTED BOOKS AND E-REFERENCES



SUGGESTED BOOKS

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- ▶▶ Explain different forms of business organisations
- ▶▶ Discuss the Partnership Act, 1932
- ▶▶ Describe Competition Act, 2002
- ▶▶ State the importance of Information Technology Act, 2000
- ▶▶ Explain the Negotiable Instruments act, 1881
- ▶▶ Discuss the importance of the Minimum Wages Act, 1948
- ▶▶ Explain the objectives and applicability of the Factories Act, 1948
- ▶▶ Describe the objectives and scope of the Workmen Compensation Act, 1923
- ▶▶ Explain the key provisions and the objectives of the Personal Data Protection (PDP) Bill, 2019

12.1 INTRODUCTION



Read

Pre-read Connect

The previous chapter discussed the Right to Information Act, 2005 in detail. In this chapter, we will discuss miscellaneous laws consisting different important Acts.

This chapter deals with various forms of business organisations, such as sole proprietorship, partnership and corporation. The chapter also discusses the Partnership Act, 1932 in detail. The Act defines partnership as a *relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all*. A partnership between persons can be established through an agreement which can be either written or oral. The law relating to the partnership in India is governed by the Partnership Act, 1932.

Further, the chapter elaborates on the Competition Act, 2002, which implements and enforces a competition policy. It also prevents and punishes anti-competitive business practices by organisations and ceases unnecessary Government interference in the market.

The Information Technology Act, 2000 was enacted to provide legal recognition to all transactions done online. The Negotiable Instruments act governs all issues related to the negotiable instruments such a cheques. Three acts namely the Minimum Wages Act, 1948; Factories Act, 1948; Workmen Compensation Act, 1923 have been enacted for catering to the issues related to employees and workers. For instance, the Workmen Compensation Act, 1923 aims at providing financial protection to workmen and their dependants in case of accidental injury by means of payment of compensation by employers. Lastly, the Personal Data Protection (PDP) Bill, 2019 has been proposed to ensure protection and privacy of the data of people.

In this chapter, you will study about different forms of business organisations and an array of critical acts such as the Partnership Act, 1932; Competition Act, 2002; Information Technology Act, 2000; Negotiable Instruments Act, 1881; Minimum Wages Act, 1948; Factories Act, 1948; Workmen Compensation Act, 1923; and the Personal Data Protection (PDP) Bill, 2019.

12.2 DIFFERENT FORMS OF BUSINESS ORGANISATIONS



NOTE

Another name of sole proprietorship is sole trader, individual entrepreneurship or proprietorship.

A business entity is an organisation that uses economic resources or inputs to provide goods or services to customers in exchange for money or other goods and services. Business organisations come in different types and different forms of ownership. The major forms of business organisations are:

12.2.1 SOLE PROPRIETORSHIP

Sole proprietorship refers to the type of business entity wherein an individual starts a business with his own capital and manages all the operations on his own. The profits and risks are also managed by the owner only. Some essential features of sole proprietorship are as follows:

- The business is owned singularly by an individual.
- The business is controlled by a single person.

- The individual assumes all the risks to which the business is exposed.
- The individual's liability is unlimited, i.e., his personal assets can be used for the payment of business liabilities.
- The business has no separate legal entity distinct from the sole proprietor.
- No legal formalities are necessary to set up the business as such, but there may be legal restrictions on a particular type of business.
- The individual derives all the benefits as he bears the entire risk.
- He enjoys almost unlimited freedom of action and decides everything for the business without fear of opposition, but at his own risk. The proprietor is his own master in this form of organisation.
- Having employees makes no difference. The proprietor may instead take the help of the members of his family.

Sole proprietorship is the best option for a business in which the investment and risks associated with it are few, the nature of the business is simple, decision-making is simple and customers are in direct contact with the business. Some examples of sole proprietorship are retail shops, professional firms, household and personal services.

Advantages of a Sole Proprietorship

- Easiest and least expensive type of proprietorship to organise.
- Sole proprietors are in total control, and inside the parameters of the law, may settle on choices as they see fit.
- Profits from the business course through specifically to the owner's personal tax return.
- The business is easy to dissolve, if wanted.

Disadvantages of a Sole Proprietorship

- Sole proprietors have boundless obligation and are legitimately in charge of all obligations against the business. Their business and personal assets are at risk.
- May be at a disadvantage in raising assets and regularly constrained to using funds from personal savings or consumer loans.
- May experience difficulties pulling in high-caliber employees, or those that are propelled by the chance to own a part of the business.
- Some employee benefits, for example, owner's medical insurance premiums are not directly deductible from business income.



ACTIVITY 1

Using the Internet, find any five types of sole proprietorship businesses that are run in India.

12.2.2 | PARTNERSHIP

A partnership is a legal relationship between persons who have agreed to work together to perform certain business activities. The persons in a partnership have

agreed to share the profits in the desired ratio of the business carried on by all or by some of them. A partnership is defined as, *the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all.*

Formation of Partnerships

A partnership firm agreement should include all the elements of a valid contract. While forming a partnership firm, the following points must be kept in mind:

Important Concept
Partnership property means the asset or property of the firm that a partnership firm purchases. The property of a partnership firm is also known as joint stock common stock, or joint estate.

- The Partnership Act provides that a minor may be admitted to be a beneficiary of a partnership.
- No consideration is required to create a partnership. A partnership is an extension of an agency for which no consideration is necessary.
- The partnership agreement may be expressed (i.e., oral or in writing) or implied, and the latter may be inferred from the conduct or course of dealings of the parties or from the circumstances of the case. However, it is always advisable to have the partnership agreement in writing.
- An alien friend can enter into a partnership, an alien enemy cannot.
- A person of unsound mind is not competent to enter into a partnership.
- A company incorporated under the Companies Act, 2013 can enter into a contract of partnership.

Rules for Determining the Existence of Partnership

There are certain rules for determining the existence of a partnership, which are as follows:

- Partnerships arise from a contract and not from status.
- The members of a Hindu Undivided Family carrying on the family business cannot form a partnership.
- A partnership cannot exist between a Burmese Buddhist husband and wife.
- The sharing of profits or gross returns arising from property by persons holding a joint or common interest in that property does not, in itself, make such persons partners.
- The receipt of any share of the profits or any other contingent receivables by a lender, as a servant or an agent as remuneration by a widow or child of a deceased partner or by a previous owner of the business as consideration for the sale of the goodwill does not in itself make the receiver a partner with the persons carrying on the business.

Advantages of a Partnership

- Partnerships are generally simple to set up; however, time should be invested in developing the partnership agreement.
- With more than one proprietor, the capacity to raise assets might be expanded.
- The profits from the business flow directly through to the partners' personal tax return.
- Prospective employees might be pulled into the business if given the incentive to become a partner.
- The business, usually, will benefit from the partners who have complementary skills.

Disadvantages of a Partnership

- Partners are jointly and individually liable for the actions of the other partners.
- Profits must be imparted to others.
- Since decisions are shared, disagreements can occur.
- Some employee benefits are not deductible from business pay on government forms.
- The partnership may have a limited life; it may end upon the withdrawal or death of a partner.

12.2.3 CORPORATION/COMPANY

A corporation or a company is a business association that has a separate legal personality from its owners. Ownership in a corporation is represented by shares or stock.

The proprietors (investors) appreciate limited liability but have limited involvement in the organisation's activities. The board of directors, an elected group from the stockholders, controls the activities of the corporation.



STUDY HINT

Minimum two and maximum 50 members are needed to form a private limited company, whereas a minimum of seven members are required to form a public limited company with no upper limit on the number of members.

Advantages of a Corporation

- Shareholders have limited liability for the corporation's debts or judgments against the corporation.
- Generally, investors must be considered responsible for their interest in the organisation.
- Corporations can raise extra finances through the offer of stock. A Corporation may deduct the cost of benefits it provides to officers and employees.

Disadvantages of a Corporation

- The process of incorporation requires more time and money than other forms of organisation.
- Corporations are monitored by federal, state and some local agencies, and as a result may have more paperwork to comply with regulations.
- Incorporating may result in higher overall taxes. Dividends paid to shareholders are not deductible from business income; thus, this income can be taxed twice.

In addition to those basic forms of business ownership, these are some other types of organisations that are common today:

- **Limited Liability Company:** Limited Liability Companies (LLPs) are hybrid forms of business that have qualities of both a traditional partnership and a company. It has the flexibility of a partnership firm and the features of an entity, such as separate personality, limited liability and perpetual succession.
- **Cooperative society:** A cooperative society is a business organisation owned by a group of individuals and is operated for their mutual benefit. The people making up the group are called members. Cooperatives may be incorporated or unincorporated.

Some examples of cooperatives are: water and electricity (utility) cooperatives, cooperative banking, credit unions, and housing cooperatives.



**SELF
ASSESSMENT
QUESTIONS**

1. _____ refers to the type of business entity wherein an individual starts a business with his own capital and manages all the operations on his own.
2. A partnership is a _____ between persons who have agreed to work together to perform certain business activities.
3. A partnership between persons can be established through an agreement which can be written or oral. (True/False)
4. The Partnership Act provides that a minor may be admitted to be a _____ of a partnership.
5. Partnership arises from an agreement, whether implied or expressed. (True/False)

12.3 PARTNERSHIP ACT, 1932

The Indian Partnership Act, 1932 extends to the whole of India. It came into force on the 1st day of October 1932, except Sec. 69 which came into force on the 1st day October 1933.

- (a) An “act of a firm” means any act or demonstration by all the partners, or by any partner or agent of the firm which gives rise to a right enforceable by or against the firm”.
- (b) “Business” includes every trade, occupation and profession.
- (c) “Prescribed” means prescribed by rules made under this Act.

As indicated by Section 4 of the Indian Partnership Act 1932, “Partnership is a relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.”

In this manner, partnership is the beginning of a relationship among its members i.e. the partners who have agreed to share the profits of a business to be carried on by all or by any of them acting for all. The following are some important characteristics of a partnership:

- **Partnership is an association of two or more persons:** There should be at least two people in a partnership firm. They should join to constitute a partnership. A partnership firm cannot be the partner of another partnership firm. Currently, the maximum number of partners in a partnership firm is 50.
- **Partnership should be the result of an agreement between two or more persons:** In a partnership firm, there should be a legal agreement between the two parties or partners involved. A partnership can neither arise as a product of status (as in the case of the Hindu Undivided Family business) nor can it arise by operation of law (as in the case of co-ownership). In addition, it cannot arise by a simple joint acquisition of property. It can only arise by a contract. The members of a HUF carrying on a family business

Important Concept
Active or ostensible partners are those who actively participate in the business operations, and dormant or sleeping partners are those who are liable for the activities performed by the partners, but do not actively participate in business operations.

cannot be regarded as a partnership firm as the members of the family get a share in the business not by virtue of an agreement but by virtue of status, i.e., by birth in the family. Of course, this does not mean that there can be no partnership between the members of a HUF to carry on a family business in partnership. But, where such a fact is alleged, it will have to be established by proper evidence.

- **The agreement must be to carry on some business:** The term 'business' includes every trade, occupation or profession. Though the word 'business' generally conveys the idea of numerous transactions, a person may become a partner with another even in a particular venture or undertaking. Unless the person joins for the purpose of carrying on a business, it will not amount to a partnership. Thus, a partnership does not exist between members of a charitable society or a religious association or a building scheme. Similarly, a club is not a partnership.
- **The agreement must be to share the profits of the business:** The joint carrying on of a business alone is not enough; there must be an agreement to share profits arising from the business. Unless otherwise agreed, sharing of profits also involves the sharing of losses. But whereas the sharing of profits is an essential element of a partnership, sharing of losses is not. Thus, a person may become a partner under a distinct understanding that he is not to share losses, but to share the profits only. Though sharing of profits is an essential feature of a partnership, the mere fact that a person is given a share in the profits of the business does not necessarily make him a partner.
- **Business must be carried on by all or any of them acting for all:** A partnership is based upon the idea of mutual agency. Every partner assumes a dual role – that of a principal and of an agent. The foundation of the law of partnership is agency, and it is, therefore, said that "the law of partnership is a branch of the law of principal and agent". Each partner is an agent binding the other partners who are his principals, and each partner is again a principal, who in turn, is bound by the acts of the other partners.



STUDY HINT

General partnership, limited partnership, limited liability partnership and limited liability partnership are the four types of partnership.

12.3.1 | SCOPE OF PARTNERSHIP

The following are the major scope of partnership:

- Each partner can buy and sell in the interest of the association either in cash or on credit.
- Each partner can enter into further agency contracts with other parties for the advantage of the partnership.
- The partners, in any case, may not donate or lend money from the capital of the partnership.
- No partner can submit a dispute relating to partnership to arbitration.

12.3.2 | PARTNERSHIP DEED AND TYPES OF PARTNERSHIPS

A partnership between persons can be established through an agreement, which can be written or can be oral. But, an oral agreement may cause disputes in a future period. So, it is better to have a written agreement between the partners.

A partnership deed is a written agreement made between the partners which contain all the rights and duties of the partners, the name and objective of the

partnership business, address and other details. This partnership deed is then the basis of functioning of the partnership business.

Main Content of Partnership Deed

- **Name and address of the firm:** The partnership deed consists of the name of the business and the place where it is being operated.
- **Name and address of the partners:** The deed also includes the names of the partners in the business. It also includes their addresses and age.
- **Nature of partnership business:** A partnership is a type of business in which two or more persons come together with their resources to invest in a common business with the purpose of sharing the profits of the business.
- **Commencement and duration of partnership:** The deed also specifies the commencement and duration for which the partnership is valid.
- **Partner's capital:** The next point in the deed is of capital contribution made by the partners in the firm.
- **Interest on capital:** The deed also decides the amount of interest which should be paid on the capital invested in the firm. The tax laws for a partnership firm do not recognise distribution by way of interest above 12% p.a. on the amount invested by the partner.
- **Drawings:** The deed also consists of the maximum amount that can be withdrawn by any partner at one time.
- **Profit and loss sharing ratio:** The utmost important point written in the deed is the sharing ratio of the profits and losses of the firm between the partners. If it is not mentioned in the agreement, then the profit and losses are to be distributed equally between the partners.
- **Admission and retirement of partners:** Another clause that exists in the agreement is the admission and retirement of the partners. It includes the rights and duties of both the retiring partner and the admitting partner along with the responsibilities and rights of existing partners.
- **Accounts and audit:** The deed of partnership also includes the preparation of books of accounts and the need for auditing them. The procedure of book keeping and their audit must be explained in the deed.
- **Dissolution of the partnership:** The clause of dissolution states the method and the reason for the dissolution of the partnership.

Important Concept

When the partnership of a firm comes to an end by consent or agreement or other reason, it is called dissolution of partnership of a firm.

Types of Partnerships

Partnership can be of the following types:

- **Partnership at will:** As per Section 7 of the Partnership Act, when there is no duration specified for a particular partnership, the partnership is made at will. Such a type of partnership can be dissolved at any time by any partner after giving prior notice in the firm. Any partner at his will can give notice and retire from the partnership. The partnership is not bound or limited by the period of time.
- **Particular partnership:** This refers to a partnership made for a particular purpose and gets dissolved on the completion of that purpose. For example,

if one person gets into a partnership with another person for the construction of a bridge, then it is said to be a particular partnership. In this case, the partnership gets dissolved on the completion of the bridge.

- **Partnership for a fixed period of time:** A partnership made for a particular period is known as partnership for a period. The period may be decided by the partners by mutual understanding. The term of this kind of partnership may be one year, two years or any fixed period.



**SELF
ASSESSMENT
QUESTIONS**

6. The term 'partnership' has been defined under
 - a. Section 3
 - b. Section 4
 - c. Section 5
 - d. Section 6
7. A partnership deed usually contains the particulars relating to a:
 - a. Name of firm and partners
 - b. Nature of business and duration of firm
 - c. Capital contribution, profit/loss sharing ratio and other agreed terms
 - d. All of these
8. Which of the following is not a type of partnership?
 - a. Partnership at will
 - b. Partnership of time
 - c. Particular partnership
 - d. Partnership between minors



ACTIVITY 2

Using the Internet, find out the important points that should be covered in a partnership deed.

12.4 COMPETITION ACT, 2002

In December 1969, the Monopolies and Restrictive Trade Practices (MRTP) Act was passed in the Parliament and came into force from June 1970. It was amended in years 1982, 1984, 1985 and 1991. The basic objective of this Act was to ensure that economic powers are not concentrated in the hands of a few rich people. This law helped the government in controlling monopolies. The law also intended to prohibit restrictive and unfair trade practices. In summary, we can say that the MRTP Act aimed at regulating trade practices and prohibit trade practices that were monopolistic, unfair or restrictive in nature.

From the late 1990s, it was being felt that the MRTP Act has become obsolete because this Act prevented the expansion of companies with assets valued at ₹ 100 crores because such companies required permission from government to expand their business. There was an urgent need to shift the focus from monopoly to competition. Taking into account all changed circumstances, the government enacted the Competition Act, 2002. The major objective of this law was to bring and promote competition into the Indian market in order to ensure consumer protection and free trade.



NOTE

Competition Commission of India was established as a corporate body under Competition Act, 2002, with the aim to ensure healthy competition by preventing and protecting against ill practices in competition.

Competition Act, 2002 is applicable to all the parts of India. The Act came into force through notification by the Central government in an official gazette. The Competition Act, 2002 was amended in 2007 and 2009. The provisions of competition laws are equally applicable to all the agreements whether these are written or oral between the parties. The Act was enacted to:

- Promote the welfare of consumers
- Implement competition policies
- Promote competition advocacy
- Promote fair and healthy competition

The Act is based on the philosophy of modern competition laws. It prohibits anti-competitive agreements and abuse of the dominant position by enterprises. The Act also regulates combinations (acquisition, acquiring of control, merger and acquisition), which may lead to appreciable adverse effects on competition in India. The components of competition laws can be summarised in the following manner:

- Any agreement which has a severe impact over the competition but not limited to:
- Any agreement which limits or makes an attempt to limit the production
- Any agreement which limits or makes an attempt to limit supply
- Any agreement which fixes the price or makes an attempt to fix price
- An agreement that attempts collusive bidding
- Refusal to deal
- The exclusive supply agreement
- Exclusive distribution agreement

To achieve the above objectives, Competition Commission undertook the following tasks:

- Create market that works for the benefit and welfare of the customers and consumers.
- Ensure fair and healthy competition for the faster growth of the economy.
- Implemented the competition policies with the aim of effective utilisation of resources.
- Carry the competition advocacy in an efficient manner and help spread the information about competition amongst all concerned persons and entities.

The objectives of the Act are to be achieved through the Competition Commission of India (CCI), which was established by the Central Government with effect from 14 October 2003.

CCI consists of a Chairperson and 6 Members appointed by the Central Government. CCI functions as a market regulator for preventing and regulating anti - competitive practices in the country. A Competition Appellate Tribunal was also established, which is a quasi-judicial body established to hear and dispose of appeals against any direction issued, or decision made by the CCI.

The Act was subsequently amended by the Competition (Amendment) Act, 2007 and Competition (Amendment) Act, 2009. The provisions of the Competition Act relating to anti-competitive agreements and abuse of dominant position were notified on 20 May, 2009.

Presentation of the Act was a key advance towards facing competition. The Competition Act, 2002 isn't proposed to prohibit competition in the market. The legislation forbids anti-competitive agreements, abuse of dominant position and regulates mergers, amalgamations and acquisitions.

12.4.1 | OBJECTIVES OF COMPETITION ACT, 2002

The Competition Act, 2002 was formulated with following objectives:

- To promote healthy competition in the market.
- To prevent those practices which are having adverse effect on competition.
- To prevent abuses of dominant position in the market actively.
- To protect the interests or concerns in a suitable manner.
- To create awareness and impart training about the competition Act.
- To ensure freedom of trade in Indian markets.
- To regulate operation and activities of combinations (acquisitions, mergers and amalgamation).

12.4.2 | FEATURES OF COMPETITION ACT, 2002

Following are some important features of the Competition Act, 2002:

- Competition Act is a very compact and smaller legislation which includes only 66 sections.
- This Act restricts agreements having an adverse effect on competition in India.
- Civil courts do not have any jurisdiction to entertain any suit which is within the purview of this Act.
- Competition Commission of India (CCI) is constituted under the Act.
- This Act suitably regulates acquisitions, mergers and amalgamation of enterprises.
- This Act has penalty provision.
- This Act is flexible enough to change its provisions as per needs.
- Competition Act has replaced the MRTP Act.
- Under this Act, "Competition Fund" has been created.



NOTE

The CCI aims to prohibit abuse of dominant position and anti-competitive agreements.

12.4.3 | NON-APPLICABILITY OF COMPETITION ACT, 2002

Competition Act, 2002 is not applicable in the following cases:

- Foreign Institutional Investors (FIIs).
- Public Financial Institutions.

- Venture Capital Funds (VCFs).
- Banks.
- Agreements related to intellectual property rights (IPRs) such as trademarks, patents, copyrights, etc.
- Central Government has the authority to exempt any class of enterprises from the provisions of Act in the common interest of national security or public interest.



**SELF
ASSESSMENT
QUESTIONS**

9. What are the objectives of the Competition Act, 2002?

10. CCI consists of a Chairperson and _____ Members appointed by the Central overnment.

12.5 INFORMATION TECHNOLOGY ACT, 2000



Quick TIP

Information Technology Act, 2000 emphasizes on combating cybercrime and promoting electronic commerce in India.

The Information Technology Act, 2000 was notified on 17th October 2000. It consists of 94 sections segregated into 13 chapters and 4 schedules.

This Act recognises alternatives to the paper-based methods of communication and storage of information. This recognition allows the use of the electronic storage of data for legal purposes. Further, other Acts such as the Indian Evidence Act, 1872 and Indian Penal Code, 1860 are amended to provide legal recognition to the documents specified under the Information Technology Act, 2000.

12.5.1 | OBJECTIVES

The objective of the Information Technology Act, 2000 is to provide legal recognition to the information and transactions that are undertaken through the means of electronic interchange or other means of electronic communication.

12.5.2 | SCOPE AND MAJOR PROVISIONS

The major provisions under the Information Technology Act, 2000 are as follows:

- **Legal Recognition to Electronic Documents:** Where any law provides that information or any matter shall be in writing or in the typewritten or printed form, then such requirement shall be deemed to have been satisfied if such information or matter is:
 - rendered or made available in the electronic form
 - accessible so as to be usable for a subsequent reference
- **Legal Recognition to Digital Signatures:** If any information/matter is required by the law to be authenticated by affixing the signature, such requirement shall be deemed to have been satisfied. If such information/matter is authenticated by the means of digital signature, it should be affixed in the prescribed manner.

The Information Technology Act, 2000 validates electronic contracts. It states that the Civil Court has no jurisdiction to the offences under the Information

Technology Act, 2000. Even the appeal lies to the High Court if anyone is aggrieved by the order of the lower court.

- **Offences:** Offences and punishments related to information technology is summarised in Table 1:

TABLE 1: Offences and Punishments Related to Information Technology

Offences	Punishment	
	Imprisonment Term up to	Fine up to (in ₹)
Tampering with the computer source document	3 years	2 lakhs
Hacking a computer system	3 years	2 lakhs
Publishing of information that is obscene in electronic form	5 years	1 lakh
Failure to comply with the orders of the controller	3 years	2 lakhs
Failure to comply with the directions of the controller to extend facilities for decrypting information	7 years	NIL
Securing access to a protected system	10 years	No limit
Misrepresentation or suppression of fact	2 years	1 lakh
Breach of confidentiality and piracy, publishing false or fraudulent DSC (Digital Signature Certificate)	2 years	1 lakh

The Information Technology Act, 2000 validates electronic contracts. It states that the Civil Court has no jurisdiction to the offences under the Information Technology Act, 2000. Even the appeal lies to the High Court if anyone is aggrieved by the order of the lower court.

12.5.3 | E-GOVERNANCE

E-governance (Electronic Governance) comes under the Information and Communication Technology (ICT) Act with aim of enhancing government ability to address the needs of the citizens. The use of e-governance is to encourage good governance. It brings the access and delivery of government services, dissemination of information, communication in a quick and efficient manner to the public through efficient use of ICT. Through e-governance, the government plans to raise the coverage and quality of information and services provided to the general public in an effective and efficient manner.

Following are the major benefits of e-governance:

- Helps in reducing corruption
- Brings transparency
- Increases convenience
- Helps in reducing overall cost
- Increases the reach of government
- Provides a chance to the constituents to directly participate with the help of e-governance.

Important Concept

E-governance refers to the process initiated by government through Information and Communication Technology, i.e., ICT in all activities. E-governance facilitates the implementation of digital democracy, online public discussion and participation.

Following are the various types of e-governance:

- **G2G (Government to Government):** When the exchange of information takes place between government bodies, it is termed as G2G e-governance. It can be at a horizontal level, for example, within government entities at the national level, state level or local bodies. It can also be at a vertical level for example between one state government and another.
- **G2C (Government to Citizen):** The interaction among the government and the general public is said to be G2C. It helps citizens to access a wide variety of services. The general public can share views and grievances on government policy anytime anywhere.
- **G2B (Government to Business):** The interaction between government and business class is said to be G2B. It helps in saving cost, time, red-tapism and establish transparency in the business environment.
- **G2E (Government to Employees):** The G2E model aims at providing information and services by the government organisation to their employees to facilitate communication and learning. The G2E model offers career advice and information on performance management, training and development of employees, etc.

Thus, e-governance plays an important role in improving and supporting the tasks performed by the government departments and agencies.

12.5.4 | DIGITAL SIGNATURE

Digital signature is a mathematical technique for presenting the authenticity of a digital document. An authoritative signatory gives consent to the recipient that the message was created by the known sender. Digital signature is commonly used as an electronic signature.

12.5.5 | ELECTRONIC RECORD

The information recorded, collected or possessed in a computerised form or captured through an electronic means is said to be an electronic record. Examples of electronic records are e-mail, word processed document, electronic spreadsheet, digital images, etc. Section 4 of IT Act, 2000 gives legal recognition to electronic records. Section 6 of IT Act, 2000 aims to reduce red-tapism and promote the use of electronic records. Section 7 allows retention of electronic records similarly to paper-based records to achieve legal recognition of retention of records. Section 8 of IT Act, 2000 allows legal recognition of electronic gazette to the publication of rules, regulation and notification.

IT Act, 2000 deals with attribution, acknowledgement and dispatch of electronic records. Let us discuss them in brief:

- **Attribution:** Sec 11 of IT Act, 2000 lays down that attribution of electronic record should be done by the person who originates it.
- **Acknowledgement:** Section 12 of IT Act, 2000 provides the manner in which acknowledgement of receipt shall be made. An acknowledgment must be given in:
 - Communication of the addressee
 - Conduct of the addressee



Quick TIP

The digital signature certificate includes the name of the user, user's email address, user's address, such as pin code, name of nations, etc., issuance date of certificate and the name of the certifying authority.

- **Dispatch:** Section 13 of the IT Act, 2000 provides time and place in which electronic records to be dispatch and receipt of the electronic record sent by the originator.

Section 14 of the IT Act, 2000 deals with the security of electronic records at a specific time and deemed to be secure electronic records with time to time verification. Section 16 of the IT Act, 2000 gives authority to the central government to prescribe the security procedure of the electronic record.

12.5.6 | CERTIFYING AUTHORITIES

The Information Technology Act, 2000 defines a certifying authority as a person who has been granted a licence to issue an electronic signature Certificate. The primary work of the Certifying Authorities (CAs) is to issue, revoke and renew digital or electronic certificates.

The work of CAs is licenced and regulated by the Controller of Certifying Authorities (CCA). It is the responsibility of the CCA to ensure that no provision of the Act is violated.

A CCA is appointed under this Act which acts as the apex regulatory body for all the CAs in India. A CA is a trusted third-party or entity that acquires licence from the CCA and issues digital signatures to the users of e-commerce. The CAs are supervised and controlled by the CAs. The functions of the CCA are as follows:

- To act as the regulator of the CAs
- To recognise foreign CAs
- To grant licence to the CAs to issue digital signature certificates
- To suspend the licence



SELF ASSESSMENT QUESTIONS

11. The civil court has no jurisdiction to the offences under the Information Technology Act, 2000. (True/False)
12. The Information Technology Act, 2000 provides recognition to e-contracts, digital signatures and electronic documents. (True/False)



ACTIVITY 3

Using the Internet, find out the provisions of the Information Technology Act, 2000 and what is covered under this Act.

12.6 NEGOTIABLE INSTRUMENTS ACT, 1881

A negotiable instrument is a mode of transferring money from one person to another. In other words, it is a document that promises payment to a specified person or the assignee. As per the Negotiable Instruments Act, 1881, it must be in a written form. The Negotiable Instruments Act, 1881 governs promissory notes, bills of exchange and cheques through which money can be transferred to the bearer of the document. Negotiable instruments such as *hundis*, railway receipt

are governed by local usage. Some of the important definitions under the Act are as follows:

According to **Section 4** of this act, a 'Promissory Note' is *an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.*

According to **Section 5** of this act, a 'Bill of Exchange' is *an instrument, in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.*

According to **Section 6** of this act, a cheque is *a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and includes the electronic image of a truncated cheque and a cheque in the electronic form.*

According to **Section 13** of this act, a 'Negotiable Instrument' means *a promissory note, bill of exchange or cheque payable either to order or to bearer.*

According to **Section 123** of this act, a cheque crossed generally is *a cheque that bears across its face an addition of the words and company or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words, not negotiable, that addition shall be deemed to be a crossing, and the cheque shall be deemed to be crossed generally.*

According to **Section 124** of this act, a cheque crossed specially is *a cheque that bears across its face an addition of the name of a banker, either with or without the words not negotiable, that addition shall be deemed to be a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker.*

According to **Section 126** of this act, a cheque crossed specially is *a cheque that is crossed generally, the banker, on whom it is drawn shall not pay it otherwise than to a banker the payment of cheque crossed specially. Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent, for collection.*

According to **Section 130** of this act, describe the cheque bearing 'not negotiable' crossing: A person taking a cheque crossed generally or specially, bearing in either case the words 'not negotiable', shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had.

12.6.1 | CHARACTERISTICS OF NEGOTIABLE INSTRUMENTS

Following are the characteristics of negotiable instruments:

- **Easy transaction:** It is always difficult to carry money physically when the amount of transaction is high. In such a case, this instrument acts in a bona fide manner because it is easier to keep one piece of paper in a pocket rather than carrying a bundle of notes.
- **Good title of transferee:** The transferee of a negotiable instrument is known as holder in due course.

- **Unconditional promise:** The promise or order must be unconditional. In case of a conditional promissory note or bill of exchange, it will cease to be negotiable.
- **Written instrument:** A negotiable instrument is a written document with a signature on it, which indicates that the drawer of the instrument intends to pay the specified amount to the drawee.

12.6.2 | TYPES OF NEGOTIABLE INSTRUMENTS

Following are the types of negotiable instruments:

- **Promissory Notes (PNs):** A promissory note is a note in a written form to pay a certain amount of money in future or promise to pay a certain amount of money in future. Promissory note is also referred to as loan agreement or just a note. PNs are used for mortgages, student loan, car loan or business loan. The PN consists of two parties, the Maker who makes the promissory document and the other is Payee who promises to pay at some decided future date.
- **Bill of exchange:** It is a written instrument that contains an unconditional order signed by the maker which directs a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.
- **Cheque:** It is a bill of exchange drawn on a specified banker and not expressed to be payable on demand. It includes the electronic mirror image of the original paper cheque.



NOTE

The Negotiable Instruments Act also covers the electronic cheques.



SELF

ASSESSMENT QUESTIONS

13. Conditional bills of exchange are also negotiable instruments. (True/False)
14. A _____ is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

12.7 | MINIMUM WAGES ACT, 1948

The Minimum Wages Act, 1948 ensures that workers and employees earn wages that are sufficient to earn their livelihood. The Act is divided into 31 sections. Some important definitions under this Act are:

“Adolescent” means a person who has completed the age of 14 years but has not completed 18 years of age.

“Adult” means a person who has completed 18 years of age.

12.7.1 | OBJECTIVES OF THE MINIMUM WAGES ACT, 1948

The Minimum Wages Act, 1948 is an Act that protects the interest of workers; the wages of workers are fixed as per the norms prescribed by the fair wage committee. It is an Act that sets minimum wages that are to be paid to skilled and unskilled labourers.

12.7.2 | SCOPE AND MAJOR PROVISIONS

The Minimum Wages Act is applicable all over India and ensures that wages are sufficient for the subsistence of workers. This Act specifies minimum wages rate on a per-day basis; the revision of minimum wages takes place on the basis of the cost of living index. The State and Central Governments have power to fix and revise minimum wages. There are two methods of fixing minimum wages:

- a. **Committee method:** Under this method, a committee is set up to make recommendations and enquiries.
- b. **Notification method:** Under this method, the rates of minimum wages are notified in the Official Gazette.

12.7.3 | CODE ON WAGES, 2019

In July 2019, the Minister of Labour and Employment, Santosh Gangwar introduced the Code on Wages in Lok Sabha. This code is proposed to regulate the wage and bonus payments in all employments in all industries, trade, business and manufacturing. This code is proposed to subsume the following four central labour acts:

1. The Payment of Wages Act, 1936
2. The Minimum Wages Act, 1948
3. The Payment of Bonus Act, 1965
4. The Equal Remuneration Act, 1976



EXHIBIT

DIFFERENCE AMONG BILL, ACT, LAW AND CODE

A bill is a draft prepared by the government or by lawmakers that proposes to establish a written law or statute. Such bills are introduced in both the houses of Parliament and are debated and voted upon. When a bill gets passed in both the houses of the Parliament, it is sent to the President for his assent and after he signs the bill, it is converted into an act. A fully established act is called a law.

A code is a collection of laws, rules, regulations or standards that are set-forth and enforced by the government. The purpose of the code may be related to protection of public safety, health, etc. For instance, the Insolvency and Bankruptcy Code (Second Amendment) Bill; 2019, the Code on Social Security, 2019, etc. are codes that have been proposed in the Indian Parliament in 2019.

This code will be applicable to all employees which is approximately 50 crores or 2/5th of the entire population. As per this code, it has been proposed that the Central Government will make wage-related decisions for employment in railways, mines, oil fields, etc. for all other employments, the state government will make wage-related decisions.

The code also proposes that the Central Government will fix a minimum or floor wage by considering the standard of living of workers and different geographical areas. The process of fixing the floor wage will be done in consultation with the

Central Advisory Board and all state governments. Also, minimum wages that are decided by the government must be greater than the floor wage. Also, if in any case, the already existing minimum wage is greater than the floor wage, then, the minimum wages cannot be decreased. All employers have to pay wages not less than minimum wages that would be notified by the central and state governments. The minimum wage will be decided on the basis of the number of pieces produced and the time taken. The central and state governments must compulsorily revise minimum wages at an interval not exceeding five years. The governments have to take into account the skill level of the workers and the level of difficulty in the work while deciding minimum wages.

The central and state governments also have to decide the number of hours which make up a normal working day and in case employees work any number of hours greater than normal working hours, they would be entitled to an overtime allowance which must not be less than two-times the normal rate of wages. The employers have to fix a wage period as daily or weekly or fortnightly or monthly and can make payments through coins, currency notes, cheques, bank credit or electronic transfer. The employer can make deductions (not exceeding 50% of the total wages) only in the following cases:

- Fines
- Absence from work
- Accommodation provided by the employer
- Recovery of advances

The central or state government has to notify a specific wage amount below which employees will be entitled to receive an annual bonus. The bonus should be the higher of 8.33% of the wages and ₹100. The employees can receive a maximum bonus of 20% of his wage.

For work of similar nature requiring the same level of skills, efforts, experience and responsibility, employers have to remunerate all workers equally and should not discriminate on the basis of gender.

This Code also contains provisions for the establishment of the Central Advisory Board and the State Advisory Boards which would comprise an equal number of employees and employers, independent persons and five state representatives. 33.33% of the total members would be women. The function of these advisory boards would be to advise respective governments on matters related to the fixation of minimum wages and for increasing employment opportunities for women.

If any employer pays a wage less than wages due to an employee or contravenes any provision of this code; then, the employer may face a penalty of up to 1 lakh rupees and an imprisonment for three months.



**SELF
ASSESSMENT
QUESTIONS**

15. The state and central governments have power to fix and revise minimum wages. (True/False)

16. Which one of the following is/are the method(s) for fixing minimum wages?
- a. Committee method b. Notification method
- c. Both of the above d. None of the above
17. Under the Minimum Wages Act, the wages are provided on a _____ basis.



ACTIVITY 4

Use the Internet to find out how minimum wage rates and their applicability can be notified.

12.8 FACTORIES ACT, 1948

The Factories Act, 1948 is the principal law concerning working conditions designed to protect labour against industrial and occupational hazards. For this purpose, it seeks to impose certain boundaries on the owner and protect the right of the labour.

12.8.1 OBJECTIVES OF THE FACTORIES ACT, 1948

The following are the objectives of the Factories Act, 1948:

- To provide for compulsory approval, licensing, registration and inspection of factories
- To regulate health, safety and welfare of workers engaged in a factory
- To regulate working hours and working conditions
- To provide for additional protection against hazardous processes in 29 industries as listed in Chapter IV –A

12.8.2 APPLICABILITY OF THE ACT

The Act is applicable only to factories. The term ‘factory has been defined as follows:

“**Factory**” includes any premises including the precincts thereof:

Whereon ten or more workers are working, or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on with the aid of power or is ordinarily so carried on; or whereon 20 or more workers are working, or were working on a day of the preceding 12 months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

However, the following are not a ‘factory’:

- Railway running shed
- Mines
- Mobile units of armed forces
- Hotels, eating places and restaurants

But companies engaged in the construction of railway lines come under the definition of a factory.

12.8.3 | MEANING OF MANUFACTURING PROCESS

The following is the meaning of a manufacturing process:

- i. Making, altering, repairing, ornamenting, finishing, packing, filing, washing, cleaning, breaking up, demolishing, treating/adapting an article with a view its use, sale, transport, delivery or disposal
- ii. Pumping oil/water/sewage/any other substance
- iii. Generating transforming, transmitting power (*except zonal offices, Workmen of DESU vs. Mgt AIR 1973 SC 385*)
- iv. Composing, types for printing, etc
- v. Constructing, repairing, refitting, etc
- vi. Preserving or storing articles in cold storage

The term is quite exhaustive and covers any process leading to the transformation of products making them commercially marketable such as making beedis, packing products, recording films on raw print, soap making, stitching gunny bags and making salt from sea water.

12.8.4 | WORKER TO BE THE MAIN BENEFICIARY OF THE ACT

Workers are main beneficiaries of provisions contained in the Act. The term 'worker' means the following:

Any person employed, directly/indirectly so that there is the existence of master-servant relationship, i.e., right of supervision (*Shankar Balaji Waje v Maharashtra AIR 1967 SC 517*). He must be working in a manufacturing process or any work incidental to or connected therewith, e.g., timekeepers employed to maintain attendance, checker of quality (*Rohtas Industries v Ramlakhan Singh & Ors AIR 1971 SC 849*) irrespective whether or not he is working for remuneration such as an apprentice.

The main provisions of the Factories Act,1948 are as follows:

- Compulsory approval, licensing and registration of factories
- Health measures
- Safety measures
- Welfare measures
- Working hours
- Employment of women and young persons
- Annual leave
- Accident and occupational diseases
- Dangerous operations
- Penalties
- Obligations and rights of employees



**SELF
ASSESSMENT
QUESTIONS**

18. Mines are also a type of factory. (True/False)
19. Any process leading to the transformation of products making them commercially marketable is called _____.

12.9 WORKMEN COMPENSATION ACT, 1923

The Workmen Compensation Act, 1923 came in force on the first day of July, 1924. This Act is divided into four chapters and 36 sections. The important definitions under this Act are as follows:

- **Compensation:** “Compensation” means compensation paid under this Act.
- **Minor:** “Minor” means a person who has not attained the age of 18 years.

12.9.1 OBJECTIVES OF THE WORKMEN COMPENSATION ACT, 1923

The Workmen Compensation Act, 1923 aims to provide relief to workers and/or their dependants in the case of an accident or the death of the worker. The object is that if an employee or worker dies during the course of employment or while undertaking or performing his duty, his family or dependants should be provided relief in monetary terms so that their livelihood is not affected. This relief is also provided in the case of disability.

12.9.2 SCOPE OF THE WORKMEN COMPENSATION ACT, 1923

The Workmen Compensation Act, 1923 extends to the whole of India. There was an amendment in the year 2000, wherein all workers were brought in the ambit of the Workmen Compensation Act, irrespective of the nature of the job for which they were employed. Hence, with the amendment, workers employed on a casual basis or otherwise than for the purpose of employer trade or business are covered in the sphere of the Workmen Compensation Act. The employees, including those employed through the labour contractor or otherwise, who suffer any injury that makes them disabled or incapable of earning similar income or in other words, reduces their earning capacity are entitled for compensation. The employer covered under this Act shall be liable to compensate workers who have suffered an accident in the course of employment, causing:

- a. **Death:** Death clause is applicable when the employee or worker dies on the account of an accident.
- b. **Permanent total disability:** This applies when the earning capacity of the worker is lost permanently.
- c. **Temporary disability:** This applies when the earning capacity of the worker is lost for a certain period.
- d. **Permanent partial disability:** Permanent partial disability takes place when the earning capacity of the worker is reduced.

The Act will apply only to individuals recognised as a “workmen” under the Act. With the amendment of the Workmen’s Compensation Act in 2000; now it is not necessary that the worker in question is engaged in the employer’s trade

or business. Further, with the Amendment of 2000, now even casual workers are covered under this law. The only requirement is:

The worker should be employed in an activity, which has to be either listed in schedule II of the Act or any duty having a connection with the specified activity mentioned in the schedule.

In addition to persons employed in the capacity mentioned in Schedule II, a driver, a mechanic, cleaner, or person employed in any other capacity in connection with a motor vehicle are also considered 'workers' under this Act.

In addition, schedule III to the Act contains a list of diseases and persons in occupations where infection is possible can claim compensation under this Act. They are 'workmen' for the purpose of this Act.

In case, part of the work of an establishment is contracted out to a contractor and a worker employed by the contractor for this purpose, is injured then, the principal employer and not the contractor (who is the worker's immediate employer), is responsible to pay compensation as though the worker was directly employed by him. (Section 12)

However, this principal employer holds the right to be indemnified by the person who would normally pay for the compensation of an injured/deceased worker, i.e. the contractor. However, nothing shall prevent the worker from claiming his compensation from the principal employer.

12.9.3 | EMPLOYER'S LIABILITY TO PAY COMPENSATION

If personal injury is caused to workmen by accident or by occupational disease arising out of and in the course of employment except when the injury does not last for more than 3 days or the injury is caused by disobedience of the worker (except in cases of death or permanent total disability).

Occupational Disease (Section 3(2))

An "occupational disease" while in service, is a disease that inflicts workers in that particular occupation in which s/he was employed in and resulting from exposure to a hazardous working atmosphere, particular to that employment.

If a worker contracts such a disease then the employer is liable to pay compensation, provided that the worker was employed by him for a continuous period of six months.

The occupational diseases for which compensation is payable are specified in a list attached to the Act specifically, Part A of Schedule III (annexure 5).

Amount of Compensation

The amount of compensation payable to a worker depends upon wages drawn by the worker and the nature of the injury caused. For example, in the case of death, the compensation shall be 50% of the monthly wages multiplied by the relevant factor or ₹ 80,000 whichever is more. Let us discuss the amount of compensation in each case:

1. **Death:** 50% of the monthly wages of the deceased worker multiplied by the relevant factor depending on the worker's age – the amount so derived or ₹ 80,000/- whichever is more.

2. **Permanent total disability:** 60% of the monthly wages of the injured worker multiplied by the relevant factor or ₹ 90,000/- whichever is higher.
3. **Permanent partial disability:** If the worker loses one hand then the compensation would be 60% of ₹ 90,000/-.
4. **Temporary disability:** A half monthly payment of the sum equivalent to 25% of the monthly wages of the worker, every 15 days till the injury lasts.

Even if two workers suffer an identical type of injury, they will get different amounts of compensation if they are earning different salaries. Compensation under this Act is calculated on the basis of the monthly wage received by the worker. According to this Act, it is the amount of wages which would be payable for a month's service i.e. irrespective of whether the worker is paid on a daily, weekly or piece rate basis.

Provisions under the Act

- Application for claiming compensation to the commissioner for workmen's compensation should be within 2 years from the date of the accident.
- In the case of contract workers, the principal employer is liable to make payments to the worker and he can recover the same from the contractor.
- A worker has the right to approach the civil court directly instead of approaching the labour commissioner in the first instance.
- The employer is bound to report to the commissioner if fatal accidents and serious bodily injuries have occurred, within 7 days of such an event.
- A worker can file the case in high court against orders of the commissioner if dissatisfied with the award.
- If the compensation is settled voluntarily between the worker and the employer, such agreement must be registered with the commissioner. Hence, if the settlement is unfair, the commissioner can take suitable actions.
- The compensation paid under the Act is protected, i.e. it cannot be attached or assigned. [section 9].
- The principal employer is liable to pay the amount of compensation for the injury suffered by workman employed through contractor, if the accident arises as a result of accident arising out of and during the course of employment. [section 12].
- A Commissioner for Workmen's Compensation is appointed by the government. The compensation must be paid only through the commissioner in the case of death or total disability. Any lump sum payment to workman under the Act must be made only through Commissioner. Direct payment to workman or his dependants is not recognised at all as compensation. However, in the case of death, if the employer has paid some compensation to the dependant, that will be refunded to the employer. [section 8(1)].
- Every employee, including those employed through contractor, but excluding casual employees who is engaged for the purpose of employer's business is eligible. The Act does not cover employees employed in clerical capacity.
- Workmen in manufacturing processes, mines, ships, construction, circus, etc. are covered. Also, tractor and mechanical appliance operators involved in

agricultural activities, drivers, watchmen etc. are covered. The compensation is payable if accident arises out of and during the cause of employment, and such accident causes either death or disability.

- Expenditure made by the employer for medical treatment of workman is not considered for the purposes of the compensation.
- The employee is eligible to get 'disability benefit' only when the injury arises out of and during the course of employment. Similarly, a workman is entitled to get compensation only if the accident is 'arising out of and during the course of employment'.



SELF ASSESSMENT QUESTIONS

20. The compensation under the Workmen Compensation Act, 1923 is paid under which of the following conditions?
- | | |
|-------------------------|-------------------------|
| a. Death | b. Permanent disability |
| c. Temporary disability | d. All of the above |
21. Employees, including those employed through the labour contractor or otherwise, who suffer any injury that makes them disabled or incapable of earning the similar income or in other words, reduces their earning capacity are entitled for compensation. (True/False)



ACTIVITY 4

Using the Internet, identify examples of the compensation paid by organisations in case of permanent partial disability under the Workmen Compensation Act, 1923.

12.10 THE PERSONAL DATA PROTECTION (PDP) BILL, 2019

We live in a knowledge-based global economy. Global economies (countries and organisations) are now concerned with the generation, storage, transfer and security of the data and associated resources. Data privacy is a burning and pressing issue. India, too, has taken certain steps towards establishing a law related to data protection.

The Union Ministry of Electronics & Information Technology (MEITY) set-up an Expert Committee under the Chairmanship of B. N. Srikrishna who is a former Justice of the Supreme Court in August 2017. The purpose of constituting the Committee was to study and identify key data protection issues along with recommending methods to address them.

In July 2018, the committee submitted its report titled "A Free and Fair Digital Economy—Protecting Privacy, Empowering Indians". Justice Srikrishna also said that data privacy laws must be developed keeping in mind the following three issues:

- Protecting citizen's rights
- Defining responsibilities of the states
- Ensuring that data protection cannot be achieved at the cost of trade and industry



NOTE

There are various permanent Standing Committees comprising MPs that meet regularly to discuss a matter pertaining to a particular subject. Unlike ad-hoc committees, these Standing Committees have a continued existence.

The report was submitted by the committee along with the Draft Personal Data Protection Bill, 2018. Some changes were made to this 2018 bill and was named as the Personal Data Protection Bill, 2019 (PDP Bill 2019, Bill No. 373 of 2019). This bill was approved from the Cabinet Committee on 4th December 2019. On 11th December, 2019, the Minister of Electronics and Information Technology, Mr. Ravi Shankar introduced the PDP Bill in Lok Sabha. On 17th December 2019, this bill was referred to the Select Committee of both the houses instead of being referred to the Standing Committee of Information Technology. It is expected that the committee would submit its report along with recommendations before the Budget session following which the bill would be presented in the February 2020 session of the Parliament.

The PDP Bill 2019 is the first attempt by India towards establishing data privacy and protection laws. The major objective of this bill is to provide protection of personal data to individuals. The bill also has a provision for the establishment of Data Protection Authority.

The objectives of this bill as laid down in the official copy of the bill are mentioned hereunder.

The PDP Bill, 2019 is a bill for:

- Protecting the personal data and privacy of individuals
- Specifying the flow and usage of personal data
- Creating a relationship of trust between persons and entities processing the personal data
- Protecting the rights of individuals whose personal data are processed
- Creating a framework for organisational and technical measures in processing of data
- Laying down norms for social media intermediary, cross-border transfers, accountability of entities processing personal data
- Laying down remedies for unauthorised and harmful processing
- Establishing a Data Protection Authority of India for the said purposes and for matters connected therewith or incidental thereto.

It is an established fact that the right to privacy is a fundamental right as enshrined in Article 21 of the Indian Constitution. Therefore, it is essential to protect the personal data to ensure informational privacy. It has also become essential because of the growth in digital economy and extensive use of data for the purpose of communication among people.

Some important definitions related to this bill are explained as follows:

- **Data:** It refers to a collection of information that is stored in computer systems in a readable format. Data may include a person's personal messages, social media posts, online transactions, browser search history, identification numbers, etc.
- **Data processing:** The processing or analysis of raw data that is not understandable and meaningful immediately to convert it into a form that helps in revealing certain useful information, pattern or trends.

- **Data principal:** The person whose data is being collected and processed is called data principal.
- **Data fiduciary:** An entity to whom the task of collecting and processing data is entrusted.
- **Data processor:** A data processor can signify two things. First, it refers to a third-party entity to whom the data fiduciary gives data for processing. Second, it may also refer to a physical machine where data is sent and stored to process the raw data into some useful form.
- **Personal data:** Data related to the characteristics, traits or attributes of identity of an individual that can be used to identify him/her.
- **Sensitive personal data:** Data related to the following is categorised as being sensitive personal data:
 - Financial data
 - Health data
 - Official identifier
 - Sex life
 - Sexual orientation
 - Biometric data
 - Genetic data
 - Transgender status
 - Intersex status
 - Caste or tribe
 - Religious or political belief or affiliation
- **The right to data portability:** The data principal has the right to receive his/her personal data in a structured and machine-readable format.
- **The right to be forgotten:** The data principal has the right to restrict or discontinue sharing his/her personal data with the data fiduciary if the data has already served its purpose.
- **Data Protection Authority of India (DPAI):** This is the government authority that is proposed to be established. This authority would be responsible for protecting personal data of people and for the implementation of the Act through codes of practice, inquiries, audits and more. Also, each organisation also has to appoint a Data Protection Officer (DPO) who would liaison with the DPAI. The DPO in association with the DPAI has to make provisions for auditing, grievance redressal, recording, maintenance related to data protection and privacy.
- **Adjudicating officers:** In DPAI, adjudicating officers would be appointed. The Adjudicating Officers in the DPAI would have the power to call people for making inquiries related to fiduciaries, assessing compliance and determining the penalties for fiduciary or for compensating the principal. Apart from the DPAI, there is a provision for the establishment of appellate tribunal. If any party is not satisfied with the decision of the Adjudicating Officers, they can approach the Appellate Tribunal. Again, if any of the parties are not satisfied even with the decision of the Appellate Tribunal, they can make an appeal in the Supreme Court.



NOTE

The data fiduciary decides how and why the data is to be processed but actual data processing may be done by a third-party. Data fiduciaries are concerned with data collection and handling and not processing.

Under normal circumstances, data fiduciaries are not allowed to process data. However, data fiduciaries can be allowed to process data if they attain the consent of the data principal.

There are three circumstances under which a data fiduciary may be allowed to process data without obtaining any consent as follows:

- For initiating legal proceedings
- In case of a medical emergency
- If data is required by the state for providing benefits to the individual

It has been proposed in this bill that the Central Government can exempt any of its agencies from provisions of this Act in the following cases:

- For ensuring security of the state
- For ensuring public order, sovereignty and integrity of India
- For ensuring friendly relations with foreign states
- For preventing the commission of any cognisable offence



**SELF
ASSESSMENT
QUESTIONS**

22. The data principal has the right to restrict or discontinue sharing his/her personal data with the data fiduciary. This right is also known as _____.
23. A third-party entity that processes data is called
- | | |
|-------------------|-------------------|
| a. DPO | b. Data fiduciary |
| c. Data processor | d. DPAI |
24. The PDP bill is proposed to protect the rights of individuals whose personal data is being processed. (True/False)

12.11 SUMMARY



- A business entity refers to an organisation that makes use of economic resources or inputs to and processes them to provide goods or services to customers in exchange for a consideration.
- The major forms of business organisations are:
 - Sole proprietorship
 - Partnership
 - Corporation
- Sole proprietorship refers to the type of business entity wherein an individual starts a business with his own capital and manages all the operations on his own.
- A partnership is a legal relation between persons who have agreed to work together to perform certain business activities.
- A corporation is a business association that has a separate legal identity from its owners.
- The Partnership Act, 1932 is also known as the Indian Partnership Act, 1932.

- The Competition Act, 2002 came into force through a notification by the central government in an official gazette. The Competition Act, 2002 was enacted to:
 - Promote welfare of consumers
 - Implement competition policies
 - Promote competition advocacy
 - Promote fair and healthy competition
- The Information Technology Act provides for legal sanctity to electronic documents or other documents that are transmitted during e-commerce.
- Under the Information Technology Act, 2000, the Certifying Authorities (CAs) can issue, revoke and renew digital or electronic certificates. The work of CAs is licenced and regulated by the Controller of Certifying Authorities (CCA).
- A negotiable instrument is a mode of transferring money from one person to another. In other words, it is a document that promises payment to a specified person or the assignee.
- Negotiable Instruments include promissory notes, bills of exchange and cheques.
- The Minimum Wages Act, 1948 ensures that workers and employees earn wages that are sufficient to earn their livelihood.
- The Factories Act, 1948 is the principal law concerning working conditions designed to protect labour against industrial and occupational hazards.
- The Workmen Compensation Act, 1923 aims to provide relief to workers and/or their dependants in the case of an accident or the death of the worker.
- The PDP Bill 2019 is the first attempt by India towards establishing data privacy and protection laws. The major objective of this bill is to provide protection of personal data to individuals.

12.12 KEY WORDS



- **Anti-competitive agreements:** Agreements that tend to restrict competition in India
- **Competition Commission of India (CCI):** The Competition Commission of India is entrusted with the duty of implementing the Competition Act, 2002 in India
- **Enterprise:** Any person or department that is engaged in any activity with the production, supply storage or acquisition or control of goods or services
- **Official Gazette:** A public journal, which prints official notices from the government for imparting information
- **Partnership:** A legal relation between persons who have agreed to work together to perform certain business activities

12.13 CASE STUDY: HOARDING AND COMPETITION COMMISSION OF INDIA (CCI)



Mr. Ankur and Mr. Nishant are traders of onions. They decide to hoard onions and start buying them in huge quantities from the wholesale market in Mumbai. A few weeks later, the price of onions shoots up. Seeing the sudden increase in the price of onions, the Competition Commission of India (CCI) starts an enquiry against the wholesalers of onions and finds that a major portion of the onions was being withheld by these wholesalers.

The CCI also holds Mr. Ankur and Mr. Nishant responsible for forming a cartel along with other wholesalers. After the preliminary enquiry, the CCI issues a show cause notice to the two. Mr. Nishant and Mr. Ankur file a case in a civil court stating that the allegations made by CCI are not true. They contest that they have not done any hoarding and have conducted the trade in the ordinary course of the business; hence, they are not liable to answer the show cause notice. They also state that the CCI has no right to issue the notice against them as it is not the correct forum for it. Moreover, they state that since they deal in onions, a vegetable, their case does not fall under the purview of the CCI.

QUESTIONS

1. Do you feel that the justification given by Mr. Nishant and Mr. Ankur is valid?
(Hint: A cartel is something against which the CCI can conduct an enquiry.)
2. Is the CCI the correct forum to issue a notice in this case?
(Hint: Hoarding of vegetables comes under the purview of the CCI.)

12.14 SHORT ANSWER QUESTIONS



1. The law relating to the partnership is regulated and governed by the _____.
2. _____ is a form of business organisation where the business is controlled by a single person.
3. A partnership firm agreement should include all the elements of a valid _____.
4. Ownership in a _____ is represented by the share or stock.
5. A _____ is a business organisation owned by a group of individuals, and is operated for their mutual benefit.
6. _____ is a mathematical technique for presenting the authenticity of a digital document.
7. The Competition Act, 2002, was enacted to promote competition advocacy. (True/False)
8. The Partnership Act came into force on the 3rd of October, 1932. (True/False)
9. Corporation is a form of business organisation. (True/False)

10. According to the Partnership Act, the maximum number of partners is 100. (True/False)
11. Which of the following authorities is proposed to be established under the PDP Bill, 2019?
 - a. DPAI
 - b. CCA
 - c. DPO
 - d. CA
12. Among the following partners, who is liable for all the activities of partners, but does not take an active part in the business operations?
 - a. Active partner
 - b. Dormant partner
 - c. Minor partner
 - d. None of these
13. Which one of the following Acts replaced the MRTP Act?
 - a. The Partnership Act, 1932
 - b. The Information Technology Act, 2000
 - c. The Competition Act, 2002
 - d. The Companies Act, 2013
14. Among the following options what is/are the major forms of business organisation?
 - a. Corporation
 - b. Partnership firm
 - c. Both a and b
 - d. None of these
15. When the exchange of information takes place between government bodies it is called:
 - a. G2C
 - b. G2G
 - c. G2E
 - d. G2B
16. Among the following, which is/are the benefit(s) of e- governance?
 - a. Helps in reducing corruption
 - b. Increases competition
 - c. Encourages good governance
 - d. Both a and c
17. When was the Information Technology Act, 2000 notified? Choose the correct option:
 - a. 20th October, 2000
 - b. 17th October, 2000
 - c. 25th October, 2000
 - d. None of these
18. The Competition Act, 2002 is not applicable in which of the following cases?
 - a. Banks
 - b. Venture capital fund
 - c. Foreign institutional investors
 - d. All of these

19. The Chairperson and members of CCI are appointed by which of the following? Choose the correct option:
 - a. State government
 - b. Central government
 - c. District government
 - d. None of these
20. Which among the following is written document made between the partners, which contains all the rights and duties of partners, name and objective of partnership business, address and other details?
 - a. Digital signature certificate
 - b. Memorandum of Understanding
 - c. Letter of content
 - d. Partnership deed
21. The Partnership Act, 1932 includes which of the following businesses?
 - a. Trade
 - b. Occupation
 - c. Profession
 - d. All of these
22. In Partnership Act, 1932, which of the following sections defines partnership?
 - a. Section 4
 - b. Section 69
 - c. Section 7
 - d. Section 2
23. Which among the following refers to a partnership made for a particular purpose and gets dissolved on the completion of that purpose?
 - a. Partnership at will
 - b. Particular partnership
 - c. Partnership for a fixed period
 - d. None of these
24. Which one of the following is the right explanation of the model that provides information and services by the government organisation to its employees?
 - a. G2B
 - b. G2C
 - c. G2E
 - d. G2G
25. Which among the following is a separate legal entity?
 - a. Partnership firm
 - b. Corporate society
 - c. Company
 - d. None of these

12.15 DESCRIPTIVE QUESTIONS



1. Explain different forms of a business organisation.
2. Describe the Partnership Act, 1932.
3. Discuss the Competition Act, 2002.
4. Explain the Information Technology Act, 2000.
5. Describe the Negotiable Instruments Act, 1881.

6. Explain the key provisions of the Code on Wages introduced in 2019.
7. Elaborate on the significance and provisions of the Personal Data Protection Bill, 2019.

12.16 ANSWER KEY



A. SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Different Forms of Business Organisations	1.	Sole proprietorship
	2.	legal relation
	3.	True
	4.	beneficiary
	5.	True
Partnership Act, 1932	6.	b. Section 4
	7.	d. All of these
	8.	d. Partnership between minors
Competition Act, 2002	9.	The Preamble states that this is an Act to establish a Commission to prevent anti-competitive practices, promote and sustain competition, protect the interests of the consumers and ensure freedom of trade in markets in India.
	10.	6
Information Technology Act, 2000	11.	True
	12.	True
Negotiable Instruments Act, 1881	13.	False
	14.	Bill of Exchange
Minimum Wages Act, 1948	15.	True
	16.	c. Both of the above
	17.	daily
Factories Act, 1948	18.	False
	19.	manufacturing process
Workmen Compensation Act, 1923	20.	d. All of the above
	21.	True
	22.	Right to be Forgotten
The Personal Data Protection (PDP) Bill, 2019	23.	c. Data processor
	24.	True

B. SHORT ANSWER QUESTIONS

Q. No.	Answer
1.	Partnership Act, 1932
2.	Sole proprietorship
3.	contract

Q. No.	Answer
4.	corporation
5.	cooperative society
6.	Digital signature
7.	True
8.	False
9.	True
10.	False
11.	a. DPAI
12.	b. Dormant partner
13.	c. The Competition Act, 2002
14.	c. Both a and b
15.	b. G2G
16.	d. Both a and c
17.	b. 17th October 2000
18.	d. All of these
19.	b. Central government
20.	d. Partnership deed
21.	d. All of these
22.	a. Section 4
23.	b. Particular partnership
24.	c. G2E
25.	c. Company

12.17 SUGGESTED BOOKS AND E-REFERENCES



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ABBREVIATIONS

- **AA:** Appellate Authority
- **ADR:** Alternate Dispute Resolution
- **AOA:** Articles of Association
- **BPO:** Business Process Outsourcing
- **BSA:** Business Software Alliance
- **CA:** Certifying Authority
- **CAG:** Comptroller and Auditor-General
- **CCA:** Controller of Certifying Authorities
- **CCI:** Competition Commission of India
- **CCPA:** Central Consumer Protection Authority
- **CCPC:** Central Consumer Protection Council
- **CDRC:** Consumer Disputes Redressal Commission
- **CIC:** Central Information Commission
- **CPA:** Consumer Protection Act
- **CPC:** Consumer Protection Council
- **CPR:** Community Property Rights
- **CSR:** Corporate Sustainability Responsibility
- **DCDRC:** District Consumer Disputes Redressal Commission
- **DCPC:** District Consumer Protection Council
- **DPAI:** Data Protection Authority of India
- **DPO:** Data Protection Officer
- **DSC:** Digital Signature Certificate
- **FII:** Foreign Institutional Investors
- **FPO:** Follow-On Public Offer
- **G2B:** Government to Business
- **G2C:** Government to Citizen
- **G2E:** Government to Employees
- **G2G:** Government to Government
- **GI:** Geographical Indications
- **IC:** Information Commission
- **ICT:** Information and Communication Technology
- **IPO:** Initial Public Offer (IPO)
- **IPR:** Intellectual Property Rights
- **IT:** Information Technology
- **KPO:** Knowledge Process Outsourcing
- **LLP:** Limited Liability Company
- **MEITY:** Ministry of Electronics & Information Technology
- **MOA:** Memorandum of Association
- **NCDRC:** National Consumer Disputes Redressal Commission
- **NFRA:** National Financial Reporting Authority
- **OPC:** One-Person Company
- **PCT:** Patent Cooperation Treaty
- **PDP Bill:** Personal Data Protection Bill
- **PNs:** Promissory Note
- **RBV:** Resource-Based View
- **ROC:** Registrar of Companies
- **SCDRC:** State Consumer Disputes Redressal Commission

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- **SCPC:** State Consumer Protection Council
- **SEBI:** Securities and Exchange Board of India
- **TRIPS:** Trade Related Aspects of Intellectual Property Rights
- **VCF:** Venture Capital Funds
- **WIPO:** World Intellectual Property Organisation
- **WTO:** World Trade Organization

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