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## Unit – 1

### Legal Aspects of Business: Law of Contract

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### Legal Aspects of Business: Law of Contract

#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning, essentials and classification of contracts.
- Describe the eligibility for capacity to contract, provide free consent and legality of object and consideration.
- Know the criteria for performance and discharge of contracts.
- Assess the remedial actions for breach of contract.
- Also understand the various types of special contracts like Indemnity, Guarantee and Agency.

#### Structure

- 1.1 Introduction
- 1.2 Meaning & Essentials of Contract
- 1.3 Classification of Contracts
- 1.4 Proposal & Acceptance
- 1.5 Capacity to Contract
- 1.6 Free Consent
- 1.7 Legality of Object and Consideration
- 1.8 Performance and Discharge of Contracts
- 1.9 Remedies for Breach of Contract
- 1.10 Special Contracts – Indemnity, Guarantee and Agency
- 1.11 Let's Sum-up
- 1.12 Key Terms
- 1.13 Self-Assessment Questions
- 1.14 Further Readings
- 1.15 Model Questions



## 1.1 Introduction

Each one of us enter into varied contracts in our routine life knowingly or unknowingly. Each contract creates certain rights and duties in an express or implied manner. The law which provides the guidelines and principles relating to the contractual relationships is The Indian Contract Act, 1872. The act came into force on 1<sup>st</sup> September, 1872. The act was passed by British India and is based on the principles of English Common Law. It is applicable to all states of India with an exception of Jammu & Kashmir. The Act deals with the formation of a contract, its performance, breach of contract and its remedies. The significant components of the act are discussed here under.

## 1.2 Meaning & Essentials of Contract

According to Section 2 (h), “Contract is an agreement enforceable by law”. Agreement means a promise. It is created when a person makes an offer to another person and other accepts it for consideration.

Agreement = Offer + Acceptance of Offer

All agreements are not contract, only those agreements which create legal right and are enforceable by law are contracts.

The following are the essential elements of a valid contract:

1. Plurality of Parties: There must be at least two parties in a contract. Generally they are called promisor and promisee.
2. Offer and acceptance (Agreement): One party should make offer and other should accept it according to the conditions of offer.
3. Intention to create legal relation (Enforceable by law): Both the parties should have an intention to create a legal relationship.
4. Contractual Capacity: Parties under contracts should be major and of sound mind. They should not be disqualified from contracts by law.
5. Consent: It means parties should agree on the same thing and in the same sense.
6. Free Consent: Consent is free if it is not due to coercion (force), undue influence, fraud, misrepresentation and mistake.
7. Consideration: It means something in return whose value is in terms of money.
8. Lawful Object: Every contract must have lawful object otherwise it is called void ab initio. It should not be fraudulent in nature or declared against public policy by the court.



9. Certainty of Meaning: Every word written in the contract should have a certain meaning. No ambiguity should be there.
10. Possibility to Perform: Agreement should be physically and legally possible to perform.
11. Agreement not declared void: Agreements which fulfill the conditions of lawful contract can also be declared void by law.
12. Compliance of legal formalities: All the legal formalities should be fulfilled.

Any agreement to be enforceable by law must have above features otherwise it will not be enforceable by law.

### **1.3 Classification of Contracts**

Contracts may be classified on the following basis:

#### **I According To Enforceability/Legality:**

- 1) Valid Agreement (Contract): A valid agreement is a contract enforceable by law. It has all essentials of contract under sec.10.
- 2) Void Agreement: Agreement not enforceable by law is called void. [Sec.2 (g)]. It lacks essentials of valid agreement. Such agreements are void ab initio (void from the beginning) and no restitution is permitted. It means any consideration given to each other by the parties, cannot be restored.
- 3) Void Contract: When a contract is valid at the time of its making but later on due to change in circumstances or in law, it becomes unenforceable, it is a void contract (not valid or legal). Under void contracts restitution and the payment for part performance is allowed.
- 4) Voidable Contract: An agreement which is enforceable by law at the option of one party & not at the option of other party. It means an agreement which is voidable at the option of aggrieved party. Aggrieved party is the party whose consent has been obtained by coercion, undue influence, fraud or misrepresentation. Such contract will remain valid till it is declared invalid by the aggrieved party. Restitution or compensation can be claimed, for loss on non-fulfillment of the contract.
- 5) Illegal Agreement: Agreement is illegal if it is not approved by law, opposed to public policy, criminal or immoral in nature. Such agreements are void ab initio and any collateral agreement will also be void.
- 6) Unenforceable Contract: If a contract cannot be enforced due to some technical defects like incomplete legal formalities, stamp, signature etc.

it is called unenforceable contract. As soon as technical defect is removed, contract becomes enforceable.

## II. According to Mode of Formation

1. Express Contract: Contract made in written or spoken words is express contract. It may be on letters, telephone, e-mail etc.
2. Implied Contract: Contract made other than words is implied. It arises from acts & conduct of the parties or by their circumstances. E.g. A calls a taxi on telephone. There is implied contract to pay if the taxi comes.
3. Quasi Contract: It is a contract imposed by the law on the parties & gives rise to obligations similar to a valid contract. E.g. A gives B (mad) some products. As B is mad or lunatic he cannot contract but law can create a contract between A & B on the principle of equity in which A can get money from B's property.

## III. According to Extent of Execution

1. Executed Contract: A contract in which all the parties have performed their obligations, is an executed contract. E.g. X sells his car to Y for 1 lakh. X gives the car & Y makes the payment. It is executed contract.
2. Executory Contract: A contract in which the parties still have to perform their obligations, is called executory contract.
3. Bilateral Contract: It is one in which both the parties exchange a promise to each other. One party promises to perform some act in the future in exchange for other party's promise to perform some act. It is similar to executory contract. Each party is both promisor & promisee.
4. Unilateral Contract: A contract in which one party promises to the other to do something if he performs his desired work. E.g. A promises to pay Rs.100 by advertisement to anyone who finds his lost horse. Anyone can search his horse & bind A for payment. But A cannot bind any one to search his horse.

### 1.4 Proposal & Acceptance

Proposal is an expression of willingness by one person to another to enter into an agreement with a view to obtain assent of the other. Person making proposal/offer is called 'proposer' or 'offerer'. On acceptance, the person making proposal is called 'promisor' & person accepting the proposal is called the 'promisee' or 'acceptor'.



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Acc. To Sec 2 (b), “When the person to whom the proposal is made communicates his assent, the proposal is said to be accepted. It is a communication of his intention to be bound by the terms of the offer.”

Following are not proposals: -

- i) Intention to put a proposal: - It is the declaration by a person that he intends to offer something in future. It is not made to obtain assent of the other. E.g. advertisement for auction sale or sale of goods.
- ii) Invitation to put a proposal: - It is made to receive a proposal from others. E.g. Menu Card of restaurant is an invitation to put an offer. Time Table of railways/Roadways/Airlines is an invitation to put an offer.

### 1.5 Capacity to Contract

According to Section 11, “Every person is competent to contract who is of the age of majority, who is of sound mind & is not disqualified from contracting by any law”.

The following persons do not have the capacity to contract:

- Minors
- Persons of Unsound Mind.
- Persons disqualified from contracting by any law

#### A. Minor

According to Sec. 3, “Minor is a person who has not completed 18 years of age.”

But in the following cases, he attains majority when he completes 21 years:

\* When guardians has been appointed for minor under Guardians & Wards Act 1890.

\* When superintendence of minor’s property is under court of wards.

#### Law relating to minor’s Agreements:

1. Agreement with minor is void ab initio.
2. No Ratification after attaining majority: Ratification means approving a past contract. Minor’s agreements are void ab initio so they cannot be ratified.
3. Minor can be a beneficiary or can take benefit out of a contract. He cannot be asked to return or mortgage his property.
4. A minor can plead minority i.e. even if he does something wrong he cannot be held responsible for it, in the court. E.g. A (minor) fraudulently represent himself as a major & ask B to lend Rs.1000. B lends the amount but cannot sue A for recovery.



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5. Parents/ Guardians can contract on behalf of minor with an exception that they cannot buy & sell fixed property on his behalf.
6. Minor cannot enter into a contract of partnership of firm but can be a partner in profits.
7. Minor can be an agent and can bind the principal for his acts without being personally liable.
8. Minor's parents are not liable for contracts made by minor with an exception that minor act as agent of his parents.
9. Under negotiable instrument Act, minor can write, accept, endorse bills of exchange but is not liable if they are dishonoured.
10. Minor can be a shareholder for fully paid up shares.
11. For criminal act, minor is fully liable for punishment.
12. Marriage contract by minor is void even after attaining majority.

### **B. Persons of Unsound Mind**

According to Sec. 12, a person has sound mind if:

- He is capable of understanding the contract at the time of making it.
- He is capable of making rational judgment i.e. effect of contract on his interests.

### **Types of Unsound Mind Persons**

Following are the persons who are considered as persons of unsound mind under the act:

1. Idiot: He is a person who has lost his mental ability to understand even ordinary things. It is permanent.
2. Lunatic: He is a person who is mentally affected due to strain or personal shocks. It is temporary & can be cured. He can make valid contract during lucid intervals.
3. Drunken or intoxicated person.
4. Hypnotized person.
5. Mental decay- There may be mental decay due to old age or poor health and such person is not capable of making a valid contract.

### **C. Persons Disqualified by Law**

The following persons are disqualified by law from entering into a contract:

1. Foreign Ambassadors: They have full capacity to contract in India but they cannot be sued in our courts unless central government permits.



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2. Alien Enemy: It means a foreign citizen living in India. Contract with alien friend is valid subject to some restrictions. When alien is declared alien enemy (declaration of war) he cannot contract.
3. Companies: Company can only contract through his human agents. Company's contractual capacity is determined by "Object Clause" of its memorandum of association. Contract made outside its scope is void.
4. Married Women: She can enter into a contract but her personal property (Streedhan) can be made liable but not property of her husband. A husband is liable for contract made by his wife for supply of necessities of life. In this case, she is an agent of her husband by necessity.
5. Convicts: While imprisonment, convict cannot enter into contract & cannot sue on contracts made before conviction. If he gets a license i.e. ticket of leave he can lawfully contract. After imprisonment he can enter into contract.
6. Insolvent: Person declared insolvent cannot contract. His official receiver appointed by court can enter into contracts, sue & be sued on his behalf.

## 1.6 Free Consent

According to Sec.13, 'When two or more persons agree on same thing in the same sense, they are said to consent.'

'Consensus Ad Idem' means people agree on the same thing in the same sense at the same time.

Consent is considered free if it is not caused by the following factors:

- (i) Coercion
- (ii) Undue Influence
- (iii) Fraud
- (iv) Misrepresentation
- (v) Mistake

### I. Coercion (Sec. 15)

It means threatening or use of physical force against a person to compel him to enter into a contract. E.g. Alia Slapped Bhim & dislocated some of his teeth & threatens to repeat the same if Bhim does not lend him Rs. 30,000. The contract is caused by coercion.

#### Essential Elements:-

- 1) Committing or threatening to commit any act forbidden by Indian Penal Code;- E.g. murder, theft, physical compulsion.
- 2) Threat of suicide is coercion.



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- 3) Unlawful detaining of any property or unlawful threatening to detain any property.
- 4) The intention must be to compel the other person to enter into a contract. E.g. A beats B to take revenge for his insult. This is not coercion.
- 5) Coercion may be from the party or from any other person/stranger.

**Effects:**

- 1) Contract becomes voidable, at the option of the party whose consent is taken by coercion.
- 2) Restitution: Aggrieved party can restore the benefits given.

**II. Undue Influence (Sec. 16)**

It is a kind of moral coercion. When relation between parties are such that one party is in a position to dominate the will of the other & use that position to obtain advantage over the other. This is undue influence

**Essential Elements: -**

- 1) There must be close relation between the parties.
- 2) One party should be in the position to dominate the will. It includes following situations: -
  - a. Real authority over the other like master & servant, doctor & patient.
  - b. When relation of trust & confidence exist between parties. E.g. father & son, husband & wife.
  - c. Undue influence can be used against the person whose mental capacity is affected by old age, illness etc.
- 3) The intention should be to take undue advantage.
- 4) Misuse of position to take advantage.

**Effects:**

- (1) Contract is voidable at the option of aggrieved party.
- (2) Benefit received is restored to the aggrieved party.

**III. Fraud (Sec. 17)**

Fraud means willful misrepresentation or concealment of material facts. The intention is to deceive (cheat) the other party & induce him to enter into an agreement. It include the following acts:

- i) Suggestion of that which is not true i.e. given by person who does not believe it to be true.
- ii) Concealment of fact by one who has knowledge of it.
- iii) Promise made without any intention of performing it.
- iv) Such act which law declares to be fraudulent.

**Essential Elements:-**

- 1) Fraud may be done by a party to the contract or his agent.
- 2) There must be representation which is false. E.g. A intends to deceive B & falsely represents that the car which he offers for sale is imported but actually it is Indian.
- 3) False representation must be of material fact, not an opinion.
- 4) A promise made without intention to perform is a fraud.





- 5) The intention must be to induce the other party to act upon false representation.
- 6) The other party must have been relied upon the statement & must have been deceived & suffered some loss.

**Effects:**

- (1) Aggrieved party has the right to rescind (declare invalid) the contract (voidable).
- (2) Sue for damages or loss suffered.
- (3) Benefit received is restored.
- (4) Aggrieved party can insist for performance & ask to put him in a position in which he would have been if representation made had been true.

**IV. Misrepresentation (Sec. 18)**

Any innocent or unintentional false statement of fact made by one party to the other during negotiation of contract is called misrepresentation. It includes:

- 1) When a person positively says that a fact is true when his information does not justify it, although he believes to be true.
- 2) When there is breach of duty by a person (no intention to deceive) which brings advantage to him & loss to the other.

**Essential Elements:**

- 1) Misrepresentation must be of fact & not mere opinion.
- 2) It must be made to induce other party to contract.
- 3) Intention should not be to deceive the other party.

**Effects:**

- 1) Contract is voidable at the option of aggrieved party.
- 2) Aggrieved party may insist on performance which will put him in the position if the representation made had been true.
- 3) Benefits may be restored.
- 4) Claim for damages except in following cases: -
  - a. When aggrieved party has means of discovering the truth.
  - b. If aggrieved party gave consent in ignorance of misrepresentation
  - c. If party has not rescinded the contract within reasonable time.

**V. Mistake (Sec. 20, 21 & 22)**

Mistake means a wrong belief or misunderstanding about something. Generally, mistake does not affect the validity of the contract. According to Sec.20, where both the parties are under a mistake, the agreement is void.

**Essential Elements:**

- (1) Both parties can be at mistake (bilateral mistake).
- (2) Mistake can be of two types: Mistake of fact and Mistake of law. Mistake of fact is related to the subject matter of the contract. It may be a bilateral or unilateral mistake. If there is mistake of law, the contract is valid

because everyone is assumed to have knowledge of it. & ignorance of law is no excuse.

### **Effects:**

- 1) Acc. To Sec. 22., Contract is not voidable due to unilateral mistake of facts.
- 2) Agreement made on bilateral mistake is void.
- 3) Mistake as to foreign law is treated as a mistake of fact & is excusable.

### **1.7 Legality of Object and Consideration**

The word object is used distinctly to mean 'purpose or design' of the agreement. The word 'consideration' is different from the object. Consideration means the benefit received or suffered under an agreement.

Sec.10 implies that an agreement enforceable by law must be for a lawful consideration and with a lawful object. Every agreement of which the object or consideration is unlawful is void.

#### **Unlawful Consideration or object:**

Object or consideration is considered as unlawful in following cases:

- 1) If the act is forbidden by law. E.g. X promised Y to pay Rs.3 lakh for murder of Z. It is unlawful.
- 2) If it defeats the provisions of any law: The act may not be forbidden by law. But, if it is permitted, it will defeat the provisions of any law. E.g. P & Q married under Mohammedan law but agreed before marriage that wife would be allowed to live with her parents after marriage. This agreement is void because it defeats the provisions of Mohammedan law.
- 3) If it is Fraudulent in nature.
- 4) If it involves injury to the person or property of another.
- 5) If Court considers it immoral: E.g. An agreement between husband and wife for future separation is immoral.
- 6) If court considers it opposed to public policy: It means no person can lawfully do something which can cause injury to public welfare. E.g. agreement to sell seat in medical or engineering college, agreement for getting votes in election for consideration, agreement to get a public title like 'Bharat Ratna' for consideration.
- 7) Agreement interfering with parental rights & duties.
- 8) Agreements which restrict personal liberty.
- 9) Agreements which restricts marriage or interfere with marital duties.
- 10) Agreements creating monopoly.
- 11) Agreements not to bid in auction sale.



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## **1.8 Performance and Discharge of Contracts**

Performance of contract means fulfillment of the terms of the contract by the parties under the contract within the time & in the manner prescribed.

### **Modes of Performance**

Performance may be in two ways:

- a. Actual Performance i.e. by performing promises: when both parties have fulfilled their obligations under the contract within the time & manner prescribed.
- b. Attempted Performance i.e. offer or tender to perform: Promisor offers to perform his obligations under the contract it is called tender. It is also called attempted performance. When a promisor offers delivery of goods to promisee, it is tender of goods. An offer to make payment is called tender of money.

### **Essentials of a Valid Tender/Offer (Sec. 38)**

- 1) It must be unconditional.
- 2) It must be an offer to perform in full.
- 3) It must be made at proper time & place.
- 4) Reasonable opportunity to inspect & satisfy should be given to the promisee (applicable to tender of goods).
- 5) It must be in legal tender money: It means current Indian currency notes or coins.

## **Discharge of Contracts**

A contract is discharged when the obligation created between parties come to an end. There are several methods of discharging the contracts namely:

- 1) By performance of promise
- 2) By mutual agreement
- 3) By lapse of time
- 4) By operation of law
- 5) By impossibility of performance
- 6) By breach of contract

### **I. Discharge by Performance of Promise**

When parties perform their promises, then the contract comes to an end or is discharged. It can be performed in two ways – by actual performance or by attempted performance.

### **II. Discharge by Mutual Agreement**

Methods of discharge of an existing contract by a fresh agreement by mutual consent are:



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- 1) **Novation:** It means substitution of a new contract in place of the existing contract. It may be done in two ways:-
  - a. New contract with new terms with same parties.
  - b. New contract on same terms with one party same & one new party.
- 2) **Alteration:** It means change in one or more terms of the contract with the consent of all parties. A valid alteration discharges the original contract & a contract with new terms is created.
- 3) **Rescission:** It means cancellation of contract. Cancellation may be by mutual agreement of both parties or by aggrieved party if free consent is not given.
- 4) **Remission:** It means acceptance of a lesser performance in discharge of a whole promise made.
- 5) **Waiver:** It means intentional withdrawal of rights. When a party entitled to claim performance releases the other party from his obligation to perform it, it is called waiver.
- 6) **Merger:** - It means merger of two or more rights into one contract. When an existing inferior right of party merges into newly acquired superior right by the same party, it is merger of rights. In such case, inferior right automatically stands discharged. E.g. A person holding a property under a lease, buys the property in his name. His rights as a lessee are merged into the rights of ownership.

### **III. Discharge by Lapse of Time**

When time is fixed for the contract & a party does not perform it within that time, the contract is discharged by lapse of time.

### **IV. Discharge by Operation of Law**

The contract discharges by operation of law in the following cases:

- 1) Merger: Inferior right is discharged & not required to be enforced.
- 2) Insolvency: When court declares insolvent, the person is discharged from all obligations of any contract & they are transferred to his official receiver.
- 3) Death: If contract involves use of personal skills of promisor then on his death the contract is discharged. In other cases, the obligation is transferred to legal representatives.
- 4) Unauthorized material alteration in the terms of the contract, without the knowledge & consent of other party, the contract may be discharged by other party (voidable).
- 5) Where evidence of contract is lost, the contract is discharged. E.g. document of contract is lost or destroyed & there is no other evidence available.



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## V. Discharge by Impossibility of Performance

Where contract is impossible to perform, the contract is void. According to Sec. 56, impossibility may be of two types:

- 1) Existing Impossibility: It refers to the impossibility at the time of agreement.
- 2) Subsequent or Supervening Impossibility: The contract becomes void when the act becomes impossible later on, in the following conditions:
  - a. Destruction of subject matter.
  - b. Non-existence of a state of things necessary for performance. E.g. P hired a room from Q for 1 day for watching King's procession. The procession was cancelled, contract became impossible.
  - c. Change in circumstances.
  - d. Death or personal incapacity of the promisor.
  - e. Change in law
  - f. Outbreak of war. (Alien Enemy contract).
  - g. Order of the court (Court Stay)

### Effects of Supervening Impossibility:

- 1) Contract becomes void.
- 2) Compensation for loss if the act known to be impossible to any one of the parties.
- 3) Restitution of benefits.

## VI. Discharge by Breach of Contract

It means non-fulfillment of the promise made by any of the parties to a contract. There are two types of breach of contract:

1. Actual Breach: It takes place when a party to a contract refuses or fails to perform his obligation when it is due.

**Effects:** Claim for damages & can sue in the court.

2. Anticipatory Breach: When a party disables himself or declares that it will not perform the contract prior to the date of performance. It is also called anticipatory or constructive breach of contract.

**Effects:** Promisee is excused from further performance and he can put an end to the contract & sue other party for default. Alternatively, he may wait till the due date of performance of contract & then avail legal remedies against other party.

### 1.9 Remedies for Breach of Contract

A remedy is the means given by the law for enforcement of right. In case of breach of contract, the injured party or aggrieved party has one or more of the following remedies:

### **I. Rescission of the Contract**

Rescission means cancellation or putting an end to the contract. When promisor makes a breach of contract, the promisee can rescind the contract.

Court may grant rescission when contract is voidable or unlawful. Court may refuse rescission in the following cases:

- a. Where the aggrieved party has expressly or impliedly ratified the contract.
- b. When there is no fault of both parties & situation arises due to change in circumstances then the parties cannot restore their original position.
- c. When third parties has, during the subsistence of contract, acquired rights in good faith. E.g. X fraudulent bought a diamond bracelet from Y & pledged it to P who kept it for value & without any notice of fraud. Y cannot rescind the contract.

### **II. Suit for Damages**

Damages may be of four types:

1. Ordinary or natural damages: It is the direct loss suffered by the aggrieved party.

2. Special Damages: They include indirect loss suffered by aggrieved party. They arise due to special circumstances. If special loss can be incurred on breach of contract, it should be communicated to the other party, otherwise damages will not be given.

3. Exemplary Damages: It involves very heavy amount. It happens in the following cases:

- a) Breach of contract to marry: Amount will depend upon injury to lady's feeling & their family reputation.
- b) Dishonor of customer's cheque by the bank without any proper reason. Amount will depend upon loss to goodwill of customer.

4. Nominal Damages: The amount is very small like Rs. 5 or 10. It is given when party has proved breach of contract. It is given to recognize the right of party to claim damages.

### **Liquidated Damages & Penalty**

The Parties decide in advance, the amount to be paid as damages in case of breach of contract. Such amount may be



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a) Liquidated Damages: It represents the amount of probable loss that might result due to breach of contract. This amount is to compensate for breach.

b) Penalty: When amount for damages decided in the contract is very high as compared to likely damages in case of breach, it is called penalty.

### **III. Quantum Meruit**

Quantum Meruit means as much as earned. In certain situations, the party can claim payment of such amount which he has earned. This right is available in addition to the right of damages.

The claim for quantum meruit arises only when original contract is discharged. A party who is not in default can only claim for quantum meruit. Claim can be made only if contract is divisible and express or implied evidence to pay for work is shown.

### **IV. Specific Performance of Contract**

In case where damages are not sufficient remedy, court may ask for specific performance as per the terms of contract. It may be done in the following cases:

1. Where there exist no standard for finding actual damage by non-performance.
2. Where probable amount of compensation in money cannot be received for non-performance.

Specific performance will not be granted in cases where court cannot supervise the performance, where damages are adequate remedy, subject matter does not exist and where contract contains ambiguous terms.

### **V. Suit for Injunction**

It means order of court to a party to do or not to do any particular thing. In case of contract, injunction is the order of a court prohibiting a party from doing a particular thing.

#### **1.10 Special Contracts**

The following contracts are special type of contracts:

- Contract of Indemnity (Sec. 124)
- Contract of Guarantee (Sec. 125)
- Contract of Agency (Sec. 126)



### **Contract of Indemnity (Sec. 124)**

According to Sec. 124, a contract of indemnity is 'A contract by which one party promises to save the other from the loss caused to him by the conduct of the promisor himself or by the conduct of any other person.'

The person who promises to indemnify or make good the loss is called indemnifier. The promisee or whose loss is made good is called the indemnified or indemnity holder.

#### **Essential Elements:**

- 1) Include all essential elements of valid contract.
- 2) It may be express or implied.
- 3) Loss may be caused by promisor or any other person or accidents.
- 4) The promisee has the right to recover from the promisor the actual cost of indemnity contract.

#### **Rights of indemnity- holder or indemnified**

He has following rights against the indemnifier i.e. Promisor:

- 1) Right to recover damages: All damages he may be supposed to pay in any suit to which the indemnity applies.
- 2) Recovery of cost: All costs which he may be made to pay in defending the suit of indemnity.
- 3) Recovery of all sums paid: All sums he has paid in terms of any compromise of any suit.

#### **Rights of Indemnifier**

- 1) Right of subrogation: After paying the amount of claim, indemnifier gets all the rights of indemnified against a third party. i.e. to sue & claim for damages & all sums paid against third party.
- 2) Right to refuse claim or indemnity: If loss caused is out of the scope of the contract or indemnified has not acted prudently, then indemnifier can refuse claim.

### **Contract of Guarantee (Sec. 124)**

A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default.

The person who gives the guarantee is called surety. The person against which the guarantee is given is called the principal debtor. The person to whom the guarantee is given is called the creditor.

A guarantee may be given not only for a debt, but also where party wants to buy goods on credit & also for good conduct of another person (Fidelity Guarantee).

#### **Essential Elements:**





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- 1) It may be written or oral.
- 2) 3 contracts are there:
  - ❖ Between creditor & debtor
  - ❖ Between surety & creditor
  - ❖ Implied contract between surety & debtor.
- 3) Capacity to contract: The principal debtor may be a minor or a person incapable of entering into a contract. In such cases, surety shall be regarded as principal debtor & will be liable to pay.
- 4) Consideration: The consideration received by the principal debtor must be sufficient consideration to the surety for giving guarantee.
- 5) Surety is personally liable for default of principal debtor.
- 6) Guarantee is given on the request of principal debtor (implied or express).
- 7) Guarantee contract is not a contract of 'Uberrimae Fidei': A contract uberrimae fidei is one which imposes duty on creditor to disclose all material facts to the surety. A creditor is required to disclose only those material facts, which he knows & are likely to affect the degree of responsibility of surety.
- 8) Surety's liability arises from the date the principal debtor commits default & not from the date of guarantee.

**Rights of surety:**

After performing or discharging the liability of the principal debtor, a surety gets various rights against creditor, principal debtor and co-sureties.

**I. Right against Creditor**

- 1) Right of exoneration (declare free from blame): When debt has become due, surety is called to pay, he may ask the creditor to sue principal debtor. In case of fidelity guarantee, surety may call creditor to dismiss the employee whose honesty he has guaranteed (if dishonesty is proved).
- 2) Rights on Securities: After paying the creditor, surety can ask him to give all the securities which he has, against principal debtor.
- 3) Rights of Subrogation: After paying creditor, surety get all the rights of creditor against principal debtor.
- 4) Rights to Set-off: Set-off means a right of counter-claim or right of deduction from the amount of debt. This is when creditor sues surety. He can counter-claim against any possession with creditor.

**II. Right against Principal Debtor**

- 1) Right of subrogation: After paying creditor, he gets all the rights of creditor against principal debtor.
- 2) Right of Indemnity: There is implied promise by principal debtor to indemnify the surety & surety can demand all payments from him.

**III. Right against Co-Sureties**

- 1) Right to Contribute Equally: When he has paid more than his share, he has the right of contribution from co-sureties.

- 2) Contribution when co-sureties bound to contribute equally subject to the limit of their obligations.



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## **Contract of Agency**

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

Agency is the relation between an agent & his principal created by an express or implied agreement where agent is authorized by his principal to represent him in dealing with third parties and to contract with them.

### **Essential Elements:**

- 1) Express or implied by an agreement
- 2) Competence of the principal
- 3) Consideration is not necessary
- 4) Free consent of both parties
- 5) Agent is appointed to create contractual relations with third parties.

## **Creation of Agency**

A contract of agency can be created in the following ways:

- 1) By Express agreement
- 2) By Implied agreement
  - i) Agency by Estoppel
  - ii) Agency by Holding Out
  - iii) Agency by Necessity
- 3) By Ratification
- 4) By Operation of Law

### **I. By Express agreement**

When authority is given by the principal by written document or spoken words. The written document is called 'power of attorney'. It should be written & stamped.

### **II. Agency by Implied agreement**

It may be created by conduct or relation of the parties or circumstances of the case. For e.g. X lives in Jaipur & has a shop in Delhi & he visits occasionally. The shop is managed by Y. Y purchases goods from Z & make payment from X's funds with X's knowledge. Y has implied authority from X.



It includes following types of agencies:

1) **Agency by Estoppel:** The principle of estoppel is that where a person by his words or conduct willfully made other believe that certain state of affairs exists & other person acted on that belief, then he is stopped from denying the truth of such statement. Eg. X tells Y in the presence of Z that X is Z's agent & Z does not object to this statement. Y, later enters into a transaction with X believing that X is Z's agent. Z is bound by this transaction.

2) **Agency by Holding Out:** It is the extended form of agency by estoppel. The principal by his past positive act make third party believe that some other person is doing act on his behalf with authority. This is agency by holding out. For e.g. P usually sends his servant to buy goods for him on credit from Q & P pays for them. Later, servant misuses his authority & buys goods for his personal use. P is responsible for payment to Q as he had held out his servant as his agent by his past positive conduct.

3) **Agency by necessity:** Under some circumstances, law permits a person to act as agent of another person in the time of emergency without instructions from the principal. Such agency is called 'agency by necessity'. For e.g. a ship driver can borrow money at a port where owner of ship has no agent, to carry out necessary repairs of ship to complete the journey. In this situation, he can act as agent but he should act for benefit of the principal.

### **III. By Operation of Law**

Under this case, law assumes a person to be an agent of another. For e.g. a partner is assumed as an agent of his firm.

### **IV. By Ratification**

Ratification means subsequent acceptance & adoption of an act by the principal originally done by the agent without authority. For e.g. A insures B's goods without his authority. If B ratifies A's act, the policy will be valid as if A has authorized to insure the goods.

Ratification will bind the principal and the unauthorized act by agent becomes an authorized act. It applies with retrospective effect i.e. agency arises from the time act was done by agent & not from the date it was ratified.

### **I. Duties of Agent**

- 1) Agent should work within the scope of his authority following the instructions of the principal.
- 2) Carry out act with reasonable skill & honesty.
- 3) Duty to give proper accounts when demanded by principal.
- 4) Duty to communicate with the principal in case of difficulty.
- 5) Duty not to deal on his own accounts and pay all benefits to the principal.

- 6) Duty not to delegate his authority.
- 7) Duty to protect the interest of the principal.

## II. Rights of Agent

- 1) Right to retain money for expenses incurred in agency functions.
- 2) Right to receive remuneration if he do not misconduct.
- 3) Right of indemnification: agent has the right to be indemnified by the principal for injuries caused by principal's neglect.
- 4) Right of stoppage of principal's goods in transit in following conditions:
  - a) Where he has purchased goods for principal on personal liability.
  - b) Where he is personally liable to the principal for the price of goods sold.  
This right can be exercised only when buyer becomes insolvent.

## III. Duties & Rights of Principal towards Agent

The duties of agent are rights of principal & rights of agent are duties of principal.

### Termination of Agency

Termination of agency means the end of relation between principal and his agent. All the modes of termination of agency may be classified under the following two heads:

- I. Termination by acts of the parties.
- II. Termination by operation of law.

### Termination by Acts of the Parties

An agency stands terminated by any of the following acts of the parties:

1. **Agreement** – An agency may be terminated by the mutual agreement between the principal and the agent at any time and at any stage.
2. **Revocation by principal** – A principal can revoke the agent's authority subject to the following rules:
  - a. The principal cannot revoke the agency where the agent has an interest in the subject-matter of agency.
  - b. Revocation is possible only when the agent has not exercised the authority.
  - c. When the agency is for any fixed period of time, the principal is liable to make compensation to the agent.
  - d. Principal must give a reasonable notice for revocation of agency.
  - e. The revocation may be expressed or implied from the conduct of the principal.

3. **Renunciation (denial) by agent** – An agent may also terminate the agency by renouncing the business of the agency subject to the following rules: -



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- a. When the agency is for fixed period, the agent will be liable to compensate the principal.
- b. A reasonable notice of renunciation must be given by the agent.
- c. Renunciation may be expressed or implied from the conduct of the agent.

### **Termination by Operation of Law**

The relation of agency is automatically terminated by operation of law in the following cases:

- a. Completion of agency business
- b. Death, insanity or insolvency
- c. Destruction of the subject matter
- d. Principal becoming an alien enemy
- e. Event rendering the agency unlawful
- f. Impossibility of performance



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## Legal Aspects of Business: Law of Contract

### 1.11 Let's Sum-up

The Indian Contract Act 1872, governs the contracts done within the boundaries of India except the state of Jammu & Kashmir. Contract refers to an agreement which is enforceable by law. There are certain essentials which should be there in order to become a valid contract. There must be an agreement in which one person makes an offer to the other and the latter accepts it unconditionally. A minor, a person of unsound mind and a person disqualified by law cannot enter into contracts. The agreement should involve some consideration and the consent given by the parties should be free. There are special types of contracts vis-à-vis guarantee, indemnity and agency. If the parties to a contract do not perform, it leads to breach of contract. There are different remedies available to the aggrieved party in case of breach of contract.

### 1.12 Key Terms

**Agreement:** It is a promise in which one party makes an offer and the other party accepts it according to the conditions of the offer.

**Contract:** It refers to an agreement made by free consent of parties competent to contract, with a lawful purpose and consideration, which is legally enforceable.

**Consideration:** It means something in return. It is the benefit obtained by the parties entering into a contract. There may be adequate or inadequate consideration in a contract.

**Free Consent:** The consent is said to be free if it is not due to any compulsion, pressure or mistake.

**Breach of Contract:** It refers to non-fulfilment of the parties under the contract due to any reason.

**Indemnity:** It refers to a contract in which one party promises to make good the loss caused to the other party due to certain specified reasons.

**Guarantee:** It is a contract under which one party takes the responsibility of the fulfilment of the promise made by the other party.

**Agency:** Agency is the relation between an agent & his principal created by an express or implied agreement where agent is authorized by his principal to represent him in dealing with third parties and to contract with them.

### 1.13 Self-Assessment Questions



1. Anil a minor sold a shop to Bhim an adult. Anil got the consideration but the sale deed could not be registered as he was a minor. Bhim filed a suit for specific performance of the agreement. Could the amount be recovered of consideration?
2. A, a minor sold goods on credit to B, a major. Can A recover this amount from B?
3. Amit gives guarantee to Sumit for the payment of loan due from Karan, a minor. On the due date, Karan fails to repay the loan. What will be the liability of Amit for the repayment of loan?

### 1.14 Further Readings

- Pathak Akhileshwar, *Legal Aspects of Business*, Tata McGraw-Hill.
- Bulchandani K. R., *Business Law*, Himalaya Publishing House, New Delhi.
- Prasad G., *Business and Corporate Laws*, Jai Bharath Publishers, Guntur.
- Pollock & Mulla, *The Indian Contract Act 1872*, LexisNexis Publishers.

### 1.15 Model Questions

1. Discuss the various essential elements of a contract under The Indian Contract Act, 1872.
2. What is meant by 'Undue Influence'? 'A' applies to a banker for a loan at a time where there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. Whether the contract is induced by undue influence? Decide.
3. Discuss the different modes of discharge of a contract. Also state the consequences under each method.
4. Differentiate between the contract of indemnity and contract of guarantee.
5. Explain the different ways to create a contract of agency.

### Answers to Self-Assessment Questions

1. The agreement being void, cannot be specifically performed. So the amount of consideration also could not be recovered.
2. Yes, A can recover the amount from B as A is a beneficiary in the agreement.
3. This is contract of guarantee. Hence Amit is the surety or guarantor. So Amit is liable to pay the money.

## Unit – 2

### Legal Aspects of Business: Company Law

#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and nature of company.
- Describe the procedure of registration of a company and its promotion.
- Know about the preparation of the essential documents vis-à-vis memorandum of association, articles of association and prospectus.
- Also understand the role, duties and appointment of company directors and company secretary.

#### Structure

- 2.1 Introduction
- 2.2 Meaning & Nature of Company
- 2.3 Promotion of Company
- 2.4 Procedure of Registration
- 2.5 Memorandum of Association
- 2.6 Articles of Association
- 2.7 Prospectus
- 2.8 Directors
- 2.9 Company Secretary
- 2.10 Let's Sum-up
- 2.11 Key Terms
- 2.12 Self-Assessment Questions
- 2.13 Further Readings
- 2.14 Model Questions



### Legal Aspects of Business: Company Law





## 2.1 Introduction

The company law in India aims at synchronizing the working practices of companies in India. The new Companies Act 2013 has replaced the old Companies Act 1956. The Act makes comprehensive provisions to govern all listed and unlisted companies in the country. The Companies Act 2013 implemented many new sections and repealed the corresponding sections of the Companies Act 1956. This Act offers a landmark legislation change for all companies incorporated in India. This unit will highlight the key issues in the Company Law.

## 2.2 Meaning & Nature of Company

Company is a voluntary association of persons formed & registered under Companies Act, 2013.

Company is an artificial person having separate entity from its members, with perpetual succession & a common seal. The capital of the company is divided into transferable shares & shareholders are called members.

### Nature of company

1. Registered Voluntary Association: It comes into existence after registration i.e. it becomes a body corporate by the name with which it is registered.
2. Members/subscribers: Minimum 7 persons in case of public company & 2 in case of private company are required. Persons, who agree to form a company, have to sign the memorandum of the company & these signatories are called subscribers to the memorandum. On registration they are called first members of the company. Maximum members in private company may be 200 & there is no limit in public company.
3. Artificial Person: Company is created by law. It has no physical body, no soul but it is not a fictitious person. It is a real person & have same rights & powers like a person. It can purchase & sale property & enter into contract through his agents.
4. Separate Legal Entity: It has its own legal existence independent of its members. It can enter into contracts & sue & be sued by its members as well as outsider in his own name.
5. Perpetual Succession: It never dies. It continuously exists & is not affected by lunacy, retirement, death or insolvency of its members.
6. Common Seal: Every company is required by law to have a common seal. The name of the company is engraved on it. When seal is affixed on any document, it is legally binding on the company.
7. Limited Liability: In case of a company limited by shares, the liability of members is limited to nominal value of share held by him. In a company limited by guarantee, the liability of member is limited to the amount guaranteed by him.
8. Share Capital: A company is required by law to have share capital.
9. Transferable Shares: The shares in public company are freely transferable subject to conditions given in the articles. In private company, articles have to restrict this right to transfer shares.
10. Limited Capacity to Contract: A company has capacity to contract within the scope of memorandum of association.



11. **Management Team:** A company is managed by a board of directors elected by the members of the company. So, shareholders cannot directly participate in the management of the company.
12. **Decision taken by the rule of majority.**
13. **Residence:** For communication purposes, the residence of the company is the place of its registered office. For purpose of income tax Act, a company resides where its real business is carried on.
14. **Nationality:** A company has nationality of the country where it is registered.

## **2.3 Promotion of Company**

### **Promoter**

Promoter is a person or a group of persons who originates the idea of formation of a company & takes necessary steps for its incorporation, raising of capital & making it a going concern.

### **Functions of Promoters**

1. **Originating the idea of the company:** They give an idea about the activities that they want to carry out through proposed company.
2. **Investigation & verification of the idea:** They test the technical, commercial & financial feasibility of the idea.
3. **Assembling the Requirements:** They take steps to translate the idea into a reality by arranging for fully equipped office, employees, company secretary etc.
4. **Making preliminary contracts:** They make preliminary contracts related to purchase of land, securing patents, plant & machinery etc.
5. **Financial Planning:** They plan for immediate preliminary expenses and decide about capital structure, method of capital issue, arrangements with bankers, issue managers etc.
6. **Compliance of legal formalities:** Legal formalities include deciding the place of registered office of company, frame the objectives and get memorandum signed by subscribers.
7. **Getting the company incorporated or registered:** They apply for registration to the registrar of companies.
8. **Getting certificate of commencement of business:** They fulfil all legal formalities and obtain the certificate of commencement.

### **Position of Promoter**



1. Not an agent: He is not an agent because his principal (company) does not exist at the time when he acts on his behalf.
2. Not a trustee: This is because there cannot be any trust before company comes into existence.
3. Fiduciary relation to the company: Fiduciary relation means a relation of trust, confidence & good faith. So his dealings should be open, fair & in good faith.

### **Duties of Promoter**

1. To disclose all material facts related to formation of company.
2. Not to make secret profit. However, he may make profit with the knowledge & consent of company.
3. To disclose the interest in the transaction or contract done by the company.
4. Not to sell own property to the company without informing that property belong to him.
5. Not to make unfair use of the position.

### **Rights of Promoters**

1. Right to receive preliminary expenses.
2. Right to receive proportionate amount from co-promoters: In case indemnity is recovered from any promoter due to misstatement in prospectus or secret profit, the concerned promoter has the right to receive proportional amount of damages from co-promoters.
3. Right to receive remuneration for his services.

## **2.4 Procedure of Registration**

The process of forming into a legal organization i.e. a company involves the following stages:

I Promotion Stage

II Registration Stage

III Capital Subscription Stage

IV Commencement of business or trading certificate

First two stages are compulsory for all types of companies including a private company.

### **I. Promotion Stage**

Promotion is the process of discovery & investigation of business opportunities, planning & organization of physical, financial & human resources with a view to forming a company. The work of promotion is done by promoters. Promotion stage involves all the primary activities which are necessary for formation of company.

## II. Registration or Incorporation Stage

The company comes into existence only after this stage. The following key points should be kept in mind:

1. If company wants to undertake such industrial activities which require license under industries Act, 1951 then application should be made to ministry of industries.
2. Public companies limited by shares usually get capital by public subscriptions which cannot be possible without the issue of prospectus or 'a statement in lieu of prospectus' filed with the registrar of companies.
3. Filing of following documents with registrar:
  - a. Memorandum of Association with signatures of subscribers in presence of at least one witness.
  - b. Articles of Association signed by subscribers to memorandum. If public company adopts table A of schedule I, Articles are not required to be filed.
  - c. Details & list of Directors
  - d. Written consent of directors to work as first director of company & to take & pay for qualification shares.
  - e. Information about place of registered office.
  - f. Receipt of registration fee paid.
  - g. Statutory Declaration stating that all requirements regarding registration are fulfilled.
4. Scrutiny of Documents: Registrar may check the documents to satisfy that all legal formalities are fulfilled. If there is any minor defect in any document, registrar may send it for rectification. But if there is material defect, it may return all documents for correction. Also, it can refuse to register a company on lawful grounds.
5. Certificate of incorporation/Registration: It is issued by registrar after satisfaction of all legal formalities. This certificate is a proof that all the requirements of the act have been completed with respect to registration.

## III. Capital Subscription Stage

Private company does not pass through this stage. Public company with share capital passes through this stage.

### Steps

1. Filing of prospectus with registrar of companies: The registrar will register the prospectus & affix his official seal & date on the copy of prospectus.
2. Issue of Prospectus: On the advertised date prospectus will be issued to the public either through bankers or registered office of company.



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3. Application through bankers: Investors has to give applications for shares along with application money to the company's bankers who will forward the applications received to the company.

4. Allotment of shares: The directors will consider the allotment if the capital equal to the minimum subscription is subscribed as given in prospectus.

Company may raise capital from private sources i.e. from directors, members & their relatives.

#### **IV. Commencement of Business Stages**

A public company cannot commence its business unless it obtains 'Certificate of Commencement of Business from registrar.' For obtaining it, a statutory declaration is required duly verified by directors stating that:

1. Every director of company has paid the company the application & allotment money in cash.
2. Capital equal to minimum subscription has been subscribed for.
3. Refund of application money on un-allotted shares have already been made.
4. Permission of stock exchange to list the shares has been obtained.

#### **2.5 Memorandum of Association**

It is a fundamental document of the company which is also known as charter of the company. It lays down the scope & object of activities & limitations on the power of a company. It contains all the fundamental conditions upon which a company is allowed to be incorporated.

It is signed by subscribers who on registration are called the first members of the company. It is necessary for every company to prepare it. On registration, it becomes a public document. It serves as a basis of contract between the company & the outsiders. It contains the following clauses:

1. Name Clause
2. Registered office or Domicile Clause
3. Object Clause
3. Liability Clause
4. Capital Clause
5. Association or Subscribers Clause

#### **Name Clause**

It should contain the name of the proposed company. The word 'limited' must be there as last word in case of public limited company & 'private' limited as last word in case of private limited company.

- Name should not contain words like Government, Cooperative, Municipality etc.



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- Name should not resemble to already existing company or to the name of person of high reputation.
- The name of the company, which is in process of liquidation, cannot be taken unless its consent is obtained.
- Name should be shown on sign boards outside of every place where business of company is carried.
- Name should not be prohibited.
- Name should not resemble that company has protection from government.

### **Registered Office Clause or Domicile Clause**

It contains the place at which registered office is situated. The full address of registered office of company must be communicated to registrar of companies.

- Registered office provides official place to which all communications & notices may be lawfully addressed.
- It decides jurisdiction of registrar, police station & the court.
- It is the official place where all statutory registers & important books of the company are required to be kept.

### **Object Clause**

The object should be clearly & expressly defined. They should not be unlawful or opposed to public interest. They should be comprehensive & written on affirmative & negative basis. They should safeguard the interest of investors.

It is divided in 3 sub clauses:

- Main Objects: It refers to the important objectives for which the company is formulated.
- Ancillary or Incidental Objects: Objects through which main objects can be achieved.
- Other Objects: It includes the objects which are not included in main objects like to appoint officers & employees, to pay pension to employees, to purchase or take on lease property for office etc.

Any act beyond the object clause is considered as ultra vires & therefore void.

### **Liability Clause**

It states the nature & extent of liability of its members.

- In case of company limited by shares, this clause should state the liability of members is limited.
- In case company limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets of company in case of winding up.
- In case of unlimited company, this clause is not given in memorandum.

The limited liability becomes unlimited when the number of members fall below the minimum specified limit or at the time of winding up, it is proved that company carried out business for illegal purpose.



### **Capital Clause**

It states the amount of share capital with which the company is to be registered. It should also give the number & face value of shares. Companies Act has allowed only 2 classes of shares i.e. equity & preference shares. It should state the authorized capital for both equity & preference shares.

### **Association or Subscription Clause**

This is the concluding clause. In this clause, the subscribers declare that they desire to be formed into a company.

- Each subscriber should state his name, address, description & occupation.
- Each subscriber shall sign memorandum in the presence of a witness.
- Each subscriber should take at least one share.
- Each subscriber should write to his name the number of shares he takes.

## **2.6 Articles of Association**

The Articles of Association is the document of the company which contains the rules & regulations related to business activities to achieve the objectives of the company as defined in memorandum of association.

### **Features**

- It is subsidiary to the memorandum.
- It regulates the management of internal affairs of a company.
- It defines the powers & duties of the directors.
- It is a public document.
- It is alterable by following the procedure given in the law.
- It is not compulsory for a public company to have its own articles. If it does not register its articles, the table A of schedule I of the act applies to it.

### **Contents**

The articles of association includes the rules and regulations related to the following issues:

- A statement whether table 'A' has fully or partly been adopted.
- Definition of important words & phrase used.
- Adoption of preliminary contracts.
- Rules regarding allotment of shares.
- Rules regarding issue of share certificates, forfeiture of shares etc.
- Payment of underwriting commission.
- Rules regarding calls on shares.
- Rules regarding alteration of share capital.
- Borrowing powers of the company.
- Rules regarding meetings, notices, voting etc.
- Dividends & Reserves.



- Rules regarding appointment of directors, company secretary & their remuneration, conditions of services, rights, duties etc.
- Rules regarding capitalization of profits by issue of bonus shares.
- Provisions regarding payment of interest out of the capital.
- Circumstances of use of common seal.
- Winding up procedure & provisions.
- Other provisions: It includes provision for giving unlimited liability to directors, maintaining register of members abroad, and appointment of additional or alternative director.

### **Difference between Memorandum of Association & Articles of Association**

<b>Basis</b>	<b>Memorandum of Association</b>	<b>Articles of Association</b>
1.Contents	Memorandum contains the objects of a company beyond which the company cannot go.	It contains rules and regulations for management of internal affairs of the company.
2.Purpose	The purpose of memorandum is to State the objects for which the company has been established.	The purpose of articles is to provide the manner in which the company's objects are to be carried out.
3.Necessity	Every company is required to frame an original memorandum for its registration.	A company limited by shares need not frame articles for its registration. If the articles are not registered, Table A applies to it.
4.Alteration	Memorandum can be altered only under certain circumstances and sometimes with the permission of Central Government or Company Law Board.	Generally , articles can be altered by a special resolution passed in the general meeting of the company.
5.Ultra vires acts	Anything done beyond the scope of the memorandum is said to be ultra vires the company and hence absolutely void.	Anything done beyond the scope of the articles may not ultra vires the company.
6.Basis of	Memorandum generally defines the	Articles define the relationship between



relations	relations between company and the outsiders.	the company and members.
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### Doctrine of Ultra Vires

‘Ultra’ means beyond ‘Vires’ means Powers. So ultra vires means acts beyond the legal powers or objects of the company. A company is prohibited to go beyond the memorandum by doctrine of ultra vires. An ultra vires act is void. Also it cannot be ratified by written consent of all members of company. Neither the company nor the other contracting party can sue on it. Following are some of the ultra vires acts:

- Issue of unauthorized capital.
- Pay dividend out of capital.
- Pay unreasonable sums for services rendered.
- Make payments for benefit of selected shareholders.
- Subscribes to external objects of the company.
- Acts which do not fall in main, ancillary or other objects of company.

### Doctrine of Constructive Notice

It states that every person dealing with the company is deemed to have notice of the contents of memorandum & articles of the company. Also, he is assumed to have not only read these documents but have also understood their proper meaning.

Memorandum & Articles on registration become public documents. So, every person dealing with the company can easily inspect & read these documents. He can find whether or not his deal is within the powers of the company & its directors.

### Doctrine of Indoor Management

It is an exception to the ‘Doctrine of constructive notice’. Doctrine of constructive notice protects company against outsiders & doctrine of indoor management protects outsiders against company.

Outsiders are not deemed to have the constructive notice as regards the manner in which the power is exercised. They are not bound to make further enquiries. They are entitled to assume that management of internal affairs of the company has been regular & is being carried on in accordance with the memorandum & articles. This assumption is known as doctrine of indoor mgmt.

## 2.7 Prospectus

Prospectus means any document, which is described or issued as a prospectus by a company for any of the following purpose.

1. For inviting deposits from public.
2. For Inviting offers from public for purchase of its shares or debentures.

Prospectus may be any notice, circular, advertisement or other document issued for above purpose. It is a document in writing which contain the matters specified by the provisions of the Companies Act. It is signed by the directors of the company who authorized it to be issued.



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### **Shelf Prospectus**

It refers to prospectus filed by any public financial institution, public sector bank or scheduled bank whose main objective is financing. Shelf prospectus once filed with registrar is not required to be filed again at every stage of offer of securities within the period of validity.

It is compulsory to file 'Information Memorandum' containing all material facts relating to changes in financial position between first offer of securities, previous offer of securities & succeeding offer of securities. Information memorandum may be filed within the time prescribed by central government prior to making next offer of securities.

Along with shelf prospectus, information memorandum should also be issued to public with first offer of securities.

### **Red-Herring Prospectus**

It means a prospectus which does not have complete particulars on the price of the securities offered & the amount of securities offered.

### **Statement In Lieu of Prospectus**

It is not necessary for every public company to invite public if the promoters or directors are confident of obtaining required capital from their private sources. In such case, the company is not required to issue a prospectus to the public.

The promoters are only required to prepare & deliver a Statement in lieu of prospectus to the registrar at least 3 days before the date of allotment of shares.

### **Contents of Prospectus**

Section 56(I) of the Companies Act requires that every prospectus must state the following matters specified in schedule-II of the Act. Schedule-II is divided into two parts:

Part 1 and part 2.

### **I. Matters specified in Part-I of Schedule-II**

#### 1. General Information:

- a. Name of company and full address of its registered office.
- b. Approval of the Central Government to issue Industrial License.
- c. The name of Stock Exchange where the application for listing has been filed.
- d. Warning to apply for shares in fictitious names.



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- e. Date of opening the issue and last date of closure.
  - f. Name and address of auditors and under-writers.
  - g. Undertaking from the board of directors stating that:
    - i. The money to be subscribed shall be deposited in a separate bank account.
    - ii. The purpose for which the money will be spent shall be shown in a separate 'head' in the company balance sheet.
2. Capital Structure of the company:
- a. Authorized, issued, subscribed and paid up capital of the company.
  - b. Total capital of the company after the completion of the present issue.
3. Conditions attached with the issue:
- a. Conditions of payment by the allottees.
  - b. Method of filing of applications.
  - c. Special tax benefits.
4. Details regarding the issue:
- a. Purpose of the issue.
  - b. Estimated cost.
  - c. Sources of funds including promoters' contribution.
5. The company matters relating to its managerial persons:
- a. History of the company, its main objects and present business.
  - b. Name of subsidiary company.
  - c. Name, address, occupation, etc. of promoters, managing director, manager and other directors.
  - d. Details of plant and machinery, technology etc.
6. Details of other companies promoted under the same management:
- a. Name of the company promoted.
  - b. Date of closure of each issue.
  - c. Rate of dividend paid to shareholders.
7. Details about legal proceedings pending in court:
- a. Criminal matters pending against the company and its directors.
  - b. Mistakes committed towards outstanding loans, debentures and fixed deposits, outstanding dividend.

## **II. Matters specified in Part-2 of Schedule-II**

1. General Information:
  - a. Consent of directors, auditors, bankers and experts.



- b. Opinion of the expert obtained.
  - c. Details of vacation of office of directors.
  - d. The procedure of allotment and issue of share certificates.
  - e. Name and address of company secretary.
2. Financial Information:
- a. Report of the company auditors including comments on profit and loss account, assets and liabilities.
  - b. The terms and conditions of loans obtained from financial institutions.
3. Statutory and other information:
- a. Details of expenses
    - i. The fees paid to the expert, registrar to the issue.
    - ii. Under-writing commission.
  - b. Details of public issues and right issues made in the last 5 years.
  - c. Shares issued with consideration other than cash.
  - d. Name, address, and occupation of directors, and remuneration payable.
  - e. Information regarding voting rights to members and rate of dividend paid.

### **Omission & Mis-Statement in Prospectus**

It should not omit any relevant facts which influence the mind of the prospective investor. A prospectus is treated as untrue in the following situations:

1. If the statement is misleading in the form and context in which it is included; and
2. Where the omission is to mislead.

The aggrieved shareholder has the right to claim damages from the directors but shall not have the right of rescission of the contract.

### **Deemed Prospectus or Prospectus by Implication**

Companies by allotting the whole of the capital of a company to an intermediary known as an Issuing House. The Issuing House then offers the shares to the public by means of an advertisement known as 'Offer for Sale' and is 'deemed prospectus' issued by the company.

The responsibility of the company, and its directors, and promoters is, the same as in the case issue of prospectus directly by the company. Companies Act names a deemed prospectus as 'Prospectus by Implication'.

## **2.8 Directors**

Director is a person or one of the persons through whom the company acts. He directs the policy and manages, controls or superintends the affairs of the company.

Minimum No. of Directors as per Section 149(1)(a):

- Three in case of Public Company.

- Two in case of Private Company.
- One in case of One Person Company.

As per Companies Act, Board of Directors of a company must have at least one resident director i.e. a person which has lived at least 182 days in India in the previous calendar year.



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### **Methods of Appointment of Directors**

1. Appointment of first directors.
2. Appointment by the shareholders.
3. Appointment by Board of directors.
4. Appointment by third parties.
5. Appointment by Proportional representation.
6. Appointment by the central government.

### **Appointment of first director**

The person so listed in the articles shall be first directors. In the absence of any such provision subscribers to the memorandum shall be deemed to be the director of the company. Such director shall act as directors till the directors are duly appointed at the first general meeting after incorporation of the company.

### **Appointment by shareholders**

The shareholders can appoint the directors by passing a resolution in the general meeting.

### **Appointment by Board of Directors**

The Board of Directors can appoint the following directors:

1. Additional Directors:
  - a. Board may appoint additional directors if so authorized by the company's articles.
  - b. The proposed person should not have failed to get appointed as a Director in a General Meeting.
2. Directors for filling Casual vacancies: In the absence of any provision in the articles, such a vacancy may be filled by the board of directors.
3. Alternate Director
  - a. May appoint an alternate director if the board is so authorized by its articles.
  - b. He shall vacate office if and when the original director returns.

### **Appointment by Third Parties**

The articles may provide a right to the debenture-holders, financial institutions, foreign collaborators, bankers, etc. of the company to nominate directors on the board of the company.

### **Appointment by Proportional Representation**

The articles of a company may provide for the appointment of directors according to the principle of proportional representation. The appointments shall be made once in every three years. Proportional representation may be decided by any of the following systems:



1. Single transferable vote system; and
2. Cumulative transferable vote system.

1. Under the Single transferable vote system, each voter is required to give his preference to the candidates subject to the maximum number of directors to be elected. After voting, a quota of vote is calculated and fixed for getting elected.

$$\text{Quota} = \frac{\text{Total number of votes cast}}{\text{Number of directors to be elected} + 1} + 1$$

2. Under Cumulative transferable vote system, a member is entitled to one vote for every share held by him for every director to be elected. If a member has 100 shares and number of directors to be elected is 5, he is entitled to 500 votes.

### **Appointment by Central Government**

The Central Government may appoint directors on an order by Company Law Board. The Central Government may appoint the directors for such period as it may think fit, but exceeding three years on any one occasion. But such directors may be removed at any time and any other person may be appointed by the central government.

No qualification shares are required to be held. The central government may require such directors to report to it from time to time with regards to the affairs of the company.

### **Removal of Directors**

1. By Shareholders
2. By Central Government
3. By Company Law Board

### **Removal by Shareholders**

By passing an ordinary resolution at their general meeting, remove a director. But the shareholders cannot exercise this power if director is appointed by the Central Government. A copy of special notice is sent to the director. He shall be entitled to be heard on the resolution at the meeting.

### **Removal by Central Government**

The Central Government is empowered to remove a director on the recommendation of the Company Law Board. The Central Government shall make a reference to CLB by stating a case against the person with a request that the CLB may inquire into the case and record its decision whether he is fit or proper person to hold office of a director or other managerial office.

The person so removed shall not be entitled to any compensation for loss or termination of office.

### **Removal by Company Law Board**

Any member of a company can make an application to the CLB for prevention of oppression and mismanagement in the company. Director removed in such a manner shall not be entitled to claim damages for loss of office.

## Duties of Directors



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### A. Statutory Duties

1. To see that amount received for shares from applicants of shares are deposited in a scheduled bank.
2. To repay the application money to the applicants of shares if the company fails to obtain the certificate to commence business.
3. To place before the members at general meeting the profit & loss account and balance sheet of the company.
4. To check the accuracy of the prospectus before its issue to public.
5. To call the annual general meeting in time.
6. Declaration of dividends and payment of dividends.
7. To file copies of final accounts with the registrar within 30 days after an annual general meeting.
8. To disclose before the company about the shareholding by each director, in other companies.
9. To disclose their interests in any of the contracts entered into by the company.

### B. General Duties of Directors

1. Duty of good faith: To act with honesty in the discharge of their duties.
2. In discharging duties a director must exercise some degree of skill and diligence.
3. Duty to attend board meetings unless physically impossible.
4. Not to delegate powers: Directors are bound to perform personally.
5. Control on the use of funds.
6. Protect the interest of shareholders: The directors are expected to protect the interests of the shareholders, by investing money on beneficial schemes/projects.
7. Timely payment of call money against the shares held by them whenever the company makes such calls on shares.
8. Work as agent and trustee of the company.

## 2.9 Company Secretary

A company secretary means a person who is a member of the Institute of Company Secretaries of India. A person who possesses the requisite qualifications and appointed to perform the duties as prescribed under the Act, including ministerial and administrative duties is known as company secretary.

### Provisions as to appointment of company secretary

1. Only an individual is eligible to be appointed as a company secretary and not any firm, association or a body corporate.
2. In case a company fails to appoint a company secretary the person responsible for such default shall be punished. However exemption from fine can be granted on the grounds that (i) efforts have been made for the appointment, but no suitable person was available, and (ii) the company is not in a position to bear the financial burden of a company secretary.
3. The person to be appointed as company secretary shall possess the requisite qualifications prescribed by the Central Government.

4. A person may be appointed as a part time secretary in more than one company provided none of them have paid up share capital (as prescribed by the central government).

### Methods of Appointment of company secretary

1. **Appointment by promoters:** The promoters of a company usually appoint the first company secretary when company has not yet been registered. He is often referred as the pro-tem secretary. The individual acting as the pro-tem secretary may or may not be appointed as regular secretary. In case the person who has been acting as pro-tem secretary during the promotion stage of the company is considered for regular appointment, his appointment shall be got confirmed at the first meeting of the board, held immediately after the registration of the company.
2. **Appointment by provision in articles:** Sometimes the Articles of the company may name a person to be appointed as secretary. But such a person has no legal right to sue the company if he is not appointed by the company. This is because that the articles do not create any contractual relationship with third parties.
3. **Appointment by the directors of a company:** By means of a resolution passed at the board meeting on such terms and conditions with regard to remuneration, removal, etc.

### Importance of company secretary

‘The position of company secretary is like that of a hub in bicycle wheel.’ The entire business cycle of the company moves around the company secretary as almost all the important functions of the company are carried on through the secretary. The following points will illustrate the importance of company secretary:

1. **‘While directors are brains of the company, Secretary is their ears, eyes and hands.’** The duties of the secretary and directors are complementary to each other; the company needs the assistance of both.
  - a. **Directors, the brains of the company:** A company being an artificial person with no physical existence and of brain, it acts through the brains of directors. The board of directors formulates plans and policies, forecast the possible profits and losses. They enter into contracts with third parties, from time to time, keeping in view of the interest of the company. The ways in which the brain is sensitive to each activity of the human body, in like manner the brains of directors are sensitive to each activity of the company.
  - b. **Secretary, the ears of the company:** Secretary is the person who establishes direct contracts with the shareholders, employees, labour unions, government, etc. and transmits their ideas, suggestions, problems, complaints, etc. to the board of directors. Here, he acts as the ears of the company.
  - c. **Secretary, the eyes of the company:** The information he heard through ears is reviewed and analyzed to find out the truth by seeing through his eyes. This way he finds the reality of the





suggestions, complaints, etc., heard through his ears before transmitting them to the brains of directors.

- d. Secretary, the hands of the company: The Secretary is the person who takes effective steps in implementing the policies, programmes, and plans formulated and approved by the directors.

2. **‘Secretary, servant as well as guide to the directors’**: He acts under the direct control of the board and acts as the Chief Executive officer of the company. All the powers are transmitted to him from the board. Company secretary has no fundamental rights with regard to the internal management of the company, because he is an employee appointed by the board. Secretary is not only a servant but also a guide to the directors. This is because that he keeps important internal and external information about the company. While taking policy decisions, the assistance of the company secretary is sought by the board. He gives significant legal and statutory guidance to the board in routine matters, namely, the allotment of shares, calls on shares.
3. **Secretary, the mouth-piece of Directors**: He is the person who expresses, writes and speaks to others on behalf of the board of directors, the purpose for which he is authorized. He expresses the wishes of directors before the others.

### **Statutory duties of Company Secretary**

1. Maintaining of the statutory books and registers of the company and their safe custody.
2. Attending the various meetings of the company and recording their proceedings.
3. Assisting directors in the matters relating to the issue allotment, transfer, transmission, etc. of shares and debentures.
4. Keeping the common seal, title deeds, etc. in safe custody.
5. To register charges with the registrar.
6. To maintain register of members with requisite particulars.
7. To maintain register of debentures holders.
8. To file a certified copy of the statutory report with the registrar.
9. To maintain register of directors, and make arrangement for its inspection.

He has to ensure that the documents which were issued from his office, namely letters of allotment, share certificates, etc. are affixed with stamp of requisite amounts. Under Income Tax Act, he is bound to deduct income tax from the salaries of employees, officers and from dividend payable to shareholders and deposit the same with the government in time.

### **Rights and powers of company secretary**

1. Right to sign on documents.
2. Right to accept or write bills of exchange.
3. Right to receive notice of dismissal in case of premature termination of service.
4. Right to claim damages.



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## 2.10 Let's Sum-up

The Companies Act focuses on framing guidelines regarding working and management of the companies. The promoters of the company work to fulfil all the legal formalities to bring the company into existence. They prepare various documents necessary for the incorporation of the company. The significant documents include prospectus, memorandum of association and articles of association. The company is run by the directors and other managerial personnel including company secretary.

## 2.11 Key Terms

**Company:** Company is an artificial person having separate entity from its members, with perpetual succession & a common seal.

**Promoter:** Promoter is a person or a group of persons who originates the idea of formation of a company & takes necessary steps for its incorporation, raising of capital & making it a going concern.

**Memorandum of Association:** It is a fundamental document of the company which is also known as charter of the company. It lays down the scope & object of activities & limitations on the power of a company.

**Articles of Association:** The Articles of Association is the document of the company which contains the rules & regulations related to business activities to achieve the objectives of the company as defined in memorandum of association.

**Prospectus:** Prospectus may be any notice, circular, advertisement or other document issued for inviting deposits or inviting offers for the purchase of shares and debentures from the public.

## 2.12 Self-Assessment Questions

1. 'A promoter is not a trustee or agent of the company but he stands in a fiduciary position towards it.' Discuss.
2. The certificate of incorporation is the conclusive evidence of registration of company. Explain.

## 2.13 Further Readings

- The Institute of Company Secretaries of India, A Comparative Study of Companies Act 2013 and Companies Act 1956, Taxmann Publications.
- Kapoor G.K., *Corporate Laws*, Taxmann Publications.
- S.S. Gulshan & G.K.Kapoor, *Business Law Including Company Law*, New Age International, New Delhi, 16<sup>th</sup> Edition.

- Dhamija Sanjay & Dr. Kapoor G.K., *Company Law & Practice*, Taxmann Publications Pvt. Ltd., 19<sup>th</sup> Edition, New Delhi.



## 2.14 Model Questions

1. Briefly discuss the clauses of Memorandum of Association.
2. Differentiate between Articles of Association and Memorandum of Association.
3. Explain the various methods of appointment of directors in a company.
4. What is the procedure of registration of a company?
5. Enlist the documents required to be prepared for the incorporation of the company.

## Answers to Self-Assessment Questions

1. The role of a promoter is expressed as follows:
  - a) Not an agent – Promoter cannot be an agent of the company which he promotes because his Principal (company) does not exist at the time when he acts on its behalf.
  - b) Not a trustee – A promoter is not a trustee of the company which he intends to promote because there cannot be any trust before company comes into existence.
  - c) Fiduciary relation to the company – “The promoters stand in fiduciary relation to the company they promote and to those persons, whom they induce to become shareholders.”

Fiduciary relation means a relation of trust, confidence and good faith. Everything done by the promoter must, therefore, be open, fair and in good faith.

Thus, a promoter is neither an agent, nor a trustee but he is in a fiduciary relationship to the company just as the relationship of the principal and agent or the trustee and a beneficiary under the trust exists.

2. Certificate is a Conclusive Evidence of Incorporation: A certificate of incorporation in respect of any association is a conclusive evidence of the following matters:
  - (i) All requirements of the act have been complied with in respect of registration and matters precedent and incidental thereto.
  - (ii) The association is a company authorized to be registered and duly registered under the Act.
  - (iii) The company has come into existence from the earliest moment of the day of incorporation stated therein.

### Benefits of Incorporation:

1. Emergence of corporate personality.
2. Definite name.
3. Capacity to exercise all functions.
4. Perpetual succession.
5. Common seal.
6. Limited Liability.
7. Can sue and be sued.
8. Separate property.
9. Binding contract between company and members.
10. Validity of incorporation cannot be questioned.
11. Certificate of incorporation cannot be cancelled.



### **Legal Aspects of Business: Company Law**

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## Unit – 3

### Legal Aspects of Business: Consumer Protection Act

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#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and objectives of Consumer Protection Act.
- Describe the important terms under the Consumer Protection Act.
- Know about the consumer protection councils at district, state and central level.
- Understand the various dispute redressal agencies available to resolve the consumer disputes.

#### Structure

- 3.1 Introduction
- 3.2 Objectives of Consumer Protection Act
- 3.3 Definitions of Important Terms under the Act
- 3.4 Consumer Protection Councils
- 3.5 Dispute Redressal Agencies
- 3.6 Let's Sum-up
- 3.7 Key Terms
- 3.8 Self-Assessment Questions
- 3.9 Further Readings
- 3.10 Model Questions



#### Legal Aspects of Business: Consumer Protection Act



### 3.1 Introduction

The Consumer Protection Act was passed on 5<sup>th</sup> December, 1986. It received assent of the president on 24<sup>th</sup> December, 1986. This act was amended in the year 1991, 1993 and 2002. The act extends to the whole of India except the state of Jammu and Kashmir. The protection of the rights of the consumers in India is the essence of this act. There should be appropriate redressal machinery available in the country to resolve the consumer complaints promptly.

### 3.2 Objectives of Consumer Protection Act

Consumer Protection Act is formulated to achieve the following objectives:

1. To provide for better protection of the interests of the consumers.
2. To promote and protect the rights of consumers.
3. To make provision for the establishment of consumer councils and other authorities for the settlement of consumer disputes.
4. To setup quasi-judicial machinery at district, state and central level for speedy and simple redressal of consumer disputes.

### 3.3 Definitions of Important Terms under the Act

There are several terms which are used in the Consumer Protection Act which need to be clarified. The definitions of the important terms are stated below:

**1. Appropriate Laboratory:** Appropriate Laboratory means a laboratory or organization:

- (i) Recognized by the Central Government,
- (ii) Recognized by a State Government, subject to such guidelines as may be prescribed by the Central Government in his behalf; or
- (iii) Any such laboratory or organization established by or under any law for the time being in force, which is maintained, financed or aided by the Central Government or a State Government for carrying out analysis or test of any goods with a view to determining whether such goods suffer from any defect.

**2. Complainant:** A complainant means:

- (i) a consumer; or
- (ii) any voluntary consumer association (registered under the Companies Act or under any other law for the time being in force); or
- (iii) the Central Government or any State Government; or
- (iv) one or more consumers, where there are numerous consumers having the same interest; who or which make a complaint;
- (v) in case of death of a customer, his legal heir or representative.



## Legal Aspects of Business: Consumer Protection Act

**3. Complaint:** Complaint means any allegation in writing made by a complainant that:

- (i) an unfair trade practice or a restricted trade practice has been adopted by any trader or service provider;
- (ii) the goods bought by him or agreed to be bought by him suffer from one or more defects;
- (iii) the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;
- (iv) a trader or the service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price:
  - (a) Fixed by or under any law for the time being in force;
  - (b) Displayed on the goods or any package containing such goods;
  - (c) Displayed on the price list exhibited by him by or under any law for the time being in force;
  - (d) Agreed between the parties;
- (v) Goods which will be hazardous to life and safety when used, are being offered for sale to the public:
  - (a) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force;
  - (b) if the trader could have known with due diligence that the goods so offered are unsafe to the public;
- (vi) Services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety.

**4. Consumer:** Act defines two types of consumers: (a) consumer of goods, and (b) Consumer of services.

- (a) **Consumer of Goods:** A consumer of goods means any person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment. The term consumer also includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised or under any system of deferred payment when such use is made with the approval of such person. But it does not include a person who obtains such goods for resale or for any commercial purpose.
- (b) **Consumer of Services:** A consumer for services means a person who hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised or under any system of deferred payment. The term also includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised or partly paid and partly promised or under any system of deferred payment when such services are availed of with the approval of the first mentioned person. But it does not include a person who avails of such services for any commercial purpose.



**5. Consumer Dispute:** Consumer dispute means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint. [Sec. 2 (1) (e)]

**6. Defect:** Defect means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied or as is claimed by the trader in any manner whatsoever in relation to any goods. [Sec. (2) (1) (f)]

**7. Deficiency:** Deficiency means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being enforce or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service. [Sec. 2 (1) (g)]

**8. Goods:** Goods means goods as defined in the Sale of Goods Act, 1930. [Sec. 2 (1) (i)]

According to the sale of goods act, goods mean every kind of movable property other than actionable claims and money, i.e. legal tender. It includes shares, patent rights, copy rights, trademarks, growing crops, grass, fruits, minerals, water, electricity etc.

**9. Manufacturer:** Manufacturer means a person who –

- (i) makes or manufactures any goods or parts thereof; or
- (ii) does not make or manufacture any goods but assembles parts thereof made or manufactured by others; or
- (iii) puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer. [Sec. 2 (1) (j)]

**10. Person:** Person includes-

- (i) a firm whether registered or not;
- (ii) a Hindu Undivided Family;
- (iii) a cooperative society;
- (iv) every other association of person whether registered under the Societies Registration Act, 1860 or not. [Sec. 2 (m)]

**11. Service:** Service means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, board or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but



does not include the rendering of any service free of charge or under a contract of personal service. [Sec. 2 (o)]

Thus, this definition excludes two specific types of services from its scope:

- (i) the services rendered free of charge, and
- (ii) the services rendered under the contract of personal service.

**12. Restrictive Trade Practice:** Restrictive trade practice means a trade practice which tends to bring about manipulation of price or its condition of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include the following:

- (i) Delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price.
- (ii) Any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent to buying, hiring or availing of other goods or services.

**13. Spurious goods and services:** Spurious goods and services means such goods and services which are claimed to be genuine but they are actually not so.

**14. Trader:** Trader in relation to any goods means a person who sells or distributes any goods for sale and includes the manufacturer thereof, and where such goods are sold or distributed in package form, includes the packer thereof. [Sec. 2 (q)]

**15. Unfair Trade Practice:** Unfair trade practice means a trade practice which for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices:

- (1) Misleading or false representations
- (2) Advertisement of bargain or bait
- (3) Offering gifts or prizes with intention of not providing them
- (4) Conducting promotional contests
- (5) Withholding information about final results of the scheme
- (6) Noncompliance of product safety standards
- (7) Hoarding or destruction of goods

## Rights of Consumers

The consumers possess the following rights:

- 1. Right to be protected or right to safety
- 2. Right to be informed



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3. Right to choose
4. Right to be heard
5. Right to be redressed
6. Right to consumer education
7. Right to value
8. Right to healthy environment or quality of life

### 3.4 Consumer Protection Councils

The Act provides for establishment of Consumer Protection councils at three levels:

- (i) At the Central Level, the Central Consumer protection council.
- (ii) At the State Level, the State Consumer Protection Council.
- (iii) At the District Level, the District Consumer Protection Council.

#### The Central Consumer Protection Council

The main provisions as to establishment of the Central Consumer Protection Council are as under:

**Establishing by Notification:** The Central Government shall by notification, establish with effect from such date as it may specify in such notification, a council to be known as the Central Consumer Protection Council. [Sec. 4 (1)]

**Constitution:** The Central Council shall consist of the following members, namely:

- (a) The minister in-charge of the consumer affairs in the Central Government, who shall be its Chairman, and
- (b) Such number of other official or non-official members representing such interests as may be prescribed.

**Term of Office:** The term of the council shall be three years. [Rule 3 (2)]

**Filling the Vacancies:** Any member may, by writing under his hand to the chairman of the Central Council, resign from the council. The vacancies, so caused or otherwise, shall be filled from the same category by the Central Government and such person shall hold office so long as the member whose place he fills would have been entitled to hold office, if the vacancy had not occurred. [Rule 3 (3)]

**Procedure for Meetings:** The Central Council shall meet as and when necessary, but at least one meeting of the council shall be held every year. [Sec 5 (1)]

**Objects of the Central Council:** The objects of the Central Council shall be to promote and protect the rights of the consumers such as:



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- (i) The right to be protected against the marketing of goods and services which are hazardous to life and property.
- (ii) The right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices.
- (iii) The right to be assured, wherever possible, access to a variety of goods and services at competitive prices.
- (iv) The right to be heard and to be assured that consumer's interests will receive due consideration at appropriate forums.
- (v) The right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers; and
- (vi) The right to consumer education. [Sec. 6]

### **The State Consumer Protection Council**

The Act contains following provisions regarding the State Consumer Protection Council, hereinafter referred as the State Council:

**Establishing the Council:** The State Government shall by notification, establish with effect from such date as it may specify in such notification, a council to be known as the State Consumer Protection Council. [Sec. 7 (1)]

**Constitution:** The State Council shall consist of the following members, namely:

- (a) The minister in-charge of the consumer affairs in the State Government, who shall be its Chairman, and
- (b) Such number of other official or non-official members representing such interests as may be prescribed by the State Government;
- (c) Such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government. [Sec.7 (2) amended in 2002]

**Meetings:** The State Council shall meet as and when necessary but not less than two meetings shall be held every year. [Sec. 7 (3)]

**Time and Place of meeting:** The State Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government. [Sec. 7 (4)]

**Objects:** The objects of every State Council shall be to promote and protect within the state the rights of the consumers laid down in sec. 6. It means that it has the similar objectives to that of the Central Council as stated earlier. [Sec. 8]

### **The District Consumer Protection Council**

The amendment made in the year, 2002 provides for establishment of a District Consumer Protection Council. The provisions are as follows:



**Establishment:** The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification. [Sec. 8 A (1)]

**Constitution:** The District Consumer Protection Council shall consist of the following members, namely:

- (a) The collector of the District, who shall be its Chairman; and
- (b) Such number of other official or non-official members representing such interests as may be prescribed by the State Government. [Sec.8 A (2)]

**Meetings:** The District Council shall meet as and when necessary but not less than two meetings shall be held every year. [Sec. 8A (3)]

**Time and Place of meeting:** The District Council shall meet at such time and place within the district as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government. [Sec. 8A (4)]

**Objects:** The objects of every District Council shall be to promote and protect within the district the rights of the consumers laid down in sec. 6. [Sec. 8B]

### **3.5 Dispute Redressal Agencies**

To provide speedy and simple redressal of consumer disputes, a three-tier quasi-judicial machinery has been set-up. This machinery includes the following bodies:

- I. The District Forum
- II. The State Commission
- III. The Central Commission

These quasi-judicial bodies observe the principles of natural justice, i.e. justice, equity and good conscience.

#### **The District Forum**

The important provisions regarding the district forum are as under:

**Establishment:** There shall be established a consumer disputes redressal forum to be known as the district forum by the State Government in each district of the state by notification. The state government may, if deems fit; establish more than one District Forum in a district. [Sec. 9 (a)]

**Composition:** Each district forum shall consist of the following:

- (i) A person shall be its President;

- (ii) Two other members, one of whom shall be a woman. [Sec. 10 (1)]

**Qualifications:** The qualifications of the president and the members of a district forum are as follows:

- (iii) The President shall be person who is or has been or is qualified to be a District Judge.
- (iv) The other members shall have the following qualifications:
- (a) They shall be not less than thirty-five years of age;
  - (b) They shall possess a bachelor's degree from a recognized university;
  - (c) They shall be person of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration. [Sec. 10 (1)]

**Disqualifications:** A person shall be disqualified for appointment as member in any of the following cases:

- (v) If he has been convicted and sentenced to imprisonment for an offence which, in the opinion of the State Government, involves moral turpitude.
- (vi) If he is an undischarged insolvent.
- (vii) If he is of unsound mind and stand so declared by a competent court.
- (viii) If he has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government.
- (ix) If he has, in the opinion of the State Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member.
- (x) If he has such other disqualifications as may be prescribed by the State Government.

**Appointment:** Every appointment of the President and members shall be made by the State Government on the recommendation of a selection committee consisting of the following:

- (i) The President of the State Commission - Chairman.
- (ii) Secretary, Law Department of the State - Member.
- (iii) Secretary, in charge of the department, dealing with consumer affairs in the State. [Sec. 10 (1A)] - Member.

**Tenure of Office:** Every member of the District Forum shall hold office for a term of five years or up to the age of 65 years, whichever is earlier. [Sec. 10(2)]



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**Reappointment:** A member shall be eligible for reappointment for another term of five years or up to the age of sixty-five years, whichever is earlier. Re-appointment shall be subject to the condition that he fulfills the qualifications and other conditions for appointment. Such re-appointment should also be made on the basis of the recommendation of the Selection Committee.

**Resignation and Filling the Vacancy:** Any member may resign his office in writing under his hand addressed to the State Government. When such resignation is accepted, his office shall become vacant. The vacancy may be filled by the appointment of a person possessing any of the qualifications mentioned above in relation to the category of the member who has resigned.

**Salary and Terms and Conditions of service:** The salary or honorarium and other allowance payable to, and the other terms and conditions of service of the members of the District Forum shall be such as may be prescribed by the State Government. [Sec. 10 (3)]

**Jurisdiction of District Forum:** Jurisdiction of the district forum may be discussed under two heads:

- A. Monetary Jurisdiction, and
- B. Geographical or territorial jurisdiction.

**A. Monetary Jurisdiction:** The district forum enjoys the jurisdiction to entertain complaints where the value of goods or services and the compensation, if any, claimed does not exceed Rs. 20 Lakh. [Sec. 11 (1)]

**B. Geographical or territorial jurisdiction:** The Geographical Jurisdiction of the district forum for the purpose of complaints shall be any of the following places:

- (i) In case of all the opposite parties are at one place: Complaint may be filed at the place where the opposite party or each of the opposite parties actually and voluntarily resides or carries on business or personally works for gain.
- (ii) In case one of the parties is at one place: In case any of the opposite parties resides or carries on business or works for gain at a particular place, then the complaint may be filed at that place either with the permission of the district forum or with the acquiescence of the other opposite parties.
- (iii) Where cause of action arises: Complaint may be filed at the place where the cause of action, wholly or in part, arises. [Sec. 11]

### **Procedure of Filing Complaint**

The manner in which a complaint may be filed with a District Forum is as follows:



1. **Person Entitled to File Complaint:** A complaint in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided may be filed with a district forum by any of the following:
  - (i) By the customer, to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.
  - (ii) By any recognized consumer association. It is immaterial whether the consumer to whom the good sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided is a member of such association or not.
  - (iii) By one or more consumers – Where there are numerous consumers having the same interest, with the permission of the district forum, on behalf of, or for the benefit of, all consumers so interested anyone or more of such consumers can file a complaint.
  - (iv) By the Central Government.
  - (v) By the State Government.
  
2. **Written Complaint:** Every complaint made by a complainant must be in writing. [Sec. 2 (c)]
  
3. **Fee:** Every complaint filed shall be accompanied with the amount of fee. The amount of fee and the manner of payment shall be prescribed by the State Government.
  
4. **Contents of Complaint:** A complaint addressed to the District Forum must include the following facts:
  - (i) The name, description and the address of the complaint.
  - (ii) The name, description and the address of the opposite party or parties, as the case may be, so far as they can be ascertained.
  - (iii) The facts relating to the complaint and when and where it arose.
  - (iv) Documents in support of the allegations contained in the complaint.
  - (v) The relief which the complaint claims.
  
5. **Delivery of Complaint:** A complaint may be delivered personally by hand or by post.
  
6. **Admission or Rejection:** The District Forum may allow the complaint to be admitted or rejected. The admissibility of the complaint shall ordinarily be decided within twenty-one days from the date on which the complaint was received. But a complaint shall be rejected only after an opportunity of being heard has been given to the complainant.
  
7. **Proceeding with the complaint:** Where a complaint is allowed to be proceeded with the district forum may proceed with the complaint in the manner provided under this Act.



- 8. Transfer of Complaint:** Where a complaint has been admitted by the district forum, it shall not be transferred to any other court or tribunal or any authority setup by or under any other law for the time being in force. [Sec. 12(4)]

### **Complaint Redressal Procedure**

Section 13 lays down the procedure for redressal of complaints received by the district forum. The procedure may be discussed under two major heads:

- I. Procedure for complaints relating to goods
- II. Procedure for complaints relating to services

- I. Procedure for Complaints Relating to Goods:** The district forum takes following steps for redressing the complaints relating to goods:

- (i) **Reference of complaint to opposite party:** The district forum shall, on admission of a complaint refer a copy of the complaint within 21 days from the date of its admission to the opposite party. The district forum will direct him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by the district forum.
- (ii) **Settlement of dispute in case the opposite party denies or fails to represent his case:** Where the opposite party on receipt of a complaint referred to him denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the district forum, the district forum shall proceed to settle the consumer dispute in the prescribed manner. [Sec. 13 (1) (b)]
- (iii) **Obtaining sample of goods:** Where the complaint alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, the district forum shall obtain a sample of the goods from the complainant. It will seal it and authenticate it in the manner prescribed. [Sec. 13 (1) (c)]
- (iv) **Referring sample to laboratory:** The sample so sealed then be referred to the appropriate laboratory along with the following directions:
  - (a) For making an analysis or testing, whichever may be necessary, with a view of finding out whether such goods suffer from any defect alleged in the complaint or from any other defect.





- (b) For reporting its findings thereof to the district forum within a period of forty-five days of the receipt of the reference or within such extended period as may be granted by the district forum. [Sec. 13 (1) (c)]
- (v) **Deposit of fee:** Before any sample of the goods is referred to any appropriate laboratory, the district forum may require the complainant to deposit to the credit of the forum such fees as may be specified, for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question. [Sec. 13 (1) (d)]
- (vi) **Remitting the fee to the laboratory:** The district forum shall remit the amount deposited to its credit to the appropriate laboratory to enable it to carry out the analysis or test. [Sec. 13 (1) (e)]
- (vii) **Forwarding report to the opposite party:** On receipt of the report from the appropriate laboratory, the district forum shall forward a copy of the report along with such remarks as the district forum may feel appropriate to the opposite party. [Sec. 13 (1) (e)]
- (viii) **Requiring submission of objections:** If any of the parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the methods of analysis or test adopted by the appropriate laboratory, the district forum shall require the opposite party or the complainant to submit in writing his objections in regard to the report made by the appropriate laboratory. [Sec. 13 (1) (f)]
- (ix) **Hearing opportunity:** The district forum shall thereafter give a reasonable opportunity to the complainant as well as the opposite party of being heard as to the correctness or otherwise of the report made by the appropriate laboratory and also as to the objection made in relation thereto. [Sec. 13 (1) (g)]
- (x) **Issue of order:** The district forum, after giving a reasonable opportunity of being heard to all the parties, shall issue an appropriate order. The order will be in accordance with the provisions of section 14. [Sec. 13 (1) (g)]

**II. Procedure for Complaints Relating to Services:** In case the complaint received relates to any service, the district forum shall adopt the following procedure:



- (i) **Reference of complaint to opposite party:** The district forum on admission of a complaint, shall refer a copy of such complaint to the opposite party directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by the district forum. [Sec. 13 (2) (a)]
- (ii) **Procedure in case the opposite party denies allegations or fails to represent the case:** Where the opposite party, on receipt of a copy of the complaint, referred to him denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the district forum, the district forum shall proceed to settle the consumer dispute. [Sec. 13 (2) (b)]
- (iii) **Settlement of dispute by the forum:** If the opposite party denies allegations or fails to represent his case, the district forum shall proceed to settle the case in the following manner:
- (a) On the basis of evidence brought to its notice by the complainant and the opposite party, where the opposite party denies or dispute the allegations contained in the complaint, or
- (b) Ex parte on the basis of evidence brought to its notice by the complainant where the opposite party omits or fails to take any action to represent his case within the time given by the forum. [Sec. 13 (2) (b)]
- (iv) **Where complainant fails to appear:** Where the complainant fails to appear on the date of hearing before the district forum, the district forum may either dismiss the complaint for default or decide it on merits. [Sec. 13 (2) (c) inserted in 2002]

### **Other Provisions**

- 1. No Question on the ground of natural justice:** No proceedings complying with the procedure laid down in this section shall be called in question in any court on the ground that the principles of natural justice have not been complied with. [Sec. 13(3)]
- 2. Hearing and Decision:** Every complaint shall be heard as expeditiously as possible. Efforts shall be made to decide the complaint within a period of three months from the date of receipt of notice by opposite party where the complaint does not require analysis or testing of commodities. Where it requires analysis of testing of commodities efforts shall be made to decide within five months from the said date.
- 3. Adjournment:** No adjournment shall be ordinarily granted by the district forum unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by the forum.



4. **Orders as to costs:** The district forum shall make such orders as to the costs occasioned by the adjournment as may be provided in the regulations made under this act.
5. **Delayed disposal of complaint:** In the event of a complaint being disposed of after the period so specified, the district forum shall record in writing, the reasons for the same at the time of disposing of the said complaint.
6. **Interim Order:** Where it appears to the forum necessary, it may pass such interim order as is just and proper in the facts and circumstances of the case.

### **Order of the District Forum**

After the proceeding conducted under section 13, if the district forum is satisfied it shall issue an order to the opposite party directing him to do one or more of the following things:

1. Remove the defect
2. Replace the goods
3. Return to the complainant the price
4. Compensation to the consumer
5. Pay punitive damages
6. Remove the defects or deficiencies
7. Discontinue the unfair trade practice
8. Not to offer the hazardous goods
9. Withdraw the hazardous
10. Cease manufacture of hazardous goods
11. Pay such sum as may be determined a large number of consumers
12. Issue corrective advertisement to neutralize the effect
13. Provide for adequate costs

### **Appeal against the order**

1. **Within thirty days:** Any person aggrieved by an order made by the district forum may prefer an appeal against such order to the State Commission within a period of thirty days from the date of the order, in such form and manner as may be prescribed.
2. **Extension:** The State Commission may, however, entertain an appeal after the expiry of the said period of thirty days if it is satisfied that there was sufficient cause for not finding it within that period. [Sec. 15]
3. **Deposit of amount:** No appeal by a person, who is required to pay any amount in terms of an order of the district forum, shall be entertained by the State Commission unless the appellant has deposited in the

prescribed manner 50 percent of that amount or twenty five thousand rupees, whichever is less.

### **Conduct of Proceedings**

Following are the major provisions regarding the conduct of proceedings of the district forum:

1. Every proceeding referred to above shall be conducted by the President of the district forum and at least one member thereof sitting together. [Sec. 14(2)]
2. Where the member, for any reason, is unable to conduct the proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member.
3. Every order made by the district forum shall be signed by its president and the member or members who conducted the proceeding. [Sec. 14 (2A)]
4. Where the proceeding is conducted by the president and one member and they differ on any point or points, they shall state the point or points on which they differ and refer the same to the other member for hearing on such point or points and the opinion of the majority shall be the order of the district forum.
5. Subject to the foregoing provisions, the procedure relating to the conduct of the meeting of the district forum, its sitting and other matters shall be such as may be prescribed by the State Government. [Sec. 14 (3)]

### **Powers of the District Forum**

For the purpose of setting the disputes, the district forum shall have the same powers as are vested in a Civil Court under Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:

- (i) Enforcing the attendance
- (ii) Discovery production of any document
- (iii) Evidence on affidavits
- (iv) Requisitioning of the report
- (v) Examination of any witness

### **The State Commission**

The main provisions regarding the state commission are as under:

**Establishment:** There shall be established a consumer disputes redressal commission to be known as the State Commission by the State Government in the state by notification. [Sec. 9 (b)]

**Composition:** Each state commission shall consist of the following:

- (i) A person who shall be its President;



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- (ii) At least Two and not more than such number of members as may be prescribed, and one of whom shall be a woman.

**Qualifications:** The qualifications of the members of a State commission are as follows:

- (i) The President shall be person who is or has been a Judge of a high court.
- (ii) The members shall have the following qualifications:
  - (a) They shall be not less than thirty-five years of age;
  - (b) They shall possess a bachelor's degree from a recognized university; and
  - (c) They shall be person of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

**Disqualifications:** A person shall be disqualified for appointment as member in any of the following cases:

- (i) If he has been convicted and sentenced to imprisonment for an offence which (in the opinion of the State Government involves moral turpitude.
- (ii) If he is an undischarged insolvent.
- (iii) If he is of unsound mind and stand so declared by a competent court.
- (iv) If he has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government.
- (v) If he has, in the opinion of the State Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member.
- (vi) If he has such other disqualifications as may be prescribed by the State Government.

**Appointment of President:** The President of State Government shall be appointed by the State Government. However, no such appointment shall be made except after consultation with the Chief Justice of the high court. [Sec. 16 (1) (a)]

**Appointment of Members:** Every appointment shall be made by the State Government on the recommendation of a selection committee consisting of the following, namely:

- (i) The President of the State Commission -  
Chairman
- (ii) Secretary, Law Department of the State -  
Member

(iii) Secretary, in charge of the department dealing with consumer affairs in the State.

- Member

**Salary and Terms and Conditions of service:** The State and national commission other allowances payable to and the other terms and conditions of service of the members of the state commission shall be such as may be prescribed by the State Government. [Sec.16 (2)]

**Terms of Office:** Every member of the State Commission shall hold office for a term of five years or up to the age of 67 years, whichever is earlier. [Sec. 16(3)]

**Reappointment:** A member shall be eligible for reappointment for another term of five years or up to the age of sixty-seven years, whichever is earlier, subject to the condition that he fulfills the qualifications and other conditions for appointment. Such re-appointment shall be made on the basis of the recommendation of the Selection Committee.

A person appointed as a President of the State Commission shall also be eligible for re-appointment in the manner provided in this section.

**Resignation and Filling the Vacancy:** A member may resign his office in writing under his hand addressed to the State Government. On such resignation being accepted, his office shall become vacant. The vacancy may be filled by the appointment of a person possessing the qualifications in relation to the category of the member who is required to be appointed in place of the person who has resigned.

**Jurisdiction of the State Commission:** According to section 17, the Jurisdiction of the State Commission is as follows:

- A. To entertain complaints where the value of the goods or services and compensation, if any, claimed exceeds Rs. 20 lakh but does not exceed Rs. 1 crore.
- B. To entertain appeals against the order of any district forum within the State.
- C. To entertain a complaint if the opposite party or each of the opposite parties at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain within the limits of jurisdiction of the commission.
- D. To entertain a complaint if any of the opposite parties at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain within the jurisdiction of the commission.



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## Benches of the State Commission

The jurisdiction, powers and authority of the state commission may be exercised by its benches. The constitution and working procedure of a bench shall be as follows:

1. **Composition:** A bench may be constituted by the President with one or more members as the president may deem fit.
2. **Process of Decision Making:** If the members of a bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority. But if the members are equally divided, they shall state the points on which they differ and they shall make a reference to the president.
3. **Circuit Benches:** The state commission shall ordinarily function in the state capital but may perform its functions at such other place as the state government may, in consultation with the state commission, notify in the official gazette, from time to time.

## Other Provisions

1. **Transfer of cases:** On the application of the complainant or of its own motion, the state commission may, at any stage of the proceeding, transfer any complaint pending before the district forum to another district forum within the state if the interest of justice so requires.
2. **Procedure applicable to state commissions:** The provisions of sections 12, 13 and 14 and the rules made there under for the disposal of complaints by the district forum shall with such modifications as may be necessary be applicable to the disposal of disputes by the state commission. [Sec. 18]
3. **Appeals:** Any person aggrieved by an order made by the state commission in exercise of its powers conferred by sub-clause (i) of clause (a) of section 17 may prefer an appeal against such order to the national commission within a period of thirty days from the date of the order in such form and manner as may be prescribed. [Sec. 19]
4. **Hearing of Appeal:** An appeal filed before the state commission or the national commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of ninety days from the date of its admission.

## The National Commission

The main provisions regarding the National Commission are as under:



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**Establishment:** There shall be established a National Consumer Disputes Redressal Commission by the Central Government by notification. [Sec. 9 (c)]

**Composition:** The national commission shall consist of the following:

- (i) A person shall be its President;
- (ii) At least four and not more than such number of members as may be prescribed by the central government. However, one of whom shall be a woman.

**Qualifications:** The qualifications of the members of a national commission are as follows:

- (i) The President shall be person who is or has been a Judge of the Supreme Court.
- (ii) The members shall have the following qualifications:
  - (a) They shall be not less than thirty-five years of age;
  - (b) They shall possess a bachelor's degree from a recognized university; and
  - (c) They shall be person of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

**Disqualifications:** A person shall be disqualified for appointment as member in any of the following cases:

- (i) If he has been convicted and sentenced to imprisonment for an offence which involves moral turpitude.
- (ii) If he is an undischarged insolvent.
- (iii) If he is of unsound mind and stand so declared by a competent court.
- (iv) If he has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government.
- (v) If he has, in the opinion of the Central Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member.
- (vi) If he has such other disqualifications as may be prescribed by the Central Government.

**Appointment of President:** The President of shall be appointed by the Central Government. However, no such appointment shall be made except after consultation with the Chief Justice of India.

**Appointment of Members:** Every appointment under this clause shall be made by the Central Government on the recommendation of a selection committee consisting of the following, namely:

- (i) A person who is a Judge of the Supreme Court, to be nominated by the chief justice of India

- Chairman



(ii) The Secretary in the Department of legal affairs in the government of India-Member

(iii) Secretary of the Department Dealing with consumer affairs in the Government of India-Member

**Salary and Terms and Conditions of service:** The Salary or honorarium and other allowances payable to and the other terms and conditions of service of the members of the national commission shall be such as may be prescribed by the Central Government. [Sec. 20 (2)]

**Terms of Office:** Every member of the National Commission shall hold office for a term of five years or up to the age of 70 years, whichever is earlier. [Sec. 20(2)]

**Reappointment:** A member shall be eligible for reappointment for another term of five years or up to the age of seventy years, whichever is earlier. Such re-appointment shall be made on the basis of the recommendation of the Selection Committee.

A person appointed as a President of the National Commission shall also be eligible for re-appointment in the manner provided in this section.

**Resignation and Filling the Vacancy:** A member may resign his office in writing under his hand addressed to the Central Government. On such resignation being accepted, his office shall become vacant. The vacancy may be filled by the appointment of a person possessing any of the qualifications in relation to the category of the member who is required to be appointed in place of the person who has resigned.

**Jurisdiction of the National Commission:** The Jurisdiction of the National Commission is as follows:

- A. To entertain complaints where the value of the goods or services and compensation, if any, claimed exceeds Rs. 1 crore.
- B. To entertain appeals against the order of any State Commission.
- C. To call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission.

**Power and Procedure applicable to the National commission:** The provisions of sections 12, 13 and 14 and the rules made there under for the disposal of complaints by the district forum shall, with such modifications as may be considered necessary by the commission, be applicable to the disposal of disputes by the National Commission.

**Power to set aside ex party Order:** Where an order is passed by the national commission ex party against the opposite party or a complainant, as the case may be, the aggrieved party may apply to the commission to set aside the said order in the interest of justice.



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**Transfer of cases:** On the application of the complainant or of its own motion, the national commission may, at any stage of the proceeding, in the interest of justice, transfer any complaint pending before the district forum of one state to a district forum of another state or before one state commission to another state commission.

**Benches of the national commission:** The jurisdiction, powers and authority of the national commission may be exercised by its benches thereof. The constitution and procedure of a bench shall be as follows:

(a) **Constitution:** - A bench may be constituted by the President with one or more members as the president may deem fit.

(b) **Process of Decision Making:** - If the members of a bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority. But if the members are equally divided, they shall state the point or points on which they differ they shall make a reference to the president. The president shall either hear the point or points himself or refer the case for hearing on such points by one or more or the other members. Then such points shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it.

(c) **Circuit Benches:** - The National commission shall ordinarily function in the state capital but may perform its functions at such other place as the central government may, in consultation with the National Commission, notify in the official gazette, from time to time.

**Appeal:** Any person, aggrieved by an order made by the National commission in exercise of its power conferred may prefer an appeal against such order of Supreme Court within a period of thirty days from the date of the order.

**A Comparative Study of District Forum, State and National Commission**

<b>Basis of distinction</b>	<b>District Forum</b>	<b>State Commission</b>	<b>National Commission</b>
1. Establishment	A District forum is established by the State Government.	A State Commission is established by the State Government.	A National Commission is established by the Central Government.
2. Number	There can be one or more district forums in a district.	There can be only one state commission in a state.	There can be only one national commission in the country.
3. Geographical jurisdiction	Its jurisdiction extends to the district or part of the district for which it is established.	Its jurisdiction extends to the whole state which it is set up.	Its jurisdiction extends to the whole of India.

4. Monetary Jurisdiction	District forum can entertain all complaints claiming not exceeding Rs. 20 lakh.	State Commission can entertain all appeals against all District Forum of the state and the complaints claiming more than Rs. 20 lakh but not exceeding Rs. 1 crore.	National Commission can entertain all appeals made against award of all commissions. It can entertain all complaints claiming exceeding Rs. 1 crore.
5. Number of Members	It consists maximum of three members one of whom shall be a woman.	It consists at least three members one of whom shall be a woman. But members cannot exceed the number prescribed by the Government.	It consists at least five members one of whom shall be a woman. But members cannot exceed the number prescribed by the Government.
6. President	A person who is or has been or is qualified to be a District Judge, may be its president.	A person who is or has been Judge of high court, may be appointed its president.	A person who is or has been Judge of the supreme court may be its president.
7. Age limit of members	A member of district forum can hold office up to the age of 65 years.	A member of state commission can hold his office up to the age of 67 years.	A member of national commission can hold office up to the age of 70 years.
8. Salary and terms of Service	The salary and terms and conditions of service of its members are prescribed by the state government.	For its members also these are prescribed by the state government.	The salary and terms and conditions of service of its members are prescribed by the Central government.
9. Appeal	This forum entertains only complaints for claims. It cannot entertain appeals.	A state commission entertains appeals against the order made by the district forum.	National commission entertains appeals against the orders of the state commissions. Appeal against the order of the national commission can be filed in the Supreme Court of India.



10. Amount to be deposited for appeal	Appeal against the order of the district forum is entertained when appellant has deposited fifty percent of the amount specified in its order or Rs. twenty five thousand, whichever is less.	Appeal against the order of the state commission is entertained when appellant has deposited fifty percent of the amount specified in its order or Rs. thirty thousand, whichever is less.	Appeal against the order of the national commission is entertained when appellant has deposited fifty percent of the amount specified in its order or Rs. fifty thousand, whichever is less.
11. Control	The state commission has administrative control over the District forum.	The national commission has administrative control over the state commission.	The national commission is an independent institution.



### 3.6 Let's Sum-up

The Consumer Protection Act, 1986 was established to provide for better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and other authorities for the settlement of consumers' disputes and for matters connected therewith. Various consumer dispute redressal agencies has been set up at district, state and national level to resolve the consumer complaints.

### 3.7 Key Terms

**Consumer:** A consumer of goods means any person who buys any goods or services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment.

**Consumer Protection Council:** The councils established to keep a surveillance over the protection of consumer rights are called consumer protection councils.

**Dispute Redressal Agencies:** To provide speedy and simple redressal of consumer disputes, a three-tier quasi-judicial machinery has been set-up at district, state and national level. These are called consumer redressal agencies.

### 3.8 Self-Assessment Questions

1. What are the qualifications of the members of a national commission?
2. State the objectives of the Consumer Protection Act, 1986.
3. Discuss the purpose of formulating the Central Consumer Protection Council.



### 3.9 Further Readings

- Rao K. Madhusudhana, *Cases and Materials on the Consumer Protection Act, 1986*, Asia Law House.
- Singh Avatar, *Consumer Protection (Law and Practice)*, Eastern Book Company.
- Gupta S.P. Sen, *Commentaries on Consumer Protection Act*, Kamal Law House.
- Majumdar P.K., *Law of Consumer Protection in India*, Orient Publishing Company.

### 3.10 Model Questions

1. Briefly state the important provisions of Consumer Protection Act, 1986.
2. Illustrate the various consumer rights in India.
3. Explain the quasi-judicial machinery available in India, set up for the redressal of the consumer disputes.
4. Differentiate between the working and jurisdiction of State Commission and National Commission.
5. Discuss the procedure of filing a complaint with regards to defective goods.

### Answers to Self-Assessment Questions

1. The qualifications of the members of a national commission are as follows:
  - (i) The President shall be person who is or has been a Judge of the Supreme Court.
  - (ii) The members shall have the following qualifications:
    - (a) They shall be not less than thirty-five years of age;
    - (b) They shall possess a bachelor's degree from a recognized university; and
    - (c) They shall be person of ability, integrity and standing and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.
2. Consumer Protection Act is formulated to achieve the following objectives:
  - a. To provide for better protection of the interests of the consumers.
  - b. To promote and protect the rights of consumers.

- c. To make provision for the establishment of consumer councils and other authorities for the settlement of consumer disputes.
  - d. To setup quasi-judicial machinery at district, state and central level for speedy and simple redressal of consumer disputes.
3. The purpose of formulating the Central Consumer Protection Council is to promote and protect the rights of the consumers such as:
- (i) The right to be protected against the marketing of goods and services which are hazardous to life and property.
  - (ii) The right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices.
  - (iii) The right to be assured, wherever possible, access to a variety of goods and services at competitive prices.
  - (iv) The right to be heard and to be assured that consumer's interests will receive due consideration at appropriate forums.
  - (v) The right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers.
  - (vi) The right to consumer education.



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