COMPANY LAW

CHAPTER I

PRELIMINARY

Introduction :

The 'Company Law' in Pakistan is provided and governed by 'The Companies Act, 1913,' as amended up-to-date. Before independence, the Indian Companies Act. 1913, passed through major amendments, once in 1936 and then in 1938. Since independence changes not major in nature, have been introduced into the Act from time to time. A Company Law Commission, set up in 1961 to suggset necessary alterations and innovations in the Act, has not yet finalized its recommendations to the Government. These recommendations are likely to produce extensive changes in the Company Law structure of our country. But till that comes about, the Companies Act, 1913, as amended up-to-date, is the statute to which students of Company Law must turn for almost the whole of legal guidance on the subject.

Difinition of Company. A Company has been defined as "an artificial person created by law with a perpetual succession and a common seal." Now, in a Company as in a partnership, several persons are associated for the purpose of carrying on business for profit. But, as soon as formed, a Company becomes a separate legal entity—an artificial person in the eye of the law, separate in existence from the people who are its shareholders. A Company may, therefore, be defined as separate legal person brought into existence by registration or incorporation under the Company Act, 1913, in pursuance of an agreement made by several individuals to form themselves into a Company. A *Company is also called a Corporation.*

A legal person

Kinds of Companies : Private and Public :

The Companies Act provides for two types of Companies—**Public** and **Private.** As defined in Section 2, sub-Section 13 of the Act, a Private Company means a Company which by its Articles :—

(*a*) restricts the right to transfer the share, if any ; and,

(*b*) limits the number of its members to fifty not including persons who are in the employment of the Company ; and,

(*c*) prohibits any invitation to the public to subscribe for the shares, if any, or debentures of the Company.

A *Public Company* means a Company incorporated under the Companies Act, 1913, or under any Act, repealed thereby, **which is not a Private Company.**

Distinction between a Private and a Public Company. From an analysis of the respective definition of a Private and a Public Company as also other provisions of the Companies Act, the following points of distinction between the two may be drawn:—

(*i*) While a Public Compay can have any number of members, a Private Company cannot enrol more than fifty, excluding, of course, its employees.

(*ii*) The Articles of Association of a Private Company must contain restrictions on the right to transfer shares but the Articles of a Public Company need not have such restrictions.

(*iii*) A Public Company is entitled to invite the public to subscribe for any shares or debentures in the Company but a Private Company cannot issue any such invitation.

(*iv*) Two promoters are sufficient for the formation of a Private Company but a Public Company cannot be formed except by at least seven such promoters.

(*v*) A Public Company must issue prospectus or a statement in lieu of prospectus but a Private Company has no obligation toi ssue either of them.

(*vi*) A Public Company must hold its statutory meeting, and file its balance-sheet with and deliver the statutory report to the Registrar of Joint-Stock Companies. But a Private Company is not required to do any of these things.

(*vii*) A Private Company can commence its business as soon as it is registered or incorporated. But mere incorporation does not empower a Public Company to commence its business. Before proceeding to do so, it must obtain a certificate of commencement from the Registrar.

(*viii*) A Public Company is treated by the Courts as a Company, real and proper, but in the case of a Private Company the tendency of the Court has uniformly been to treat it more or less as a partnership concern and to apply the same principles to its winding up as would entitle a partner to have a firm dissolved (17 D.L.R., S.C., 52).

A Private Company and a firm

The Registrar will, however, grant, a certificate of commencement only when a statutory declaration has been filed with the Registrar (a) that shares amounting to the minimum subscription have been allotted and (b) that every director has paid for the shares which he or she has taken.

Company and Partnership :

Partnerships and Companies both are kinds of business organizations formeb yd the association of several persons for the purpose of carrying on business for profit. But, in spite of this apparent similarity, there are certain important distinctions between the two, such as the following :—

(*i*) A partnership, also called a firm, has no separate legal existence apart from the partners who constitute it. Partners can, therefore, contract only between themselves and cannot contract with the firm as such. For illustration, X, Y, and Z are partners of the firm, Green & Co. Green & Co. is not a distinct person in the eye of law. Subject to the Partnership Act, X, Y, and Z can make contract and make any arrangement as between themselves. But law does not allow any contract to be made between X or Y or Z on the one hand and the firm, Green & Co., on the other, as Green & Co is not a separate person in the eye of the law.

A firm is not a legai person

But a Company is a separate legal entity with an independent existence apart from the shareholders who compose it. Consequently, any shareholder can execute a contract between himself on the one hand and the Company on the other. This is allowed by law because once a Company is formed, it attains the status of an independent person and its personality is quite

distinct from the personality of any or all of its members. "Once a Company is incorporated, it must be treated like any other independent person, and the motives of those who promoted it are irrelevant' (*Topham : Company Law*).

(*ii*) The share of a partner cannot be transferred without the consent of his co-partners. But the transference of shares of a Company is not handicapped by any such restriction.

(*iii*) In the contemplation of law, every partner is the general and accredited agent of the partnership and may, consequently, bind all the other partners by his acts in all matters which are within the scope and objects of the partnership. But a shareholder of a Company is not an agent of the Company. A Company acts through its directors or managing agents or both.

(*iv*) The liability of each partner for the debts of the firm is unlimited. Under this rule, a creditor of the firm can sue any partner or all the partners jointly for the realization of his claim. But the liability of the shareholders in a Company is generally limited to the extent of their respective shares unless the shareholders choose to form an unlimited liability Company.

(*v*) Partners are entitled to make any agreement between themselves regarding the constitution of the partnership or the conduct and management of its business. But the Companies Act disallows certain arrangements to be made between the shareholders of a Company, e. g., the Company cannot buy the shares of the members.

(*vi*) In a partnership, unless there is an agreement to the contrary, every partner is entitled by right to participate in the management of the business of the firm. But in a Company, the shareholders cannot, by right, take part in the management of the Company simply because of his membership. The management of the affairs of a Company is generally carried on by the directors or managing agents or both.

(*vii*) The object of a partnership can be changed by a simple agreement between the partners. But to change the object of a Company a special procedure has to be followed and the Court's sanction has to be obtained for such change.

CHAPTER II

CONSTITUTION AND INCORPORATION

Stages in the formation of a Company :

The *first stage* in the formation of a Company is that a few people known as **promoters** get together to bring it into existence, for the purpose of carrying on a joint-stock business.

In the *second stage*, the promoters, having decided to form a Company, must fix up five things : (a) **objects or purposes** to achieve which the Company is to be formed ; (b) the **name** of the Company ; (c) The place where the business of the Company is to be carried on ; (d) how far each member undertakes to be responsible for the liabilities of the Company and (e) the amount of capital necessary for the business to be carried on successfully. The decisions of the promoters on these five points are recorded in a document called the "*Memorandum of Associations*."

Five essentials of a Company.

In the *third stage*, the promoters have to decide upon the manner of carrying on the business of the Company. This calls for the appointment of directors of the Company, the division and allotment of shares, meetings of shareholders and such other things as are necessary for the internal administration of the Company. This arrangements are expressed in a document called the "*Articles of Association.*"

In the *fourth stage*, the promoters have to submit to the Registrar of Joint-Stock Companies informations regarding the Memorandum, the Articles, the names with addresses of the directors and so on for the purpose of the Company's incorporation and thus get it registered.

In the *fifth stage*, after the Company has been incorporated by registration, it has to commence its business. A Private Company can commence business as soon as it is registered. But a Public Company has to pass through certain preliminary formalities before its business can be commenced.

Let us now discuss each of the above stage at some length.

Promoters :

A promoter has been defined as "one who undertakes to

form a Company with reference to a given object and to set it going and who furthers the necessary steps to accomplish that purpose" (*Twyeross V. Grant*, 1877, 2 C.P.D., 541). The number of promoters in the case of a Private Company is to be at least two and in the case of a Public Company, at least seven. The promoters are required by law to sign the Memorandum of Association before it is submitted to the Registrar of Joint-Stock Companies and each such subscriber has to state against his name the number of shares he agrees to subscribe to.

Memorandum of Association. This document is the constitution, the primary framework within and inside which the Company has to carry on its functions. It is the Charter of the Company, defining its objects and limiting its powers. It has been held in *Ashbury Railway Carriage Co. V. Riche* (1875) that no act which goes beyond the Memorandum can be authorized by the shareholders even if the shareholders want to do any such thing by unanimous decision.

Company limited by shares. Section 6 of the Companies Act requires that a Memorandum of Association of a Company limited by shares must contain the following particulars :—

Contents of Memorandum.

1. *The name.* The Company is at liberty to choose any name subject to the following conditions :—

(*i*) Without sanction in writing from the Central Government the name must not contain any of the following words, namely, "Crown", "Emperor", "Queen", "Quaid-e-Azam Jinnah", "Royal", "State", "Dominion" or any word which suggests or is calculated to suggest the patronage of Her Majesty or the Quaid-e-Azam or of any member of the Royal family or any connection with Her Majesty's Government or with the Government of Pakistan or any department of either Government (Section 11-3).

(*ii*) Without previous permission in writing from the Central Government, the name must not also contain the word "Municipal" or "Chartered" or any word which suggsts or is calculated to suggest connection with any Municipality or other local authority or any Society or Body incorporated by Royal Charter.

(*iii*) The name must also not contain in any form the name or any abbreviation of the name of the United Nations or of any subsidiary body set up by the United Nations or of the World Health Organization unless the Company has obtained the previous authorization in writing of the Secretary-General in the case of the United Nations and the subsidiary body as aforesaid or the Director-General of the world Health Organization in the case of that Organization.

(*iv*) The name must be legibly shown on every place of business and every document issed by the Company.

(*v*) The name must not be identical with, or too closely resemble, the name of any other Company or firm, nor may such a name be chosen as is calculated to mislead the public into confusing it with that of an existing business. In the first case, the Registrar may refuse to register the Company, and in the second, the Company so using the name may be restrained by an injunction from using such a name.

(*vi*) The word 'Limited' (abbreviated as Ltd.) must be used as the last word of the name. If any officer of the Company makes a contract on behalf of the Company without the word Limited, he will be held liable on the contract personally and the contract will not be binding on the Company.

Change of name. Any Company, already registered under a name, may change the name by passing a special resolution to that effect and by obtaining the sanction of the Central Government for the change. The Company resolving to change the name must send a copy of the special resolution to the Registrar together with the sanction of the Central Government. On receipt of these two documents "the Registrar shall enter the new name on the register in place of the former name and shall issue a certificate of incorporation altered to meet the circumstances of the case. On the issue of such a certificate the change of name shall be complete."

How the name is to be changed?

2. *Registered Office.* The Memorandum must mention the place with the name of the province in which the registered office of the Company is situated, so that all communications to the Company may be correctly addressed.

3. *Objects.* The "objects clause" contains a statements in detail of the business and acts which the Company is empowered to transact. In this clause may be included any business which is not illegal or against public policy. The consequence of enumeration of the objects is to confine the scope of the Company's activity to the objects set forth in the Memorandum so that anything done which is not covered by the "objects clause" is done without authority. As Topham puts it : "The Company cannot do anything outside the *powers* given in the Memorandum—anything so done becomes *ultra vires*, and the Memorandum cannot be changed without leave of the Court. If an act is done by the directors which is *ultra vires*, it is void. The Company cannot make it valid even if every member assents to it."

Objects clause

The "objects clause" must, therefore, be drafted with great care. Full and complete powers must be taken for all business in which the Company is likely to be engaged and such business must be clearly stated. The phrase "such other things as may be deemed incidental or conducive to the attainment of the above objects or any of them" would only cover operations of a nature similar to the subjects specially stated and will not include any entirely new business (*London Financial Association V. Kelk*, 1884, 26 Ch., 107). In *Ashbury Railway Carriage Co. V. Riche* (1875), the Memorandum of Association of the Company authorized the making and selling of Railway Carriages. The Company purchased a Railway concession for which power was not given in the Memorandum. It was held that the purchase was bad as being without authority. In course of his judgment in the case Lord Cairns observed : "If every shareholder had been in the room and if every shareholder had said 'that is a contract which we authorized the directors to make,' it would be void."

The powers given in the Memorandum are not, however, interpreted with strict rigidity, so that a Company is taken to have power to do the following acts which are not, and need not be, stated in the 'objects clause':—

Powers not covered by the objects clause

(*i*) Any act which is fairly incidental to or necessary for, carrying into effect the objects stated in the Memorandum. Thus a Railway Company can let out arches on which the Railway is

Alteration of Articles :

The Articles of Association of a Limited Company may be altered by a special resolution subject to the following conditions:—

(*i*) That the altered articles are not contrary to any statutory provision.

(*ii*) That the alteration does not seek to increase the liability of the shareholders.

(*iii*) That the alteration does not conflict with the Memorandum.

(*iv*) That the alteration is not a fraud on the minority and is made *bona fide* and in the interest of the company as a whole. Thus, where the majority of the shareholders passed a special resolution altering the articles so as to enable nine-tenths of the shareholders to buy out any other shareholder, it was held that the alteration was void as it was a fraud on the minority (*Brown* V. *British Abrasive Wheel* Co., 1919, 1 Ch. 290). In some cases, however, the articles may be altered so as to exclude the minority where this is done *bona fide* and in the interest of the company as a whole.

Registration:

For the purpose of registration of a company, the Memorandum and the Articles, if any, signed by at least seven persons in the case of a public company and two persons in the case of a private company, have to be filed with the Registrar of Joint-Stock Companies, along with the following particulars:--

(*a*) A list of persons who have agreed to act as directors

(*b*) The written consent of those whose names have been given as directors that they have agreed to act as such directors.

(*c*) A statement giving the address of the Registered office.

(*d*) Where the directors have not subscribed to the Memorandum a contract of them to take qualification shares, i. e., the minimum number of shares which, according to the articles, the directors must take

(*e*) A declaration from an Advocate, Attorney or Pleader that the provisions of the Companies Act have been complied with.

After being satisfied that all the requirements have been complied with and the prescribed fees have been paid, the Registrar enters the name of the company in the register and issues a

certificate of incorporation. The company comes into existence as a legal person from the moment the certificate of incorporation is issued.

Effect of Registration. On the registration of the company the registrar issues a certificate under his hand that the company is incorporated, and in the case of a limited company that the company is limited.

From the date of incorporation mentioned in the certificate of incorporation, the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, shall be a body corporate by the name contained in the Memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in the Companies Act.

CHAPTER III

COMMENCEMENT OF BUSINESS

Prospectus:

A prospectus has been defined by the Companies Act as "any prospectus, notice, circular, advertisement or other invitation, offering to the public for subscription or purchase any shares or debentures of a company, but shall not include any trade-advertisement which shows on the face of it that a formal prospectus has been prepared and filed".

As we have seen before, a private company can commence its business immediately after it is incorporated. But a public company has to issue a prospectus (or a statement in lieu of prospectus) inviting the public to subscribe to shares in order to raise the minimum subscription without which it cannot commence business.

In order to be an offer to the public, the offer contained in the prospectus must be an offer to any person who chooses to come in and take the share. A private offer to friends does not, therefore, make the document a prospectus. Generally issued immediately after the incorporation of the company, a prospectus must be dated and signed by all persons named as directors or by their authorized agents.

Filing of prospectus. A copy of the prospectus signed as above has to be filed with the Registrar of Joint-stock Companies "on or before the date of its publication and no such prospectus shall be issued until a copy thereof has been so filed for registration" (Sec.92.-II).

Requirements as to particulars of prospectus. Section 93 of the Companies Act requires that every prospectus must contain the following particulars:—

(*i*) The number of founder's shares, if any, and the natures' and extent of the interest of the holders thereof in the property and the profits of the company.

(*ii*) The number of redeemable preference shares intended to be issued together with the date and proposed method of redemption or where no date is fixed, the period of notice required for the purpose of redemption.

(*iii*) The number of shares, if any, fixed by the articles as the qualification of a director, and any provision in the articles as to the remuneration of the directors.

(*iv*) The names, description and addresses of the directors, manager, and managing agents together with their remuneration and terms of appointment.

(*v*) The minimum subscription on which the directors may proceed to allot shares and the amount payable on application and allotment of each share. In the case of a second or subsequent offer of shares the amount offered for subscription on each previous allotment made within the two preceding years, and the amount actually allotted, and the amount, if any, paid on the shares so allotted.

(*vi*) The number and amount of shares and debentures issued within the two preceding years.

(*vii*) If any part of the issue is underwritten, the names of the underwriters and the opinion of the directors that the resources of the underwriters are sufficient to discharge the underwriting obligations.

(*viii*) The names and addresses of vendors of any property purchased or acquired by the company or proposed so to be purchased or acquired.

(*ix*) If the property was purchased within two years of the issue of the prospectus the history of all previous transfers of the property, and if the property purchased is a business, the profits and the balance-sheet of the business.

(*x*) The amount or estimated amount of preliminary expenses.

(x*i*) The amount paid to any promoter within the two preceding years and the consideration for any such payment.

(x*ii*) The names and addresses of the auditors, if any, of the company.

(x*iii*) The dates of, and parties to, every material contract including contracts relating to the acquisition of property and a

reasonable time and place at which any material contract or a copy thereof may be inspected.

(*xiv*) Particulars regarding the nature and extent of the interests of the directors in the promotion of the company or in the property proposed to be acquired by the company.

(*xv*) Where the company is a company having shares of more than one class, the rights of voting at meetings of the company conferred by, and the right in respect of capital and dividends attached to, the several classes of shares respectively.

(*xvi*) If the articles impose any restrictions on the rights of members to attend, speak or vote in meetings or to transfer their shares, a statement about such restrictions.

(xvii) If the company issuing prospectus has carried on business before, a report of the auditor regarding profits and dividend for three preceding financial years, and a report if the proceeds of any part of the proceeds of the issue of the shares or debentures are or is to be applied directly or indirectly in the purchase of any business.

Misrepresentation in the Prospectus:

As stated in Section 100 of the Companies Act, the law with regard to misrepresentation in the prospectus is as followns:--

(*i*) Where a prospectus invites persons to subscribe for shares in or debentures of a company, every person who is a director of the company at the time of the issue of the prospectus, and every person who has authorized the naming of himself and is named in the prospectus as a director or any person having agreed to become a director either immediately or after an interval of time, and every promoter of the company and every person who has authorized the issue of the prospectus, shall be liable to pay compensation to all persons who subscribe for any shares for debentures on the faith of the prospectus for all loss or damage they may have sustained by reason of any misleading or untrue statement therein, or in any report or memorandum appearing on the face thereof, or by reference incorporated therein or issued therewith, *unless it is proved* :--

(*a*) with respect to every misleading or untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, that he had reasonable ground to believe and did, up to the time of the allotment of the shares or detentures as the case may be, believe that the statement fairly represented the facts or was true;

(*b*) with respect to every misleading or untrue statement purporting to be a statement by or contained in what purports to be a copy or extract from a report or valuation of an expert, that it fairly represented the statement, or was a correct and a fair copy of or extract from the report or valuation. Provided that the director, person named as director, promoter or person who authorized the issue of the prospectus shall be liable to pay compensation as aforesaid if it is proved that he had no reasonable ground to believe that the person making the statement, report or valuation was competent to make it; and,

(*c*) with respect to every misleading or untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, that it was a correct and fair representation of the statement or copy of or extract from the document:

Or unless it is proved—

(*i*) that having consented to become a director of the company he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or,

(*ii*) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent; or

(*iii*) that, after the issue of the prospectus and before allotment thereunder, he, on becoming aware of any misleading or untrue statement therein, withdrew his consent thereto, and gave reasonable public notice of the withdrawal, and of the reason therefor.

The representation must, of course, be of fact and not of law and must be a material one on which the person applying for shares relied when he made his application. If the whole pros-

pectus is of a nature, where, a number of statements taken together would create a false impression, it is held to be nonetheless false though it may not be possible to show any specific statement as untrue. The applicant must apply for his remedy within a reasonable time of his coming to know of the false statement, otherwise he would be deprived of it. The right to the recession of shares and the consequential right to compensation which such a misrepresentation gives rise to, would be lost in case the company goes into liquidation as the right of creditors would then intervene. It should also be noted that only those shareholders who relied upon the statements in the prospectus when they applied for their shares are entitled to the relief laid down and, therefore, those who bought the shares from some other shareholders cannot claim their relief as they are not party to the misrepresentation. This stands on the principle that the office of the prospectus is exhausted when the allotment has once been made (*Peek* V. *Gurney*, 1874, L. R. 6, H. L. 377-411).

Statement in lieu of prospectus.

A company may choose either to issue a prospectus or a statement in lieu of prospectus. A statement in lieu of prospectus must be signed by every person named or proposed as director or by his agent authorized in writing to sign it. It must be in a prescribed form and contain almost all the particulars as required to be set forth in a prospectus.

Underwriting.

Underwriting means a contract to take up a number of shares of the company in consideration of the payment of a certain amount of commission, in case the issue is not fully subscribed for. Those who enter into this contract are known as underwriters. As we have seen before, commission for underwriting must be allowed by the articles and the prospectus must disclose the rate of the underwriter's commission.

Allotment of shares.

Allotment means the distribution of shares among those who apply for such shares. It shows that the company has accepted the offers of the applicants. The company being the acceptor in

every case, it has also the right to refuse allotment in particular cases. Those applicants whose offers are accepted are sent letters of allotment and those whose offers are rejected receive from the company letters of regret.

Restriction as to allotment. As per provision of Section 101 of the Companies Act, no allotment of shares can be made unless the minimum subscription has been subscribed and the amount due on application, which must not be less than 5% of the nominal value of the shares, has been received by the company in cash or by cheque. (Sec. 101)

Minimum subscription. It means the minimum amount which, in the opinion of the directors, must be raised by the issue of share capital in order to provide for:—

(*a*) the purchase price of any property purchased or to be purchased which is to be defrayed in whole or in part out of the proceeds of the issue;

(*b*) preliminary expenses;

(*c*) underwriting commission;

(*d*) repayment of money borrowed for any of the above purposes;

(*e*) working capital.

Effect of irregular allotment. An allotment made by a company to an applicant in contravention of the relevant provisions of the Companies Act shall be voidable at the instance of the applicant within one month after the holding of the statutory meeting of the company. Where the company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting, the avoidance can be effected within one month after the date of the allotment and not later. An irregular allotment is so voidable notwithstanding that the company is in the course of being wound up.

If any director of a company knowingly contravenes or permits or authorizes the controvention of any of the provisions of the Companies Act relating to allotment, he shall be liable to compensate the Company and the allottee respectively for any loss, damages or costs which the Company or the allottee may have sustained or incurred thereby: Provided that proceedings to recover any such loss, damages or cost shall not be commenced

after the expiration of two years from the date of the allotment. (Sec.102).

A Certificate of Commencement :

A company cannot commence business even after the shares have been allotted. In order to be able to do so, the company must file with the Registrar a duly verified declaration of the Secretary or one of the directors in a prescribed form to the effect (a) that shares to an amount not less than the minimum subscription have been allotted, (b) that every director of the company has paid on each of the shares taken or contracted to be taken by him, and for which he is liable to pay in cash, a proportion equal to the proportion payable on application and allotment on the shares offered for public subscription or, in the case of a company which does not issue a prospectus inviting the public to subscribe for its shares, on the share payable in cash.

On receipt of the aforesaid declaration, the Registrar grants a *Certificate of Commencement* which is conclusive evidence that the company is entitled to commence business forthwith (Sec. 103).

CHAPTER IV

CAPITAL

The capital of a company means the amount of money which it is authorized by its Memorandum to raise, generally by the issue of shares. Hence a company's capital is also called 'share capital'. Sometimes the phrase "debenture capital" is used to denote the amount borrowed by the company and secured by debentures. But this designation is not correctly given, for, the capital of a company should not mean borrowed capital.

The capital of a company is used in four different senses, namely:—

(*i*) *Nominal or Authorized Capital.* This means the whole capital of the company which it is authorized by its Memorandum to raise for the purpose of investment and expenditure.

(*ii*) *Issued capital.* The whole of the authorized capital is not usually offered to the public for subscription. That portion of the authorized capital which is actually offered to the public for subscription is called *issued capital.*

(*iii*) *Subscribed Capital.* That portion of the issued capital which has actually been taken up by the public and allotted to them is called the subscribed capital.

(*iv*) *paid-up capital.* The portion of the subscribed capital which is actually paid up by those who have taken them is known as the *Paid-up Capital.* And the portion of the subscribed capital which remains unpaid is known as the *uncalled capital.* The shareholders may be called upon to pay this portion of the subscribed-capital whenever occasion arises.

Shares:

"Share" means share in the share capital of the company and includes stock except when a distinction between stock and share is expressed or implied, (Sex. 2-XVI). In *Borland's Trustee* V. *Steel Brothers & Co.* (1901), Justice Farewell defines a share thus: "A share is the interest of a shareholder in the company measured

by a sum of money for the purpose of liability in the first place and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se*. A share is not a sum of money, but is an interest measured by a sum of money, and made up of various rights contained in the contract." Now, the capital of a company is generally divided into : (*i*) Preferred shares, (*ii*) Ordinary shares and (*iii*) Deferred shares. This classification is provided either in the Memorandum or in the articles.

Let us now examine the different classes of shares:

(*i*) *Preference shares.* Preference shares are those whose holders are entitled to a fixed rate of dividend, say, five per cent, before any dividend is paid on the ordinary shares. But, unless expressly provided in the articles, the holder of a preference share cannot be paid dividend at more than the fixed percentage, however prosperous the company might become.

Preference shares might be cumulative or non-comulative. If the preferential shares are cumulative, the fixed dividend of any year, if unpaid in part or whole due to insufficient profits, the unpaid dividend can be carried forward as a charge on the profits of the succeeding years. But in the case of non-cumulative preferential shares, if dividend is not paid in any one year, the deficiency cannot be met from the profits of succeeding years.

Preferential shares are always deemed to be cumulative unless they are made non-cumulative by express provision or by any language which is sufficiently clear, e. g., if the articles provide that the dividend of preferential shares shall be paid out of the net profits of each year.

Preferential shares are also divisible into (a) shares preferential as to capital and (b) shares non-preferential as to capital. In cases in which they are made preferential as to capital, if, on the dissolution or winding up of the company, any surplus assets are left after meeting all the debts, these must be applied first in paying off the holders of these shares. But where they are non-preferential as to capital, their holders are paid off at par with the holders of ordinary shares.

Redeemable Preference Shares. It is not generally lawful for a

company to pay back the capital subscribed by shareholders without the sanction of the court. But under Section 105(B) of the Companies Act, a company limited by shares may, if so authorized by its articles, issue preference shares which are, or at the option of the company to be, liable to be redeemed provided that: (a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend to be called "the capital redemption reserve fund", or out of the proceeds of a fresh issue of shares made for the purposes of the redemption or out of the sale proceeds of any property of the company; (b) no such shares shall be redeemed unless they are fully paid.

Every balance-sheet of a company which has issued redeemable preference shares shall include a statement specifying what part of the issued capital of the company consists of such shares and the date on or before which those shares are, or are to be, liable to be redeemed or, where no definite date is fixed for redemption, the period of notice to be given for redemption.

Subject to the provisions of Sec.105 (B) of the Act, the redemption of preference shares thereunder may be effected on such terms and in such manner as may be provided by the articles of the company.

(*ii*) *Ordinary shares.* Ordinary shares are those whose holders are entitled to dividend out of the net profits of the company after the fixed dividend on preference shares has been paid up.

(*iii*) *Deferred shares or Founder's shares.* These are those whose holders are unsually entitled to dividend after the dividend on ordinary shares has exceeded a fixed amount, e. g., the Memorandum or the articles may provide that the deferred shares shall be entitled to half of the profits after a dividend of 10% has been paid on the ordinary shares.

Reserve capital. When a company by a special resolution declares that the '*uncalled capital*' of the company shall not be capable of being called up except when the company is wound up, this '*uncalled capital*' becomes the *Reserve Capital* of the company. For illustration, The Patrika Ltd. issues capital of Rs. 100,000/-. Rs. 80,000/- of it is subscribed and the allottees pay to the company Rs. 40,000/- on allotment and Rs. 20,000/- on first call. If at

that stage, the company resolves that the remaining Rs. 20,000/- which is the uncalled capital of the company is not to be called up except in the event and for the purpose of the company being wound up, this sum of Rs. 20,000/- due from the shareholders to the company becomes the 'reserve capital' of the company.

Stock :

Shares fully aid-up may be turned into stock. When the capital of a company is converted into stocks, division of the capital into equal parts or shares is no longer necessary. It may then be divided into any amounts. Thus, there may be in relation to the capital of a company stocks of Rs. 4.50, though the shares originally were of Rs. 10.00 each.

Distinction between share and stock. The chief points of distinction between stock share and may be enumerated as follows:

(*i*) Shares may not necessarily be fully paid up but are usually payable in instalments known as Application money, Allotment money, First call money and so on but stocks must always be fully paid up.

(*ii*) Shares can be issued and transferred only in terms of complete and indivisible units of the capital, e. g., a capital of Rs. 10,000/- can be divided only into 2,000 shares of Rs. 5/- each or 1,000 shares of Rs. 10/- aech and so on. Further a share cannot be bought and sold in fractions. If it is of Rs. 10/- half of it cannot be sold for Rs. 5/-. But stocks may be issued and transferred in terms of any amount.

(*iii*) Each share is known by its distinctive number but no such number is borne by stocks.

It may be noted in this connection that when a company converts any portion of its fully paid-up capital into stocks, it has to give notice of such conversion to the Registrar. The register of members would, in such a case, show the amount of stock held by each member, instead of the amount of shares, with all the particulars relating to the holders of such stock as in the case of share register.

ALTERATION OF CAPITAL

The capital of a company may be altered in the following ways:

(*i*) By increasing its share capital by the issue of new shares or such shares as it thinks expedient ;

(*i*) By consolidating all or any of its share-capital into shares of larger amount than its existing amount ;

(*iii*) By converting all or any of its paid-up shares into stock and re-converting that stock into paid-up shares of any denomination ;

(*iv*) By sub-dividing its shares or any of them, into shares of smaller amount than is fixed by the Memorandum so that in the sub-division the proportion between the amounts paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived ;

(*v*) By diminishing the amount of its share capital.

(*vi*) By reorganizing the existing classes of shares.

Let us now study some of these methods at some length

Increase of capital :

If authorized by the articles every company, subject, however, to any condition in the articles, may increase its nominal or authorized capital by a resolution of the company in a general meeting. If the articles do not authorize such an increase the company has first of all to alter its articles in the manner prescribed by law.

When the alteration is effected, the new capital may be divided into preference, ordinary or deferred shares, provided it is not contrary to the memorandum. If such division is not permitted by the memorandum, the Memorandum may be altered to that effect by sanction of the Court.

Consolidation and subdivision :

Consolidation and subdivision are antithesis of each other. By a resolution of the company in a general meeting shares of smaller value may be consolidated into shares of larger value, e. g., every ten Re. 1/- share may be consolidated into one Rs. 10/- share. Similarly, by a resolution of the company in a general meeting, every Rs. 10/- share may be subdivided into ten Re. 1/- share.

Reduction or Diminution of Capital :

Under Section 55 of the Companies Act, subject to confirmation by the court, a company may reduce is share capital by a special resolution, provided such reduction is authorized by the articles. Reduction or diminution of share-capital may be effected :—

(*i*) by extinguishing or reducing the liability on any of its shares in respect of share-capital not paid up ; or,

(*ii*) by returning paid-up capital to the shareholders on the ground that it is no longer required for the company's purposes ; or.

(*iii*) by writing down the paid-up capital on the ground that assets have been lost and that the capital is not now fully represented by the assets.

If the existing creditors of the company are not affected by the proposed reduction of capital, e. g., if it is a case (*iii*) above and not case (*i*) or (*ii*), the court will sanction the reduction and confirm the special resolution. But if the rights of the creditors are affected by the diminution, e. g., where the case is as in (*i*) or (*ii*), creditors settled by the court would be entitled to object to the reduction and must, therefore, be notified of such proposed reduction or diminution. On being satisfied that every one of such creditors has either consented to the reduction or his claim or debt has been discharged, determined or secured, the court will sanction the reduction and confirm the special resolution.

Reorganisation of share-capital :

Reorganisation of capital means altering the rights of the holders of different classes of shares. Reorganization may be effected in the following ways :—

(*i*) Ordinarily, the rights of the different classes of shareholders are contained in the articles. Where such is the case and the Memorandum is not involved in the act, reorganization can be effected by changing the articles by a special resolution.

(*ii*) Where the Memorandum is involved, i. e., where the rights of the different classes of shareholders are set out in the Memorandum, the reorganization can be effected only by altering the memorandum which, as we have seen above, requires the sanction of the court.

CHAPTER V

MEMBERS AND SHAREHOLDERS

Definition of 'Member':

In so far as a company limited by share is concerned, a member is identical with a shareholder, for, in such a company the members who collectively constitute the company are none but the shareholders. But there may be an unlimited company or a company limited by guarantee which exists either with or without a share capital. Hence it has been laid down in the case of *South London Fish Market Co.* (1888), that a member is not necessarily a shareholder, though in relation to a company limited by share these two terms are synonymous.

Under Section 30 of the Company's Act, membership in a company is constituted in the following manner :—

(*i*) The subscribers of a memorandum of a company shall be deemed to have agreed to have become members of the company, and on its registration shall be entered as members in its register of members.

(*ii*) Every other person who agrees to become a member of a company and whose name is entered in its register of members shall be a member of the company.

The implication of clause (*ii*) is that a person can become member of a company also in three other indirect ways :

(*a*) Any person to whom a member transfers his share or shares can become a member, if the transfer is recognised by the Directors.

(*b*) The heir or legal representative of a deceased shareholder also becomes a member on his name being substituted on the register.

(*c*) In some cases, a person giving the public an impression that he was a member in some other manner, may make himself a member by estoppel in liquidation by allowing his name to remain on the register of members.

Who can be a member ?

An individual as well as a Joint-stock Company may be admitted as members. A company which is a member of another may, by a resolution of the directors, authorize any if its officers, or other persons, to act as its representative at any meeting of that other company when the person so authorized shall be entitled to exercise the same powers on behalf of the company he represents as if he were an individual shareholder of that other company (Sec. 80).

Cessation of Membership :

Membership of a company is terminated in any of the following events :—

(*i*) When the share of a member is transferred.

(*ii*) When the share or shares of a member are forfeited for non-payment of calls or otherwise.

(*iii*) When the share or shares of a member are surrendered.

(*iv*) When a member dies.

(*v*) When a member rescinds the contract on the ground of misrepresentation in the prospectus.

(*vi*) When a member's name is removed from the register upon its being rectified by the order of the Court.

Transfer of shares :

A shareholder is empowered to transfer his share under Section 28 (1) of the Companies Act which runs thus : "The shares and other interests of any member in a company shall be movable property, transferable in manner provided by Articles of the Company". Thus, a shareholder is perfectly competent to dispose of his shares subject only to restrictions imposed by the Articles of Association. The most common form of such restrictions is that a transfer must receive the prior sanction of the Board of Directors. Where the articles lay down such a restriction, the transferee's title will not be complete unless that sanction to the transfer has been accorded.

It must be noted in this connection that the mere execution of a share transfer form does not terminate the transferor's lia-

bility on the share or shares. It subsists, i.e., a transferer continues to remain liable on the share or shares until the transferee's name is substituted on the register of members.

Mode of effecting transfer :

The transfer of shares must be effected by means of executing an instrument of transfer in writing and the company must not register a transfer unless a proper instrument duly executed has been delivered to it. It is not necessary to execute a "deed of transfer" unless the articles expressly require so.

The instrument of transfer is executed by the transferer and handed over to the transferee along with the share certificate. The transferee then executes it and sends it to the company for registration. The transfer is complete only after registration is made and the transferee's name is put on the register of members.

Transmission of shares :

Transmission of shares means transfer of shares from one person to another not by voluntary action of the transferer but by the operation of law, such as by death or insolvency. When a shareholder dies his share vests in his heirs or legal representatives, with his estate remaining liable for calls. On the insolvency of a shareholder, the shares of the insolvent can be sold and transferred by the official Assignee or the Receiver.

Rights of Members :

Acting individually a member of a Public Company has the following rights:—

(*i*) He can transfer his share subject only to the restrictions imposed by the articles.

(*ii*) He has the right to inspect the register of members kept open in the registered office of the company without being required to pay any fee for that.

(*iii*) He can require a copy of the register, or of any part thereof for the list and summary required by the Companies Act or any part thereof, on payment of annas -/6/- (37 paisa) for every hundred words or fractional part thereof required to be copied.

(*iv*) At all reasonable times, he can demand inspection of the minute books of the general meetings of the company, register of directors, managers and managing agents, register of contracts in which any director or directors are directly or indirectly concerned or interested, and also copies of mortgages or charges requiring registration under Section 109 of the Companies Act.

(*v*) He is entitled to have a copy of the statutory report at least 21 days before the statutory meeting and a copy of the balance-sheet, profit and loss account, auditor's report and the director's report at least 14 days before the date of the annual general meeting and also of notice of meetings of the company at least 14 days before such meetings.

(*vi*) He is entitled to be furnished with a copy of the minutes of general meetings within 7 days after he has made a request to that effect at a charge not exceeding annas -/6/- (37 paisa) for every hundred words or part thereof.

(*vii*) He is entitled to be supplied a copy of the memorandum and articles within 14 days at his request and on payment of Re. 1/- or such less sum as the company may prescribe.

(*viii*) He can require a copy of the register of holders of debentures or any part thereof, and also copies of mortgages and charges and the company's register of mortgages on payment of annas -/6/- (37 paisa) for every hundred words required to be copied.

(*ix*) He is entitled to be furnished with copies of the balance-sheets and the profit and loss accounts or the income and expenditure accounts and the auditor's report at a charge not exceeding annas -/6/- (37 paisa) for every hundred words.

(x) He has a right to apply to the court for rectification of the share register if (a) the name of any person is fraudulently or without sufficient cause entered in or omitted from the register of members of a company, or (b) unnecessary delay takes place in entering in the register the fact of any person having ceased to be a member.

(x*i*) He is entitled to apply to the court to call or direct the the calling of a general meeting of the company if default is made in holding such a meeting in accordance with the provisions of the Companies Act.

(*xii*) He can apply to the court for compulsory winding up of the company on the ground of default in filing the statutory report.

The members of a company acting collectively can do any one of the following acts by ordinary resolution adopted by a simple majority of votes :—

(*i*) They can increase the share capital by the issue of new shares if so authorized by the articles.

(*ii*) They can consolidate and divide all or any of its share capital into shares of larger amounts or subdivide the shares into shares of smaller amounts.

(*iii*) They can convert shares into stocks and *vice versa.*

(*iv*) They can cancel the shares which have not been taken or agreed to be taken by any person.

(*v*) They can discuss and pass any resolution relating to the statutory report in the statutory meeting.

(*vi*) They can appoint the directors.

(*vii*) They can declare dividend within the bounds fixed by the recommendation of the directors.

(*viii*) They can consent to the selling or disposing of the undertaking of the company by the directors or to the remitting of any debt due by a director.

(*xi*) They can appoint auditors.

(x) When the period fixed by the articles for the duration of the company expires, the members can pass a resolution for the winding up of the company.

Acting collectively, the members or shareholders, **by** special resolution, can do the following :—

(*i*) Alter the articles.

(*ii*) Alter the memorandum subject, of course, to the sanction of the Court.

(*iii*) Reorganize the share capital by readjusting the rights attached to different classes of shares.

(*iv*) Appoint inspectors for investigating the affairs of the company.

(*v*) Wind up the company.

Acting collectively the members or shareholders, *by extraordi-*

nary resolution, can—

(*i*) Declare that the company cannot, by reason of its liabilities, continue its business and that it is advisable to wind-up.

(*ii*) Remove any director, whose period of office is liable to determination at any time by retirement of directors in rotation, before the expiration of his period of office and may appoint another person in his stead.

Liabilities of Members :

Like rights, members have also liabilities some of which are statutory as being enjoined by the Companies Act and some contractual as being imposed by the articles which every shareholder is deemed to have adopted. Some of the most important of these liabilities are as follows:—

1. *Liability in respect of reduced shares.* According to Section 63 of the Companies Act, a member of the company, past or present, shall not be liable in respect of any share to any call or contribution exceeding in amount the difference, if any between the amount paid, or (as the case may be) the reduced amount, if any, which is to be deemed to have been paid, on the share and the amount of the share as fixed by the minute.

Provided that, if any creditor, entited in respect of any debt or claim to object to the reduction of share capital, is, by reason of his ignorance of the proceedings for reduction, or if their nature and effect with respect to his claim not entered on the list of creditors, and, after the reduction, the company is unable, within the meaning of the provisions of the companies Act with respect to winding up by the court, to pay the amount of his debt or claim, then :—

(*a*) every person who was a member of the company at the date of the registration of the order for reduction and minute, shall be liable to contribute for the payment of that debt or claim an amount not exceeding the amount which he would have been liable to contribute if the company had commenced to be wound up on the day before that registration ; and,

(b) if the company is wound up, the court, on the applica-

tion of any such creditor and proof of his ignorance as aforesaid, may, if it thinks fit, settle accordingly a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list as if they were ordinary contributories in a winding up.

Nothing provided for in this section shall, however, affect the rights of the contributories among themselves.

2. *Liability to pay 'call'.* Every shareholder is under a statutory liability to pay the uncalled portion of a share when the directors make a 'call' in the manner specified in the articles. A shareholder's liability is, however, confined to the amount unpaid on his shares.

What is a 'Call' ? Shares are generally issued stipulating that payment shall be made by instalments, e. g., a share of Rs. 100/- is issued stipulating that Rs. 20/- is to be paid on application, Rs. 30/- on allotment, and the rest when called for. If the company wants the whole or part of the remaining Rs. 50/- the directors issue a demand on the shareholders specifying the amount to be paid on each share. This demand is known as 'call'.

The call must be made strictly according to the manner specified in the articles. Otherwise the call is invalid (*Re Cawby & Co.*, 1888, 42 Ch. D. 209). If the call is invalid, the shareholders need not pay. Mere trifling irregularities will not, however, vitiate a call and the articles may provide that a call will be valid in spite of all irregularities (*Dawson* V. *African Consolidated Company*, 1898, 1 ch. 6).

The power to make a call is in the nature of a trust and must be exercised only for the benefit of the company. A call not so made may be restrained by an injunction. Where the directors make a call on some shares and not on others or on all shares excepting their own, the call has been held to be inoperative (*Alexander* V. *Automatic Telephone Co.*, 1900 2 ch. 56).

3. *Liability to forfeiture.* The articles of a company usually provide that the shares of members are liable to be forfeited in case the shareholders fail to pay on call. It is, however, not

always for default to pay call that forfeiture of share can be made., If sanctioned by the articles and the power is exercised *bona fide* for the interest of the company, forfeiture for other reasons also may be valid and shall be sanctioned by the court.

The liability to forfeiture for non-payment of call is a statutory liability sanctioned by the Companies Act.

4. *Surrender.* The articles of a company generally provide that shares may be surrendered. But surrender of partly paid up shares is void because such surrender means diminution of the share capital to the extent of the unpaid amount of the shares. Surrender is valid when made of fully paid up shares and accepted by the company *bona fide* and for the interest of the company.

5. *Lien.* It is generally provided in the articles that the company shall have the first lien on the shares of the members for their debts and liabilities to the company in preference to other creditors of the shareholders. But if the shareholder mortgages his share and the mortgagee gives notice to the company and the shareholder becomes indebted to the company subsequently, the mortgagee will receive priority over the lien of the company. But if the shareholder's debt to the company is of an earlier date than the mortgage, the lien of the company will have priority over the mortgage.

6. *Liability to contribute in case of liquidation.*

(1) Under Section 156 of the Companies Act, in the event of a company being wound up every present and past member shall, subject to the provisions of this section, be liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and the costs, charges and expenses of the winding up, and for the adjustment of the rights of the contributories among themselves with, however, the following qualifications.

(i) A past member shall not be liable to contribute if he has ceased to be a member for one year or upwards before the commencement of the winding up.

(*ii*) A past member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member.

(*iii*) A past member shall not be liable to contribute unless it appears to the court that the existing members are unable to satisfy the contributions required to be made by them in pursuance of this Act.

(*iv*) In the case of a company limited by shares, no contributions shall be required from any member exceeding the amount, if any, unpaid on the shares in respect to which he is liable as a past or present member ;

(*v*) In the case of a company limited by guarantee, no contribution shall be required from any member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up.

(*vi*) Nothing in the Companies Act shall invalidate any provision contained in any policy of insurance or other contract whereby the liability of individual members on the policy or contract is restricted, or whereby the funds of the company are alone made liable in respect of the policy or contract.

(*vii*) A sum due to any member of a company in his character of a member, by way of dividends, profits or otherwise, shall not be deemed to be a debt of the company payable to that member in a case of competition between himself and any other creditor not a member of the company ; but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves.

(2) In the winding up of a company limited by guarantee which has a share capital, every member of the company shall be liable in addition to the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up, to contribute to the extent of any sums unpaid on any share held by him.

Dividends :

In *Lamplough* V. *Kent Water* the term dividend has been defined as "the sum paid and received as the quotient forming the share of the divisible sum payable to the recipient."

There is no obligation for a company to divide the whole of its profits amongst its shareholders unless clearly provided by its

memorandum or articles that it shall do so. Whether the whole profit or part thereof shall be divided and if the whole is not offered for division, then what portion shall be divided and what retained are ordinarily questions to be decided by the shareholders subject to provisions made by the memorandum or the articles and the court has no jurisdiction in that realm (*Burland* V. *Earne* 1902, S.E. 95).

The declaration of a dividend creates a debt due from the company to each shareholder and payable at the date at which the dividend is made payable. Until the declaration of dividend is made, no shareholder, not even a preference shareholder, has a right to sue for enforcing payment. If the dividend due to a shareholder is not paid by the due date, he can bring an action to enforce payment. It should be borne in mind that the dividends must be paid in or by cheque or draft but not by the issue of debentures bearing interest.

Rules regarding payment of dividend. The most important rules with regard to the payment of dividends are:—

1. The dividends shall be paid only out of the profits of the company or any other undistributed properties and cannot be paid out of the company's capital. Thus the payment of interests to the shareholders before any profits have been realized, out of capital or borrowed moneys, is *ultra vires* of the law.

If the directors wilfully pay dividends out of capital, they would have to make good the amount personally (*Oxford Benefit Building Society* 1887, 53 ch. D. 502). So would have to do the auditors of the Comapany who are parties to the payment of dividends out of capital (*Municipal Freehold Land Co. Ltd* V. *Pollington*, 1890, 63 L.T. 238). In such cases, however, the shareholders who received the dividends with the knowledge that the same was paid out of capital are bound to return the dividends received by them (*Mazham* V. *Grant*, 1900, 1 Q.B. 88 C.A.).

A difficult question that arises in this connection is : What are the divisible profits ? As a general rule the balance of the earnings of a company after deducting from them the expenses for bringing about those earnings is a measure of such profits. Of course, before arriving at the amount of profits, allowance for

the proper depreciation for wasting assets should be made. "The profits of the years, of course, mean the surplus in receipts after paying expenses and restoring the capital to the place it was on 1st January in that year" (*Dent* V. *London Tramway Co.* 1880, 16 Ch. D. 354). On this last point, that is, restoration of lost capital, there has been conflicting decisions until the House of Lords pronounced thus in *Lee* V. *Newchatel Ashlte Co.* (1899) : "A dividend may be declared out of the profits without deducting losses of fixed capital but the loss on floating capital must be deducted out of the profits before arriving at the balance of divisible profits".

This would, of course, mean that the depreciation on wasting capital assets as well as other may not be charged to profits before arriving at the figure of profits out of which dividends are to be paid as per the articles. Profits, of course, mean trading profits, but under certain circumstances dividends may also be paid out of capital profits (*Lubbock* V. *British Bank of South America*, 1892, 2 ch. 198). Such a case arises where there is a sale of some capital assets which results in a surplus in total assets in excess of the paid-up capital and the company's liability to outside creditors. In such a case, the company is allowed to treat the excess as profits and distribute the same as dividend.

Where the profits are capital profits, i. e., the increase which the capital itself has brought about, e. g., the rise in the value of fixed assets, for the payment of dividend out of such profits, it profits, it is necessary to remember that the capital as meant by Law, in case of JointStock Companies, is the actual amount subscribed pursuant to the Memorandum of Association and that which is represented by such subscription. If, therefore, there has been any accretion to that capital, such an accretion may be realised and distributed among the shareholders by way of dividend. In order to ascertain such an accretion, it is, however, necessary to get all the assets and liabilities re-valued and the balance that remains after deducting the figure of subscribed capital may be said to be the capital profits of the company.

2. The payment of dividend for any particular year is entirely at the discretion of the directors and shareholders cannot

insist on the declaration of dividends even if the profits are amply sufficient except in case of fraud. The directors have also the power to cancel the declaration of dividends which they declare as an *ad interim* dividend if they find later on that the same would have to be paid out of capital.

3. Profits paid to a reserve fund remain profits and may be paid as dividends, though there is a loss on capital.

4. The dividends must be paid in cash unless the articles otherwise provide.

5. Though dividend cannot be out of capital, Section 107 of the Companies Act provides for the payment if interest out of capital in cases in which shares are issued by a company for the purpose of raising money to defray expenses for the construction of any work or buildings or for the provision of any plant which cannot be made profitable for a lengthened period. Such interest may be paid for so much of the share-capital as is for the time being paid up for the period. This can, however, be done if authorized by the articles or by a special resolution and, that too after having obtained the previous sanction of the Central Government.

It is also provided by the same Section of the Act that:—

(a) The rate of interest shall not exceed 4% per annum or any lower sum as may be prescribed by the Central Government.

(b) The payment of interest shall be made only for such period as may be determined by the Central Government.

(c) The payment of the interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid .

(d) The provision of this section will not affect any company to which the Railway Comapnies Act, 1895, or the Tramways Act, 1902, appl.

CHAPTER VI

MANAGEMENT AND ADMINISTRATION

1. Director:

Directors are persons elected by the shareholders from among themselves for the purpose of managing the business of the company.

Section 83A of the Companies Act requires that every public company shall have at least three directors. This rule does not apply to a private company except where a private company is a subsidiary company of a public company.

2. Position of directors:

The position of the directors of a public company is that they are merely agents of the company. Though the company is a person it cannot act except through directors. As regards those directors the case is merely the ordinary case of principal and agent. Wherever, therefore, an agent is liable those directors would be liable. Where, however, the liability would attach to the principal and the principal only, it is the company which would be liable and not the directors. Thus--

(*i*) If a director duly makes a contract on behalf of the company, it is the company which is liable on it. The directors cannot be made personally liable on the contract unless they undertook personal liability, such as, by contracting in their own name or by contracting on behalf of the company without using the word 'Ltd'.

(*ii*) If the directors make a contract in their own names but really for the benefit of the company, the other party to the contract, on discovering that the real principal is the company, can sue the company on the contract.

(*iii*) Where directors enter into a contract which is within the powers of the company, i. e., allowed by the memorandum but beyond the powers of the directors, the company, like any other principal, can ratify the contract.

3. Are directors trustees ?

In its simplest sense, a trust is a relation between two persons by virtue of which one of them, called the trustee, holds property vested in him for the benefit of the other, called the *beneficiary* or *cestui que trust.* In *Re Barney* (1892), a trustee has been defined thus. "A trustee, properly so-called, must have property vested in him or a right to call for a transfer of or to possess such property and there must be a person or persons for whom he holds, or ought to hold, such property".

Considered in the light of the above definition of a trustee, the directors of a company cannot be said to be trustees, for, they are not persons in whom the property of the company may be said to be vested. The property of the company is vested in the company and in none else. Besides, the property of the company is not held or managed entirely for the benefit of another, for, the directors themselves have large stakes in the company and as such the services rendered by the directors are as much in self-interest as in the interest of others. Hence in a number of leading Indo-Pakistani cases it has been categorically stated: "Directors of companies are not trustees".

The directors are not trustees also in point of their respective duties. The primary duty of trustee is to preserve the trust property while the directors have to carry on business by investing the company's property which involves risk. Thus in the *City Equitable Case* (1925), Romer J. said: "It has sometimes been said that directors are trustees. If it means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading. I can see but little resemblance between the duties of a director and the duties of a trustee".

But, nevertheless the directors are persons selected to manage the affair of the company for the benefit of the shareholders. It is an office of trust whose duties, when undertaken, must be discharged with utmost faith and honesty. Considered in this

context, directors are trustees of the company to a limited extent of holding the company's funds and other assets in something like a trust for the shareholders with an implied pledge to deal with these with utmost faith and for the benefit of the shareholders.

4. Appointment of Directors:

The first directors of a company are generally appointed by articles. But if such appointment is not provided for by the articles, the subscribers to the memorandum shall be deemed to be the directors of the company until the first directors shall have been appointed.

Subsequent appointment of directors is made by the shareholders in general meetings. Any casual vacancy occurring among the directors either by death or retirement is filled up by the directors by means of appointment but the person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last appointed a director.

Usually the method of appointing directors is laid down in the articles to which the rules noted above are subject. Directors appointed must retire by rotation and not less than two-thirds of the whole number of directors shall be persons whose period of office is liable to determination by retirement of directors by rotation (Sec.83-B).

Restrictions on appointment. Section 84 of the Companies Act lays down that a person shall not be capable of being appointed director of a company by the articles nor shall be named as director or proposed director of a company in any prospectus issued by or on behalf of a company, or in relation to any intended company or in any statement in lieu of prospectus filed by or on behalf of a Company, unless, before the registration of the articles or the publication of the prospectus or the filing of the statement in lieu of prospectus, as the case may be, he has, by himself or by his agent authorized in writing :---

(*i*) signed and filed with the registrar a consent in writing to act as such director; and

(*ii*) except in the case of companies not having a share capital either signed the memorandum for a number of shares not less than his qualification shares or taken from the company and paid for or agreed to pay for his qualification shares or signed or filed with the registrar a contract in writing to take from the company and pay for his qualification shares or made and filed with the registrar an affidavit to the effect that a number of shares, not less than his qualification, are registered in his name.

On the application for registration of the memorandum and articles, if any of a company the applicant shall file with the registrar a list of the persons who have consented to become directors of the company and if this list contains the name of any person who has not so consented, the applicant shall be liable to a fine not exceeding five hundred rupees.

The above provisions do not, however, apply to a private company or a company which was a private company before becoming a public company nor to a prospectus issued by or on behalf of a company after the expiration of one year from the date at which the company is entitled to commence business.

Qualification shares. The articles usually fix a minimum number of shares which every director must subscribe in order to become a director. This minimum number is known as the qualification shares.

It is the duty of every director who is required by the articles to hold a specified share qualification and who has not already qualified himself accordingly, to obtain his qualification within two months after his appointment or such shorter time as may be fixed by the articles. If after the expiration of the period specified by the articles any unqualified person acts as a director of the company he shall be liable to a fine prescribed by sub Section (2) of Section 85 of the Companies Act.

Managing Director. The articles of a company may give special powers to one or more of its directors by styling him or them as 'Managing Director' or 'Managing Directors'.

5. Remuneration of Directors:

The remuneration of directors is regulated by the Articles of Association of a company. Unless provided for in the Articles or voted by the shareholders in a general meeting, the directors are not entitled to any remuneration. When so provided or voted, the remuneration of directors is a debt owing by the company and as such can be paid out of capital.

The peculiar feature of director's remuneration is that unless fixed by the Articles, the directors are not entitled to remuneration as of right. If, on the other hand, the articles are silent on this point and the remuneration of the directors is voted by the company in a general meeting, such remuneration is merely a gratuity and not one that can be enforced as a matter of right (Geo Newman & Co., 1895, 1 ch. 674).

The most popular method of paying remuneration is a fee for every meeting attended. Sometimes it takes the form of a commission paid upon the profits made by the company. In such a case, it will not include the profits made on the sale of the whole undertaking. If the fees are paid in a lump sum a year to all the directors, the director who has not served for a complete year is not entitled to be paid anything. Where, however, the remuneration is to be paid "at the rate of so much a year", the director who has served for less than a year would be entitled to claim his proportionate fee.

6. Rights and Duties of Directors:

The rights and duties of directors are generally contained in the articles and, subject to the articles, the directors have the right to do and get done all that is necessary for the proper conduct of the business of the company. Since directors are in the position of trustees as regards the exercise of their powers, they have the supreme duty to exercise their powers and discharge their functions in utmost good faith and for the interest of the company as a whole. The powers of the directors are, in general, exercisable as a body by the 'Board of Directors'. The articles may, however, provide and generally provide the vesting of special powers to one or more directors known as 'Managing Directors' or to what is called 'Managing Agent'.

7. Restriction on the powers of Directors :

Certain restrictions have been imposed by the Companies Act on the powers of directors. They may be stated as follows:--

(*i*) The directors of a public company or of a company subsidiary to a public company shall not, except with the consent of the company in general meeting (a) sell or dispose of the undertaking of the company or (b) remit any debt due by a director (Sec. 86-H).

(*ii*) The directors cannot make any loan or guarantee any loan made to a director of the company or to a firm of which such director is a partner or to a private company of which such director is a member or director (86-D).

(*iii*) No director or firm of which such director is a partner or a private company of which such director is a director shall, without the consent of the company in general meeting, hold any office of profit under the company except that of a managing director or manager or a legal or technical adviser or a banker. For the purpose of this rule, the office of 'Managing Agent' shall not be deemed to be an office of profit uner the company (86-E).

(*iv*) A director cannot enter into any contract for the sale, purchase or supply of goods and materials with the company without the consent of the other directors (Sec. 86-F).

(*v*) A director interested in a contract must give notice to other directors and when decision is taken on any such contract in any meeting of the board of directors, he cannot vote on it nor shall his presence count for the purpose of forming a quorum at the time of any such vote; and if he does so vote, his vote cannot be counted.

(vi) The directors of an insolvent company cannot exercise their powers with a view to benefiting themselves in view of the approaching winding up (Syke's case, 1872, L. R. 13. Eq.2 55).

8. Vacation of Office by Directors :

Under Sec. 86(I) of the Companies Act, a director must vacate his office if :—

(*i*) he fails to obtain the required share qualification within the specified time; or,

(*ii*) he is found by a court of competent jurisdiction to be a man of unsound mind; or,

(*iii*) he is adjudged an insolvent; or,

(*iv*) he fails to pay calls made on his shares within six months of such calls; or,

(*v*) he or any firm of which he is a partner or any private company of which he is a director, without the sanction of the company in general meeting, accepts or holds any office of profit under the company other than that of a managing director or manager or a legal or technical adviser or a banker; or,

(*vi*) he absents himself from three consecutive meetings of the directors or from all meetings of the directors for a continuous three months whichever is the longer period without leave of absence from the board of directors; or,

(*vii*) he or any firm of which he is a partner or any private company of which he is a director accepts a loan or guarantee from the company in contravention of Section. 86-D of the Companies Act; or

(*viii*) he enter into a contract with the company for the sale; supply and purchase of goods without the consent of the Board of Directors; or,

(*ix*) he is convicted of any criminal offence against the company.

9. **Liability of Directors :**

The directors of a company are liable in the following ways :

(*i*) They are liable for wrongful application of the company's money. This liability may be either in the nature of a breach of trust by which any director or more of them benefit. Acceptance of a present of qualification shares from a promoter is a breach of trust of this kind. The liability may also be due to gross negligence in dealing with the company's property in some manner not approved by the memorandum or the articles or the Companies Act, e. g., paying dividends to shareholders when no profits have been made. But in such cases, where the director or directors concerned cannot be shown to have derived any personal benefit, they are excused if they act honestly and reasonably.

(*ii*) Under Section 102 (2) of the Companies Act, if any

director of a company commits or allows the commitment of any contravention of the law relating to allotments, he shall be liable to compensate the company and the allottee respectively for any loss, damage or costs which the company or the allottee may have sustained or incurred thereby. But the director or directors are excused if they can prove that the default was due to any misconduct or negligence on their part.

(*iii*) Under Section 101 they are also liable to persons who apply for shares on the faith of misstatements in the prospectus. But a number of defences against this liability are available to the directors. These defences have been outlined before.

(*iv*) They may also become liable on the winding up of the company if it is shown that they were knowingly parties to the carrying on of the business of the company for any fraudulent purpose and, in particular, for the purpose of defrauding creditors.

Exemption from liability. Directors are exempted from liability under the following conditions :—

(*i*) in case of regligence, default, etc., exemption is available if the directors are found to have acted honestly and reasonably;

(*ii*) in cases of errors of judgment;

(*iii*) in cases of fraud committed by subordinate officer of the company if it can be shown that the directors had no knowledge of such fraud.

It should be borne in mind in this connection that no director can escape liability for his own default, neglect, breach of duty or breach of trust for which the ordinary law of the land has made him personally liable. The liability for such act or omission will attach to him irrespective of any agreement with the company or any provision in the articles exempting him from such liability.

Managing Agents :

Definition. "Managing Agent" means a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the company and under such control and direction of the directors as may be provided for in the

agreement. Thus if the agreement so provides, a managing agent may be almost free from the control and direction of the directors.

For the purposes of the Companies Act, if a person occupying the position of a managing agent calls himself a manager he shall nevertheless be regarded as managing agent and not as manager. (Sec. 2-9A).

Managing Agent and *Manager*. A managing agent and manager are similar in so far as both are entrusted with the management of the company. But a manager differs from a managing agent in two respects in the main. *First*, a manager is an individual person, whereas a managing agent may be a person, a firm, or a company and most commonly it is a firm. *Secondly*, a manager is usually a salaried official subject to the control of the directors but a managing agent is appointed under an agreement with the company which may secure a large measure of freedom of the managing agent from the control of the directors.

Appointment and *Removal* of *Managing Agent*. The appointment of managing agents is made by an agreement signed between the company and the managing agents. The company is represented in such agreement by the promoters or the directors. Every such agreement of appointment has to be approved by the company at a general meeting. No such approval is necessary to be accorded to the appointment of a company's first managing agent made prior to the issue of the prospectus or statement in lieu of prospectus where the terms of the appointment of such managing agent are set forth therein.

A company may always remove a managing agent by a resolution passed at a general meeting, notice of which has been given to the managing agent in the same manner as to members of the company, if he has been convicted of a non-bailable offence in relation to the affairs of the company. For the purpose of this rule, where the managing agent is a firm or company, an offence committed by a member of such firm or a director or an officer of such company holding a general power of attorney shall be deemed to be an offence committed by such firm or company. It has, however, been provided by the Companies Act that a managing agent shall not be liable to be removed as above if the

offending member, director or officer as aforesaid is expelled or dismissed by the managing agent within thirty days from the date of his conviction or if his conviction is set aside on appeal (Sec. 87 B).

The managing agent will also have to vacate his office if he is adjudged an insolvent (Sec. 87B-b).

Duration of appointment. Before the Companies (Amendment) Act, 1936, was passed, the terms including the duration of appointment of managing agents were left entirely to be settled by the agreement made between the company and the managing agent, leading to the result that the promoters could appoint such agents to hold office for any length of time. The Companies (Amendment) Act, 1936 has fixed the maximum period for which a managing agent can be appointed to hold office and this is twenty years. After the lapse of the first tenure the same agent can be reappointed for a second term of twenty years. In any case, however, a managing agent can continue to function even after twenty years until all claims payable to the managing agent have been paid.

As regards a managing agent appointed before the commencement of the amending Act of 1936, he can continue in office until twenty years have elapsed from the commencement of the Act, notwithstanding anything to the contrary contained in the articles of a company or in any agreement with the company and after the lapse of that period he can continue to act as such only if he is reappointed. In such a case also, a managing agent can continue in office after the lapse of his tenure until "all moneys payable to the managing agent for loans made to or remuneration due up to the date of such termination from the company are paid up". (Sec. 87-A).

Remuneration. Where a company appoints a managing agent after the commencement of the Companies (Amendment) Act, 1936, the remuneration of the managing agent shall consist of a sum based on a fixed percentage of the net annual profits of the company. Provision may, however, be made in the agreement stipulating that a minimum amount shall be paid in case of absence or inadequacy of profit and also providing for the payment of an office allowance to be defined in the agreement of management.

Any stipulation for remuneration additional to or in any other form than the remuneration specified above shall not be binding on the company unless sanctioned by a special resolution of the company (Sec. 87-C).

Restrictions on the powers of Managing Agents. The powers belonging to the managing agents are subject to certain restrictions which may be enumerated as follows:--

(*a*) No company can make to a managing agent of the company or to any partner of the firm, if the managing agent is a firm, or to any member or director of the private company if the managing agent is a private company, any loan out of the moneys of the company or guarantee any loan made to a managing agent. This restriction does not apply to a private company except one which is the subsidiary company of a public company.

(*b*) Except with the consent of the three-fourths of the directors present and entited to vote on the resolution, a managing agent of the company, or the firm of which he is a partner, or any partner of such firm, or, if the managing agent is a private company, a member or director thereof, shall not enter into any contract for the sale, purchase or supply of goods and materials with the company, provided that nothing herein contained shall affect any such contract for such sale, purchase or supply entered into before the commencement of the Companies (Amendment) (Act, 1936—87D-5).

(*c*) A managing agent cannot exercise the power to issue debentures in respect of the company or cannot invest funds of the company except with the authority of the directors and within the limits fixed by them (87-G).

(*d*) A managing agent cannot on his own account engage in any business which is of the same nature as, and directly competes with, the business carried on by the company under his management or by a subsidiary company of such company (87-H).

(*e*) Notwithstanding anything contained in the articles of a company other than a private company, if the articles provide for the appointment of a certain number of directors by the managing agent the number to be so appointed by the managing agent must not exceed one-third of the whole number of directors (87-1).

CHAPTER VII

BOOKS, ACCOUNTS AND AUDITORS

Statutory Books :

The Companies Act requires every Company to keep the following dooks :

1. *A register of members* in one or more books entering therein the following particulars:

(*a*) the names and addresses, and occupations, if any, of the members, and, in the case of a company having a share capital, a statement of the shares held by each member, distinguishing each share by its number, and of the amount paid or agreed to be considered as paid on the shares of each member;

(*b*) the date on which each person was entered in the register as member;

(*c*) the date at which any person ceased to be a member (Sec.31).

2. *A register of directors, managers and managing agents* containing with respect to each of them the following particulars:—

(*a*) in the case of an individual, his present name in full, any former name or surname in full, his usual residential address, his nationality and, if that nationality is not the nationality of origin, than his nationality of origin and his business occupation, if any and, if he holds any other directorship or directorships the particulars of such directorship or directorships.

(*b*) in the case of a corporation, its corporate name and registered or principal office; and the full name, address and nationality of each of its directors ; and

(*c*) in the case of a firm , the full name, address and nationality of each partner, and the date on which each became a partner, (Sec 87).

3. Every company shall keep **a register of mortgages** and enter therein all mortgages and charges specifically affecting property of the company and all floating charges on the undertaking or on any property of the company, giving in each case, a short

description of the property mortgaged or charged and except in the case of securities to bearer the names of the mortgages or persons entitled thereto, (Sec. 123).

4. Every company having a share capital shall within eighteen months from its incorporation and thereafter once at least in every year make a list of all persons who, on the day of the first or only ordinary general meeting in the year, are members of the company, and of all persons who have ceased to be members since the date of the last return or, in the case of the first return or since the date of the incorporation of the company.

The annual summary shall state the names, addresses and occupations of all the past and present members mentioned therein together with particulars of the number of shares held by each of the existing members at the date of the summary, specifying shares transferred since the date of the last return or since the date of incorporation as the case may be (Sec. 32).

5. *The Minute book.* Section 83 of the Companies Act lays down that every company shall cause minutes of all proceedings of general meetings and of directors to be entered in the books kept for that purpose, and that such minutes ought to be signed by the chairman of the meeting at which the proceedings were held or by the chairman of the next succeeding meeting and that they shall be evidence of the proceedings. These minutes should not be altered subsequently by additions or subtractions because such alterations are held as irregular.

Accounts:

Section 130 of the Companies Act requires that every company must maintain proper books of account with respect to:--

(*a*) all sums of money received and spent by the company and the matters in respect of which the receipt and expenditure takes place;

(*b*) all sales and purchases of goods by the company;

(*c*) the assets and liabilities of the company.

The books of account shall be kept at the registered office of the company or at such other place as the directors think fit and shall be open to inspection by the directors during business hours.

Annual Balance-sheet and Profit and Loss Account:

Under Section 131 of the Companies Act the directors of every company must at some date not later than 18 months after the incorporation of the company and subsequently once at least in every calendar year lay before the company in general meeting a balance-sheet and profit and loss account or in the case of a company not trading for profit an income and expenditure account for the period, in the case of the first account since the incorporation of the company and in any other case since the preceding account, made upto a date not earlier than the date of the meeting by more than 9 months or in the case of a company carrying on business or having interest outside Pakistan by more than 12 months. Provided that the Registrar may for any special reason extend the period for submission of such balance-sheet and profit and loss account by a period not exceeding 3 months.

The balance-sheet and the profit and loss account or income and expenditure account shall be audited by the auditor of the company and the auditor's report shall be attached thereto, or there shall be inserted at the foot thereof a reference to the report, and the report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

Every company other than a private company shall send a copy of such balance-sheet and profit and loss account or income and expenditure account so audited together with a copy of the auditor's report to the registered address of every member of the company at least fourteen days before the meeting at which it is to be laid before the members of the company, and shall deposit a copy at the registered office of the company for the inspection of the members of the company during a period of at least fourteen days before that meeting.

Director's report: Section 131 A of the Companies Act requires that the directors shall make out and attach to every balance-sheet a report with respect to the state of the company's affairs, the amount, if any, which they recommend for payment by way of dividend and the amount, if any, which they propose to carry

to the Reserve Fund. If authorized in that behalf by the directors, the report referred to above may be signed by the chairman of the Board of Directors.

Contents of balance-sheet. Under Section 132 of the Act, the balance-sheet must contain a summary of :—

(*i*) the authorized capital,

(*ii*) the issued capital,

(*iii*) the liabilities,

(*iv*) the assets with the particulars showing the nature and liabilities of the assets and also showing how the fixed assets have been arrived at.

The balance-sheet must also show separately :—

(*i*) the preliminary expenses,

(*ii*) the expenses of any issue of shares or debentures,

(*iii*) the amount of the goodwill, patent and trade marks,

(*iv*) all the debts of the company which, if ascertainable, are secured on any of its assets must be stated to be secured,

(*v*) commissions and discounts on shares and debentures of shares,

(*vi*) loans for the purchase of shares by the employees,

(*vii*) the number and amount of any redeemable debentures,

(*viii*) particulars as to debentures which have been redeemed but are available for re-issue,

(*ix*) shares in and loans to subsidiary companies,

(*x*) the amounts and loans as directors and officers,

(*xi*) the total amount paid to the directors for remuneration.

(*xii*) Under Section 132A, if the company is what is called a **"holding company"**, holding shares, either directly or through a nominee in a subsidiary company or in two or more subsidiary companies, there shall be annexed to its balance-sheet the last audited balance-sheet, profit and loss account and auditors' report of the subsidiary company or companies, and a statement signed by the persons by whom, in pursuance of Section 133, the balance-sheet of the holding company is to be signed, stating how the profits and losses of the subsidiary company, or, where there are two or more subsidiary companies, the aggregate profits and losses of these companies, have been dealt with in or

for the purposes of the accounts of the holding company and in particular how and to what extent :—

(a) provision has been made for the losses of a subsidiray company either in the accounts of that company or of the holding company or of both ; and,

(b) losses of a subsidiary company have been taken into account by the directors of the holding company in arriving at the profits and losses of the company as disclosed in its accounts.

Contents of profit and loss account. The profit and loss account must include particulars showing the total of the amount paid whether as fees, percentages or otherwise to the managing agent, if any, and the directors respectively as remuneration for their services, and, where a special resolution passed by the members of the company so requires, to the manager, and the total of the amount written off for depriciation. If any director of the company is by virtue of the nomination, whether direct or indirect, of the company, a director of any other company, any remuneration or other emoluments received by him for his own use, whether as a director of, or otherwise in connection with the management of that other company, shall be shown in a note at the foot of the account or in a statement attached thereto.

Authentication. The balance-sheet and profit and loss account or income and expenditure account shall be authenticated :—

(*i*) in the case of a banking company, by the manager or managing agent, if any, and, where there are more than three directors of the company, by at least three of those directors and, and, where there are not more than three directors, by all the directors ;

(*ii*) in the case of any other company, by two directors or when there are less than two directors, by the sole director and by the manager or managing agent, if any, of the company.

Filing of copies. A copy of the balance-sheet and profit and loss account or an income and expenditure account together with a copy of the auditor's report must be sent to the registrar and every member of a company at least fourteen days before the

meeting at which the same is to be laid before the members of the company.

After the balance-sheet and profit and loss account or the income and expenditure account, as the case may be, have been laid before the company at the general meeting three copies thereof signed by the manager or secretary of the company shall be filed with the registrar at the same time as the copy of the annual list of members and summary prepared in accordance with the requirements of Section 32.

If the general meeting before which a balance-sheet is laid does not adopt the balance-sheet, a statement of that fact and of the reasons therefor shall be annexed to the balance-sheet and to the copies thereof required to be filed with the registrar.

These rules do not apply to a private company.

If in any return, report, balance-sheet or certificate, any statement is made which, for any reason, is not true with regard to any material particular, and if the falsehood is committed wilfully knowing it to be false, a person responsible for the falsehood is punishable with imprisonment and fine.

Investigation by the Registrar :

Section 137 lays down that where the registrar, on perusal of any document which a company is required to submit to him under the provisions of this Act, is of opinion that any information or explanation is necessary in order that such documents may afford full particulars of the matter to which it purports to relate, he may, by a written order, call on the company submitting the document to furnish in writing such information or explanation within such time as he may specify in his order. On the receipt of such an order, it shall be the duty of all persons who are or have been officers of the company to furnish such information or explanation to the best of their power.

AUDITORS

Appointment of auditors :

We have noticed above that the annual balance-sheet and the profit and loss account of every company must be audited once a year by an auditor. The articles of a company usually provide for the appointment of an auditor in the following manner :

The first auditors may be appointed by the directors before the statutory meeting and, after being so appointed, they hold office until the first annual general meeting, unless removed earlier by a resolution of the members of the company in general meeting. When the auditors are so removed, the members at that very meeting may make fresh appointment of auditors.

Subsequent appointment of auditors must be made at each annual general meeting. Such auditor or auditors are to hold office until the next annual general meeting. If it is proposed to appoint a person other than the retiring auditor, notice of intention to nominate that person to the office of auditors must be given by a member of the company to the company not less than fourteen days before the annual general meeting whereupon the company must send a copy of such notice to the retiring auditor and give notice thereof to its members either by advertisement or in any other manner allowed by the articles not less than seven days before the annual general meeting.

Qualification of auditors. No person can be appointed to act as an auditor of any company unless he holds a certificate from the Central Government entitling to act as an auditor of comnanies. This rule does not apply to a private company. A firm whereof all the partners practising in Pakistan hold such certificates may be appointed by its firm-name to be auditor of a company and may act in its firm-name.

If an appointment of an auditor is not made at an annual general meeting, the Central Government may, on the application of any member of the company, appoint an auditor of the company for the current year and fix the remuneration to be paid to him by the company for his services.

Restriction on the appointment of auditors :

The following persons cannot be appointed auditors :—

(*a*) A director or officer of the company.

(*b*) A partner of such director or officer except in case of a private company.

(*c*) Any person indebted to the company. If any person, after being appointed auditor, becomes indebted to the company his appointment shall thereupon be determined.

Powers and Duties of Auditors :

Powers. Under Section 145 (i), every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explantion as may be necessary for the performance of the duties of the auditors.

The auditors are entitled to receive notice of and attend any general meeting of the company at which any accounts which have been examined or reported on by them are to be laid before the company and may make any statement or explanation they desire with regard to the said accounts.

Duties. The most important duty of the auditors is to make a report to the members of the company on the account examined by them and on every balance-sheet and profit and loss account laid before the company in general meeting during their tenure of office. The report must, *inter alia*, state :—

(*a*) whether or not they have obtained all the informations and explanations they have required ;

(*b*) whether or not in their opinion the balance-sheet and the profit and loss account referred to in the report are drawn up in conformity with the law ; and,

(*c*) whether or not such balance-sheet exhibits a true and correct view of the state of the company's affairs according to the best of their informations and the explanations given to them and as shown by the books of the company ; and,

(*d*) whether in their opinion books of account have been kept by the company as required by Section 130 of the Companies Act.

It is also the duty of the auditors to make themselves acquainted with their duties under the articles of the company and under the Companies Act. They must be honest and must discharge their duties with reasonable care ; otherwise they would be liable for damages.

It is not the duty of the auditors to give advice. It is not for them to bother about the way in which the business is carried on. They are not concerned with whether the business of the company is being carried on prudently or imprudently, profitably or unprofitably. Their duty is to ascertain, with reasonable accuracy, the true financial position of the company at the time of the audit and state in their report the result of such ascertainment. And in ascertaining the same, they are not to work as detectives, for, "they are watchdogs and not bloodhounds" (In *Re London & General Bank*, 1895, 2 ch. 673).

If the auditors fail in their duty to state the correct financial position of the company and it suffers loss in consequence, the auditors are liable for such damage as prescribed by law.

CHAPTER VIII

MEETINGS AND PROCEEDINGS

Though the general management of the company is carried on by the 'directors' or the 'managing agents' for which purpose they meet from time to time, the shareholders of the company also are summoned to meet according as the Companies Act or the Articles of Association lays down, in order that they may obtain a broad idea of how the affairs of the company are going on and also that they may exercise their ultimate supervisory control on the management of the company's business. The meetings of shareholders generally held are the : (i) statutory meeting, (ii) Annual General Meeting and (iii) Extraordinary General Meeting. Besides, as noted above, the directors meet now and then to perform the responsibilities vested in the 'Board of Directors.'

Statutory Meeting :

Section 77 of the Companies Act required that every company limited by shares and every company limited by guarantee and having a share capital must, within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which is called the "statutory meeting". At least twenty-one days before the day on which the meeting is held, the directors must forward to every member of the company a report called the "statutory report".

The *statutory report* must be certified by at least two directors of the Company or by the Chairman of the Board of Directors if authorized in this behalf and shall contain the following particulars :—

(*a*) the total number of shares allotted.

(*b*) the total amount of cash received by the company in respect of all the shares allotted,

(*c*) an abstract of the receipts of the company and of the

payments made thereout upto a date within seven days of the date of report ,

(*d*) the names, addresses and descriptions of the directors, auditors, managing agents and managers, if any, and secretary of the company and the changes, if any, which have occurred since the date of the incorporation.

(*e*) the particulars of any contract, the modification of which is to be submitted to the meeting for its approval, together with the particulars of the modification or proposed modification ,

(*f*) the extent to which underwriting contracts, if any, have been carried out.

(*g*) the arrears, if any, due on calls from directors, managing agents and managers ; and,

(*h*) the particulars of any commission or brokerage paid or to be paid in connection with the issue or sale of shares or any director, managing agent or manager or a partner of the managing agent if the managing agent is a firm or a director of the managing agent if the managing agent is a private company.

So far as it relates to the shares allotted by the company, to the cash received in respect of such shares and to the receipts and payments of the company, the statutory report shall be certified as correct by the auditors of the company.

The directors shall cause a copy of the statutory report certified as above to be delivered to the registrar for registration forthwith after the same has been sent to the members of the company.

The directors shall cause a list showing the names, descriptions and addresses of the members of the company, and the number of shares held by them respectively, to be produced at the commencement of the meeting, and to remain open and accessible to any member of the company during the continuance of the meeting.

The members of the company present at the meeting shall be at liberty to discuss any matter relating to the formation of the company or arising out of the statutory report, whether previous notice has been given or not. No resolution of which notice has not been given in accordance with the articles may be passed.

The meeting may adjourn from time to time, and at any ad-

journed meeting any resolution of which notice has been given in accordance with the articles, either before or after the former meeting, may be passed and an adjourned meeting shall have the same powers as an original meeting.

If default is made in filing the statutory report or in holding the statutory report a shareholder, a creditor or the registrar may apply to the court for the winding up of the company and upon the petition being presented, the court may, instead of directing that the company be wound up, give direction for the statutory report to be filled or the statutory meeting to be held, or make such other order as may be deemed just.

The above rules do not apply to a private company.

Annual general meeting :

A general meeting of every company shall be held within eighteen months from the date of its incorporation and thereafter once at least in every calendar year and not more than fifteen months after the holding of the last preceding general meeting. If default is made in calling such a meeting, every director or manager of the company who is knowingly and wilfully a party to the default shall be liable to a fine not exceeding five hundred rupees. Besides, on the application of a member of the company the court may call or direct the calling of a general meeting of the company.

The directors of every company must lay before the company in general meeting a balance-sheet and profit and loss account, or in the case of a company not trading for profit, an income and expenditure account, for a period covering nine months from the date of the meeting, and in the case of the first meeting after incorporation, for a period covering eighteen months from the date of incorporation. The balance-sheet and the profit and loss account or the income and expenditure account must be audited by the company's auditor and the auditor's report must be attached therewith.

Every company other than a private company must send a copy of such balance-sheet and profit and loss account or income and expenditure account so audited together with a copy of the

auditor's report to the registered address of every member of the company, at least fourteen days before the meeting at which it is to be laid before the members of the company and shall deposit a copy thereof at the registered office of the company for the inspection of the members. The directors must also attach to every balance-sheet a report about the state of the company's business, the amount, if any, which they recommend to be paid by way of dividend and the amount, if any, which they propose to carry to a reserve fund.

Statutory meeting :

All meetings of the shareholders other than the annual meetings or those provided for in the articles are known as **extraordinary general meetings**. These meetings may be called by the directors either *suo moto* or on the requisition of not less than one-tenth of the shareholders and, where the directors fail to call such a meeting so requisitioned within the prescribed time limit, by the requisitionists themselves.

Section 78 of the Companies Act provides that "notwithstanding anything contained in the articles, the directors of a company which has a share capital shall, on the requisition of the holders of not less than one-tenth of the issued share-capital of the company upon which all calls or other sums then due have been paid, forthwith proceed to call an extraordinary general meeting of the company".

The requisition must state the objects of the meeting, and must be signed by the requisitionists and deposited at the registered office of the company, and may consist of several documents in like form, each signed by one or more requisitionists.

If the directors do not cause a meeting to be called within twenty-one days from the date of the requisition being so deposited, the requisitionists or a majority of them in value, may themselves call the meeting, but in either case any meeting so called shall be held within three months from the date of the deposit of the requisition.

Any reasonable expenses incurred by the requisitionists by reason of the failure of the directors to convene the meeting duly

must be repaid to the requisitionists by the company and the company may deduct the sum so repaid from the fees or other remuneration of such of the directors as were in default.

Rules of meetings and evote :

Who can convene meetings. The meetings of a company are usually called by directors. But unless otherwise provided by the articles, two or more members holding not less than one-tenth of the total share-capital paid up or, if the company has no share capital, not less than five per cent, in number of the members of the company may call a meeting, (Sec. 79-II).

Notice of meeting. Notwithstanding any provision made in the articles of the company, a meeting of a public company other than a meeting for the passing of a special resolution may be called by not less than fourteen days' notice in writing ; but with the consent of all the members entitled to receive notice of a particular meeting that meeting may be convened by such shorter notice and in such manner as those members may think fit.

The notice is to be served personally on every shareholder, but if the articles allow, it may be served by post. The notice must be sufficient to show the members substantially the object of the meeting, e. g., a notice of resolution to increase the capital should specify the amount of the proposed increase. If any special business is to be transacted, the notice must specify its nature. A notice convening an extraordinary general meeting to consider two alternative schemes of reconstruction was held bad because the notice did not disclose that the directors were interested as underwriters in one of the schemes (*Tiessen* V. *Henderson*, 1-99, 1 ch. 861). The only business which can be validly transacted at the meeting is to confirm or reject the proposal of which notice has been given. Alternatives proposed by way of amendment will be out of order unless covered by the terms of the notice.

Quorum. The term 'quorum' has been defined as "the fixed minimum number of members of anybody which must be present for the proper and valid transaction of any meeting of that body". In the case of a company, the quorum for the meetings of share-

holders is usually fixed by the articles. Where the articles do not make any provision for the same, the quorum of a public company is made up of five members and if a private company by two members, all being personally present in the meeting.

Chairman. The articles of a company generally provide as to who shall preside over each meeting. Where no such provision is made by the articles, each meeting chooses its own chairman, provided there is a quorum before the election of the chairman takes place.

The chairman of a meeting is entitled to exercise the following powers. :—

(*a*) to maintain order and conduct the meeting property ;

(*b*) to declare the result of a vote taken by show of hands and his declaration is final and conclusive, unless obviously wrong on its face ;

(*c*) to adjourn the meeting at his discretion but only if a case for adjournment has arisen.

(*d*) if provided by the articles, to exercise a casting vote, in addition to his ordinary vote, where there is an equality of votes cast prior to his using the casting vote.

(*e*) to decide points of order and at any time to take a vote of the majority on the question whether the discussion shall stop.

Voting. In the case of a company limited by shares every member has one vote in respect of each share. Where the shares are turned into stock, every member has one vote in respect of each hundred rupees of stock. If the company is not limited by shares, each member has only one vote irrespective of the number of shares held by him.

Poll. As a general rule, all questions in a meeting are divided by the show of hands. Where, however, voting by the show of hands is considered unsatisfactory or where it is undesirable, a poll may be demanded, by at least five members present in person or by proxy or the chairman of the meeting or any member or members holding not less than one-tenth of the issued capital which carries voting rights. In the case of a private company, one member, if not more than seven members are personally pre-

sent, and two members, if more than seven members are personally present, are entitled to demand a poll. The demand for the poll being made, the chairman fixes the time and place for taking the poll and on a poll even absent members may vote through proxies.

Proxy. A 'proxy' is a stamped instrument in writing authoring a person to vote as proxy for a shareholder at a certain meeting. The person appointed a proxy must be a shareholder himself.

The instrument of proxy must be signed by the appointer or his attorney duly authorized in writing or, if the appointer is a corporation, it must be either under seal or under the hand of an officer of the corporation or an attorney duly authorized. The instrument must be deposited at the registered office of the company at least seventy-two hours before the time of the meeting. The power to vote by proxy must, however, be expressly provided for by the articles, otherwise representation by proxy will not be in order.

Court's jurisdiction regarding meeting. If for any reason it is impracticable to call a meeting of a company in any manner in which meetings of that company may be called or to conduct any meeting of the company in manner prescribed by the articles or the Companies Act, the court may, either of its own motion or on the application of any director of the company or of any member of the company who would be entitled to vote at the meeting, order a meeting of the company to be called, held and conducted in such manner as the court thinks fit, and where any such order is given may give such ancillary or consequential directions it thinks expedient and any meeting called, held and conducted in accordance with any such order shall for all purposes be deemed to be a meeting of the company duly called, held and conducted, (Sec. 79-III).

RESOLUTIONS

Resolutions passed by a company are of three kinds. They are :—

1. **Ordinary Resolution :**

This is passed by a majority of members at a general meeting. Such a resolution is passed in the ordinary way and deals with ordinary business, such as passing of accounts, appointing directors and so on. Unless required by the articles, no notice of such resolution need be given. But notice must be given of all ordinary resolutions to be proposed at the statutory meeting.

2. **Extraordinary Resolution :**

A resolution is termed an 'extraordinary resolution' when it has been passed by a majority of not less than three-fourths of such members entitled to vote as are present in person or by proxy (where proxy is allowed) at a general meeting, such meeting being convened by notice specifying the resolution and stating that it would be proposed as an extraordinary resolution (Sec. 81-I). Unless so required by the articles, it is not necessary that all extraordinary business must be conducted by extraordinary resolution. The voluntary winding up of a company by shareholders is usually done by extraordinary resolution. The articles generally provide that directors may be removed by extraordinary resolution.

3. **Special Resolution :**

A resolution is designated as a 'special resolution' when it is passed by a three-fourths majority of those entitled to vote and voting at a general meeting, of which not less than twenty-one days' notice has been given specifying the resolution and stating that it would be proposed as a special resolution (Sec. 81-II).

Special resolution is necessary for the following purposes among others:—

(*a*) to alter the articles of the company ;
(*b*) to alter the memorandum with the leave of the court ;
(*c*) to change the name of the company ;
(*d*) the reduce the capital of the company with the leave of court.

Copies of special resolutions must be sent to the registrar within fifteen days from the date of their adoption.

Meetings of directors :

The rules and regulations as to the meetings of directors are to be found in the Articles of Association of all Companies. Such rules as may thus be prescribed should be followed in calling and holding the meetings of directors, otherwise the proceedings of a meeting not convened or held in the regular way shall be invalid. To that end it is imperative that due notice should be given to all directors. This rule, however, does not apply to an adjourned meeting.

The Articles of Association usually prescribe a quorum for a directors' meeting in the absence of which a majority of the Board must meet. (York *Tramways Co.* V. *Willows*, 187, 8 Q. B. D., 685). If, however, a smaller number than the one prescribed for quorum is established as quorum by long practice, business transacted by such smaller number shall be declared by the Court as legally done. (Re : *Peruvian Railways Co., Exparte International Contract Co.*, 1868, 19 L. T., 803).

The convening of and the presiding over of the meeting of directors is governed by such rules as the articles prescribe.

CHAPTER IX

DEBENTURES

Definition and classification :

A debenture has been defined as "a document by which a company acknowledges its debt to the holder thereof under certain terms and conditions contained in the document". The terms and conditions contained in the debenture usually relate to the interest to be paid, the mode of repaying the principal and the security given for ensuring these payments.

Debentures may be classified into the following categories on the basis of terms and conditions of their issue.

(a) *Simple or Naked Debentures :* By these debentures the company simply promises to repay the principal amount lent by their holder together with interest at fixed rates thereon. Those debentures are called *simple* or *naked* because the promise to repay contained therein is not secured by any specified charge or morgage of the assets of the company or any part thereof. The holders of such debentures are thus unsecured creditors of the company.

(*b*) *Mortgage debentures.* When the promise of the company to pay the interest and repay the principal is secured by some charge or mortgage on the total assets of the company, or any part thereof, the debenture by which the promise is made is called *Mortgage debenture.*

Now the "charge" by which the debenture is secured may be either "fixed" or "following". When the debenture is secured by such a specific mortgage on any assets of the company that the debenture-holders become the virtual owners of the assets, the charge is **fixed** and the debenture in that case is known as *Debenture with a fixed charge or fixed debenture.* When, on the other hand, the debenture is secured only by such general charge or lien on the assets that the company can deal with the assets in anyway they like in the interest of the business, the charge is called

'*floating*' and the debenture secured thereby is known as. *Debenture with a floating charge or Floating debenture.*

A *floating charge* may get "fixed" by an event such as the winding up of the company. Until such events occur the company is, as we have seen, free to deal with its property and, therefore, it can even mortgage such property in priority to the *floating charge.* When such a *floating charge* is created, the usual practice is to draw out a trust deed as between the trustees on behalf of the debenture-holders on one side and the company on the other. The trustees come in as soon as the charge becomes fixed.

(*c*) *Redeemable Debentures.* These debentures are such as the company reserves the right to pay off or cancel on or after a certain date. Usually the payment to redeem debentures is made out of a specially created fund known as the '*Debenture Redemption Fund*' or out of a fresh issue of debentures.

(*d*) *Irredeemable or Perpetual Debentures.* These debentures are those which, by the terms of their issue, the company is never bound to pay off except in the case of winding up or default in the payment of interest.

Power to re-issue redeemed debentures :

Where a company has redeemed any debenture previously issued, the company, unless the articles or the conditions of issue expressly otherwise provide, or unless the debentures have been redeemed in pursuance of any obligation on the company so to do, shall have power to keep the debentures alive for the purpose of re-issue, and where a company has purported to exercise such a power, the company shall have power to re-issue the debentures either by re-issuing the same debentures or by issuing other debentures in their place, and upon such re-issue the persons entitled to the debentures shall have the same rights and priorities as if the debentures had not been previously issued, (Sec. 127-I).

Distinction between a shareholder and a Debenture-holder :

The position of a shareholder is fundamentally different from a debenture-holder. The following are the main points on which they differ:—

(*a*) Money raised by the issue of shares make up the capital of the company. But money contributed by a debenture-holder is only a loan due by the company.

(*b*) A shareholder is a proprietor of the company while a debenture holder is only its creditor.

(*c*) A shareholder receives profit, called dividend, either at a fixed or at a variable rate but a debenture-holder derives profits, called interest, only at a fixed rate.

(*d*) A debenture can be redeemed but money received on account of share cannot be returned except where the company is wound up or a reduction of capital is effected by returning the uncalled money on shares.

(e) When a company is wound up, the claims of debenture-holders take priority over those of shareholders.

Debenture Stock :

As shares can be turned into stock, so also debentures can be converted into debenture stock. In fact, the relation between debenture and debenture stock is very much like the relation between the shares and stock. Like stocks debenture stocks need not be of any particular demonination but may be subdivisible into any amount. Debenture stock is, therefore, the whole debt of the company merged in one lump. A debenture stock holder can, as such, lend either Rs. 10/- or Rs. 10/8/- or Rs. 11/- and so on as part of the total debt of the company, but debenture-holders cannot lend otherwise than in terms of fixed denomination, e. g., Rs. 10/- or Rs 20/- or Rs 50/- or Rs. 100/- and so on.

Remedies of Debenture-holders :

The following remedies are available to a debenture-holder who wants to realize his security and recover the money he has lent:—

(*i*) The debenture-holder will be deemed a secured creditor and will have priority over all other creditors, if the debenture is registered before the winding up of the company. But he will rank equally with other unsecured creditors if the debenture is registered after the winding up has already commenced.

(*ii*) A single debenture-holder may sue on behalf of himself and all other debenture-holders for the recovery of the money

lent. When such a suit is brought, the court appoints a receiver and, if necessary, a manager and declares the debentures to be a charge on the assets of the company and orders a sale of the property.

(*iii*) A debenture-holder may present a petition for the winding up of the company.

(*iv*) He may realize his security by forclosure (i. e., by closing the right of the company to redeem the debentures) and sale when the company fails to make payment of the principal and interest thereon as stipulated in the terms of issue.

(*v*) At any time after the principal money secured by the debenture has become payable, the debenture-holder may appoint a receiver or receivers for the property charged by the debenture. Any person so appointed as receiver shall have the power :—

(*a*) To step in and take possession of any of the property charged ;

(*b*) to carry on the business of the company ;

(*c*) to sell any of the property charged ;

(*d*) to make any arrangement or compromise which he shall consider to be in the interest of the debenture-holders ;

(*e*) to apply to the court to appoint a receiver.

Receiver :

To facilitate recovery of money lent by a debenture-holder the Companies Act has provided for the appointment of a receiver, or receivers in any of the three ways :—

(*i*) a debenture-holder can appoint a receiver himself ;

(*ii*) he can apply to the court to appoint such a receiver.

(*iii*) in a debenture-holder's action for the recovery of money lent, the court may appoint a receiver in the following cases :—

(*a*) if the principal money lent has become due ; or,

(*b*) if the company is wound up ; or,

(*c*) if the security, i.e., the debenture is likely to be jeopardised even though there has been no default in the payment of interest and no winding up, e. g., if the property of the company is attached in execution of a decree obtained by a creditor of the company or if the company has closed its business and so on.

Distinction between a receiver appointed by the court and a receiver appointed by a debenture-holder :—

(*i*) A receiver appointed by the court is the agent of the court. He is personally liable on contracts he makes because the court cannot be liable on contracts made by him. He is, however, entitled to be indemnified out of the assets of the company in preference to the claims of the debenture-holders if the receiver incurs loss or damage on account of such contracts.

But a receiver appointed by the debenture-holders is the agent of the debenture-holders. As such the debenture-holders are liable on the contracts of the receiver unless the terms of the debenture provide that such receiver will be the agent of the company and not of debenture-holders.

(*ii*) A receiver appointed by the court enjoys certain advantages in the performance of his duties. He works under the protection of the court and is thus free from any extraneous interference. Furthermore, no suit can be commenced against him or in respect of the property under his care without leave of the court.

But a receiver appointed by the debenture-holder enjoys no such protection.

Registration of security :

A debenture, as we have seen before, can be secured either by mortgage or a charge. Now, the following mortgages and charges created by a company should be registered within twenty-one days of their creation, unless the court extends the period of such registration, in order that they may be treated as secured debts in case of winding up :—

(*a*) A mortgage or charge for the purpose of securing any issue of debentures.

(*b*) A mortgage or charge on uncalled share-capital of the company.

(*c*) A mortgage or charge on any immovable property.

(*d*) A mortgage or charge on any movable property.

(*e*) A floating charge on the undertaking or property of the company.

If any of the above mortgages or charges are not registered within twenty one days of their creation, they will be void as against the liquidator appointed in the event of the winding up of the company and also against other creditors. In the absence of such registration, they will rank only as unsecured debts.

CHAPTER X

WINDING UP OR LIQUIDATION

Definition:

'Liquidation' or 'Winding up' has been defined as "a legal process in respect of a joint-stock company by which its affairs are wound up and its assets sold and converted into hard cash for being divided among the persons entitled thereto, i. e., first, the creditors of the company, and next, after the full settlement of the claims of this class, the shareholders." Now, the shareholders of a joint-stock company are its proprietors. Naturally, they stand in the position of debtors to the creditors of the company, and, therefore, unless creditors are fully paid, the shareholder cannot expect any return of the capital paid by them to the company. It may be noted here that *in the case of liquidation the shareholders are known as contributories.*

It should be borne in mind in connection with liquidation that insolvency is not the only cause of the winding up of a company. There are records of some of the flourishing companies having been wound up voluntarily by the shareholders because it appeared to them to be the best course in the face of a possibility that the company might face difficulty in future owing to the change in time and circumstances. In a majority of the cases, however, liquidation was imposed or decided upon to avert a total loss of the capital either because the company was running at heavy recurring loss or it had already fallen into a hopeless state of insolvency wherefrom recovery was thought impossible.

Modes of winding up:

The Companies Act has laid down three modes of winding up a company:---

(*i*) *Compulsory winding up by the court,*

(*ii*) *Voluntary winding up,*

(*iii*) *Voluntary winding up under the supervision of the court.*

1. Compulsory winding up by the court:

Under Section 162 of the Companies Act a company may be wound up by the court :

(*i*) if the company has by special resolution resolved that the company be wound up by the court ;

(*ii*) if default is made in filing the statutory report or in holding the statutory meeting ;

iii) if the company does not commence its business within a year from its incorporation or suspends its business for a whole year ;

(*iv*) if the number of shareholders is reduced, in the case of a private company, below two, or in the case of any other company, below seven ; and,

(*v*) if the company is unable to pay its debts. **A company is deemed unable to pay its debts :---**

(*a*) if a creditor, by assignment or otherwise, to whom the company is indebted in a sum not exceeding five hundred rupees then due, has served on the company by causing the same to be delivered by registered post or otherwise at its registered office, a demand under his signature requiring the company to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor; or,

(*b*) if a creditor, who has obtained a decree against the company, cannot get his decree satisfied; or,

(c) if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company.

(*vi*) if the court is of the opinion that it is just and equitable that the company should be wound up. Under this clause, the court has jurisdiction to wind up on any ground not necessarily akin to the grounds listed above. In particular, however, the following cases have been held to be within the scope of this clause: ---

(*a*) where the principal business for which the company was formed has become impossible or impracticable.

(*b*) if the company was formed for a fraudulent purpose or if its business is being carried on in a fraudulent manner.

(*c*) if the company cannot function due to a total deadlock.

Procedure in winding up by the court. When an order for compulsory winding up by the court is sought to be obtained, proceedings has to be started by a petition presented either by the company or by one or more of the creditors or by a contributory, or by the registrar of joint-stock companies. (*A contributory is usually a partly paid up shareholder*).

A contributory is not entitled to present a petition for winding up a company unless:—

(*a*) either the number of members is reduced, in the case of a private company, below two, or in the case of any other company, below seven; or,

(*b*) the shares in respect of which he is a contributory have been held by him for at least six months during the eighteen months before the commencement of winding up.

The registrar is not entitled to present a petition for winding up a company :---

(*a*) except on the ground that from the financial condition of the company as disclosed in its balance-sheet or from the report of an inspector appointed under Section 138 of the Act, it appears that the company is unable to pay its debts; and,

(*b*) unless the previous sanction of the Central Government has been obtained to the presentation of the petition.

A petition for winding up a company on the ground of default in filing the statutory report or in holding the statutory meeting shall not be presented by any person except a shareholder nor before the expiration of fourteen days after the last day on which the meeting ought to have been held.

The petition for winding up must be verified by an affidavit, copy of which must be served on the company. The day of hearing is appointed by the court and after hearing the parties and considering all the circumstances of the case, the court may either refuse to grant an order for winding up or order that the company be wound up. The court cannot give a hearing to a petition by a contingent or prospective creditor until such

security for costs has been given as the court thinks reasonable and until a *prima facie* case for winding up has been established to the satisfaction of the court.

If the order for winding up is made, the court generally appoints an official liquidator or liquidators in order to conduct the proceedings in the winding up the company and to perform all such functions as are incidental to the winding up.

Where the High Court makes an order for winding up a company, it may, if it thinks fit, direct all subsequent proceedings to be had in a District Court; and thereupon such District Court shall, for the purpose of winding up the company, be deemed to be "the court" within the meaning of this Act, and shall have, for the purposes of such winding up, all the jurisdiction and powers of the High Court. (Sec.164).

If during the progress of a winding up in a District Court it is made to appear to the High Court that the same could be more conveniently prosecuted in any other District Court having jurisdiction to wind up companies, the High Court may transfer the same to such other court, and thereupon the winding up shall proceed in such other District Court. (Sec.165).

Effect of winding-up by the Court:

A winding-up by the Court has the following consequences :---

(i) An order for winding up a company operates in favour of all the creditors and of all the contributories of the company as if the order is made on the joint petition of a creditor and a contributory. (Sec. 167).

(*ii*) The company is deemed to be wound up from the date on which the petition for winding up was presented (Sec. 168)

(*iii*) When a winding-up order has been made or a provisional liquidator has been appointed, no suit or other legal proceeding can be commenced or proceeded with against the company except with the leave of the court and subject to such terms as the court may impose. (Sec. 171).

(*iv*) If a decree has been obtained against the company it cannot be executed or the property of the company cannot be attached without the leave of the court. (Sec.232).

(*v*) All the property of the company comes into the custody of the court from the date of winding-up order and the official liquidator takes charge of such properties as the agent of the court (Sec.175).

2. **Voluntary winding-up :**

Under Section 203 of the Companies Act, a company may be wound up voluntarily:

(*i*) when the period, if any, fixed in the articles for the duration of the company has expired or an event has happened upon the happening of which, according to the articles, the company is to be wound up, and the company in general meeting has passed an ordinary resolution requiring the company to be wound up voluntarily;

(*ii*) if the company has, for any reason whatsoever, passed a special resolution to wind up voluntarily; or,

(*iii*) if the company resolves by extraordinary resolution to the effect that it cannot by reason of its liabilities continue its business and that it is advisable to wind up voluntarily.

Effect of voluntary winding-up:

(*i*) The voluntary winding-up is deemed to commence from the passing of the resolution which sanctioned it (Sec.204).

(*ii*) When it is decided to wind up a company voluntarily, the company must, from the commencement of the winding up, cease to carry on its business, except so far as may be required for its beneficial winding up, with the result that no share can be transferred without the sanction of the liquidator. Thus in *Taylor's case* (1897, 1 ch. 298), it was held that shares transferred with the consent of the liquidator had the effect of making the transferee members of the company.

(*iii*) Members cannot alter their status after the commencement of winding-up. Thus, in *Castello's case*, it was held that where shares were transferred to a minor after the winding up commenced , the minor could not ratify the transfer after he attained majority as he cannot change his status as a minor after the winding up.

(*iv*) Notwithstanding anything to the contrary contained in its articles, the corporate state and corporate powers of the company continue to exist until the company is completely dissolved.

Kinds of voluntary winding-up:

There are two kinds of voluntary winding-up: (a) **members' voluntary winding-up** and (b) **creditors' voluntary winding-up.**

1. **Members' voluntary winding-up :**

Where it is proposed to wind up a company voluntarily, the following preliminary steps must be taken:—

(*i*) Notice of any special resolution or extraordinary resolution for winding up a company voluntarily is to be given by the company within ten days of the passing of the same by advertisement in the official gazette and also in some newspaper, if any, circulating in the district where the registered office of the company is situated (Sec. 206)

(*ii*) The majority of the directors must deliver to the registrar a statutory declaration that they have made a full enquiry into the affairs of the company, and that, having so done, they have formed the opinion that the company is solvent and will be able to pay its debts in full within a period of three years from the commencement of the winding-up. Such a declaration must be supported by a report of the company's auditors on the company's affairs. (Sec. 207)

(*iii*) After the above statutory declaration, the shareholders must meet and pass a resolution, ordinary, special or extraor- dinary as the case may be, for the winding-up of the company (Sec. 207)

In the meeting in which the resolution for winding up is passed or in a subsequent meeting if the shareholders so desire, the company must "appoint one or more liquidators for the purpose of winding up the affairs and distributing the assets of the company, and may fix the remuneration to be paid to him or them". As soon as the liquidator is appointed all the powers of the directors cease, except so far as the continuance thereof may be sanctioned by the company in general meeting or by the liquidator. (Sec. 208A).

If the winding-up continues for more than a year the liquidator must summon a general meeting of the company at the end of the first year from the commencement of the winding-up and of each successive year and lay before the meeting an account of his acts and dealings and of the conduct of the winding-up during the preceding year and a statement in the prescribed form containing the prescribed particulars with respect to the position of the liquidation (Sec. 208D).

As soon as the affairs of the company are fully wound up, the liquidator shall make up an account of winding up showing how the winding up has been conducted and the property of the company has been disposed of and thereupon shall call a general meeting of the company called the "**final** meeting' which must be properly advertised at least one month before the date of the meeting and specifying the time, place and object thereof. Within a week of the final meeting the liquidator must send a copy of the account and a return of the meeting to the registrar. If a quorum is not present at the meeting, the liquidator shall, in lieu of the said return, make a return that the meeting was duly summoned and that no quorum was present thereat and upon such a return being made a return of the meeting shall be deemed to have been received.

On receiving the account and either of the returns mentioned above, the registrar shall forthwith register them and on the expiration of three months from such registration, the company is deemed to be finally dissolved (Sec. 208E).

2. Creditors' voluntary winding-up:

A winding-up in the case of which no declaration as to the solvency of the company is made and delivered to the registrar (as required in the case of members' voluntary winding-up under the Provisions of Section 207 of the Act) and the shareholders pass a resolution for winding-up, the winding-up is known as 'creditors' voluntary winding-up'.

The procedure for a creditors' voluntary winding-up is as follows:--

(*i*) The company in a general meeting passes a resolution

for voluntary winding-up without any prior declaration of solvency by directors (as required in the case of members' voluntary winding-up.

(*ii*) The company shall cause a meeting of the creditors of the company to be summoned for the day or the day next following the day, on which there is to be held the meeting at which the resolution for voluntary winding-up is to be proposed, and shall cause the notices of the said meeting of creditors to be sent by post to the creditors simultaneously with the sending of the notices of the said meeting of the company (Sec. 209A-1).

(*iii*) The company shall cause notice of the meeting of the creditors to be advertised in the official gazette and also in some newspaper, if any, circulating in the district where the registered office of the company is situatd.

(*iv*) When the meeting is held, the directors must lay before it a statement of the position of the company and a list of creditors.

(*v*) One of the directors of the company is to preside over the meeting of the directors.

(*vi*) If the meeting of the company at which the resolution for voluntary winding up is to be proposed is adjourned and the resolution is passed at an adjourned meeting, any resolution, passed at the meeting of the creditors held in pursuance of sub-Section (*i*) of Section 209A of the Act, shall have effect as if it had been passed immediately after the passing of the resolution for winding up the compan

(*vii*) The creditors and the shareholders may in their respective meetings nominate a person as liquidator, but if they choose different persons as liquidator, the nominee of the creditors shall become the liquidator for the purpose of winding-up the company and distributing the assets of the company. If no person is nominated by the creditors the nominee of the shareholders, if any, shall be the liquidator.

In the case of different persons being nominated by the creditors and the shareholders, any director, member or creditor of the company may, within seven days after such nomination by the creditors, apply to the court for an order either directing that

the person nominated as liquidator by the company shall be liquidator instead of or jointly with the person nominated by the creditors or appointing some other person to be liquidator instead of the person appointed by the creditors.

(*viii*) If the winding-up continues for more than a year, the liquidator must summon a general meeting of the company and a meeting of the creditors at the end of the first year from the commencement of the winding-up and of each successive year and lay before the meetings an account of his acts and dealings and of the conduct of the winding during the preceding year.

(*ix*) At the meeting to be held in pursuance of Section 209A of the Act or at any subsequent meeting, the creditors may, if they think fit, appoint a **'Committee of Inspection'** consisting of not more than five persons, and if such committee is appointed the company may appoint not more than five persons to act as members of the committee appointed by the creditors.

The creditors may, however, if they think fit, resolve that all or any of the persons so appointed by the company ought not to be members of the **'Committee of Inspection'**, and, if the creditors so resolve, the persons memtioned in the resolution shall not unless the court otherwise directs, be qualified to act as members of the committee, and on any such application to the court, may, if it thinks fit, appoint other persons to act as such members in place of the persons mentioned in the resolution.

(x) Upon the affairs of the company being finally wound up, the liquidator shall make up an account of the winding-up showing how the winding-up has been conducted and the property of the company has been disposed of, and thereupon shall call a general meeting of the company, and a meeting of the creditors, called **'Final Meetings'** for the purpose of laying the accounts before the meetings and giving any explanation thereof.

Each such meeting shall be called by advertisement specifying the time, place and object thereof and must be notified at least one month before the date of each meeting.

Within one week after the date of the meetings, or, if the meetings are not held on the same date, after the date of the

later meeting, the liquidator shall send to the registrar a copy of the account, and a return of the meetings.

On receipt of the account and the returns, the registrar shall forthwith register them and on the expiration of three months from the registration thereof, the company shall be deemed to be dissolved.

The court, however, on the application of the liquidator or of any other person who appears to the court to be interested, may make an order deferring the date at which the dissolution of the company is to take effect for such time as the court thinks fit (Sec. 209H).

3. Voluntary winding-up under the supervision of the Court:

When a company has by special or extraordinary resolution resolved to wind up volutarily, the court may make an order that the winding-up shall take place under the supervision of the court and with such liberty for creditors, contributories or others to apply to the court, and generally on such terms and conditions as the court thinks fit (Sec. 221).

The effect of such an order by the court is that the liquidator may exercise all his powers without the sanction of the court as in a voluntary winding up but subject to such restrictions as the court may direct.

An order for supervision by the court may be made on any of the following grounds : (a) Partiality of the liquidator ; (b) non-observance of the rules of winding-up ; (c) negligence or dilatoriness on the part of the liquidator in releasing the assets ; (d) the winding-up resolution being obtained by fraud.

The court has absolute discretion both as regards the passing of the supervision order and as regards the nature of restrictions to be imposed on the liquidator in case the order for supervision is passed. In all matters relating to the winding-up subject to supervision, however, the court may have regard to the wishes of the creditors and the contributories as proved to it by any sufficient evidence (Sec. 223).

Powers of Liquidators :

1 *Official liquidator.* In doing anything with respect to the conduct of the winding-up of the company, an official liquidator must obtain the sanction of the court. Without such sanction, however, he can take into his custody and control the property and assets of the company and prepare the list of contributories.

With the sanction of the court, the official liquidator has power to do the following things.

(*a*) To institute and defend any civil suit or criminal prosecution in the name of or on behalf of the company.

(*b*) To carry on the business of the company so far as may be necessary for the beneficial winding up of the company. Thus the liquidator can complete contracts undertaken by the company before the winding-up and left incomplete at the date of the winding-up, which, if not completed, would seriously deplete the assets of the company or otherwise put the company to difficulty. But the liquidator cannot undertake new business because the net effect of such action would be to resuscitate the company.

(*c*) To sell the immovable and movable property of the company by public auction or private contract, with power to transfer the whole thereof to any person or company, or to sell the same in parcels.

(*d*) To do all acts and to execute, in the name of and on behalf of the company, all deeds, receipts and other documents, and for that purpose to use, whenever necessary, the company's seal.

(*e*) To prove, rank and claim in the insolvency of any contributory, for any balance against his estate, and to receive dividends in the insolvency, in respect of that balance as a separate debt due from the insolvent, and rateably with the other separate creditors.

(*f*) To draw, accept, make and indorse any bill of exchange, hundi or promissory note in the name of or on behalf of the company.

(*g*) To raise on the security of the assets of the company any money requisite.

(*h*) To take out, in his official name, letters of administration to any deceased contributory, and to do on his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot be conveniently done in the name of the company.

1. To do all such other things as may be necessary for winding up the affairs of the company and distributing its assets.

The court may provide by any order that the official liquidator may exercise any of the above powers without the sanction or intervention of the Court, and, where an offidial liquidator is provisionally appointed, may limit and restrict his powers by the order appointing him (Sec. 180).

2. *Liquidator in voluntary winding-up* :—In a voluntary winding up a liquidator may exercise all the powers of an official liquidator without the sanction of the Court. In the case of members' voluntary winding up with the sanction of an extraordinary resolution of the Company and in the case of a creditors, voluntary winding up with the sanction of the court or the committee of Inspection, a liquidator can (1) pay any classes of creditors in full, (2) compromise with creditors, and (3) compromise calls, liabilities, debts, and claims between the Company and the contributories or other debtors.

A liquidator under supervision of the Court has the same powers as a liquidator in voluntary winding up subject to such restrictions as the court may impose.

The exercise by the liquidator of the powers enumerated above shall be subject to the control of the court, and any creditor or contributory may apply to the court with respect to any exercise or proposed exercise of any of these powers.

Duties of official Liquidator :

Under Section 182 of the Companies Act, the official liquidator has the following duties to perform.

(*i*) He shall keep proper books of account and also minute books in which the minutes of proceeding at meetings must be entered. Any creditor or contributory may, subject to the control of the court, personally or by his agent inspect any such book.

(*ii*) He must submit to the court not less than twice a year during his tenure of office an account of his receipts and payments as such liquidator.

(*iii*) Under Section 183 (*ii*) the liquidator may summon general meetings of the creditors or contributories for the purpose of ascertaining their wishes and it shall be his duty to summon meetings at such times as the creditors or contributories, by resolution, may direct, or whenever requested in writing to do so by one-tenth in value of the creditors or contributories, as the case may be.

(*iv*) He must prepare a list of the contributories after giving them notice and hearing their objection. This list is later settled by the court under the provision of Section 184 (*i*), the effect of which is that every person liable to make contribution towards the assets of the company is included in the list.

(*v*) He must collect the assets of the company, make calls as the court directs and distribute the assets amongst the creditors, and if any surplus be left, to distribute it amongst the contributories according as the articles provide.

(*vi*) Within one month from the date of the order for the winding-up of a company, the official liquidator must convene a meeting of the creditors in order to ascertain whether or not the creditors want to appoint a 'Committee of Inspection' to assist the liquidator, and if so, who are to be the members of the comittee so appointed.

If the creditors want such a committee, the liquidator must convene a meeting of the contributories within a week from the date of the creditors' meeting to consider the decision of the creditors and to accept the same with or without modification.

If the contributories do not accept the decision of the creditors in its entirety, it shall be the duty of the official liquidator to apply to the court for directions as to whether there shall be a 'Committee of Inspection' and, if so, what shall be the composition of the committee and who shall be members thereof.

If the contributories accept the decision of the creditors a committee of Inspection is appointed with 12 representatives from the creditors and contributorties, the proportion of represent-

ation being determined by agreement between the creditors and the contributories or, in the case of difference, by direction of the Court (Sec. 178A).

(*vii*) The official liquidator must submit to the court a preliminary report, not later than six months from the date of the order:—

(*a*) as to the amount of capital issued, subscribed and paid up, and the estimated amount of assets and liabilities, giving separately under the heading of assets particulars of :—

(*i*) cash and negotiable securities ;

(*ii*) debts due from contributories ;

(*iii*) debts due to and securities, if any, available to the company ;

(*iv*) movable and immovable properties belonging to the company ;

(*v*) unpaid calls ; and ,

(*b*) If the company has failed, as to the causes of failure and,

(*c*) whether in his opinion further inquiry is desirable as to any matter relating to the promotion, formation, or failure of the company, or the conduct of the business thereof.

Distribution of Assets :

After the assets of the company have been fully realised, the expenses in connection with the winding up must be paid first. The surplus that remains is to be appropriated towards making the following **preferential payments,** in priority to all other debts.

(*i*) All revenues, taxes, cesses and rates, whether payable to the Central Government or to any local authority.

(*ii*) All wages and salaries of any clerk or servant, and all wages of any labourer or worker in respect of service rendered within two months before the winding up, not exceeding Rs. 1,000/- for each clerk or servant, and not exceeding Rs. 500/- for each labourer or workman.

(*iii*) Compensation payable under the Workmen's compensation Act, 1923, in respect of the death or disablement of any officer or employee of the company.

(*iv*) all sums due to any employee from provident fund,

a pension fund, a gratuity fund or any other fund for the welfare of the employees maintained by the company ; and,

(*v*) The expenses of any investigation held by the Central Government.

If any balance remains after the above payments have been made, the unsecured creditors must be satisfied first and if any surplus is still left out, it is to be distributed among the contributories. **The aforesaid preferential payment does not, however affect the secured creditors.**

Powers of the Court in Liquidation proceeding :

Ordinary powers. (*i*) The court shall settle a list of contributories, with power to rectify the register and shall cause the assets of the company to be collected and applied in discharge of its liabilities.

(*ii*) At any time after making a winding up order, the court may require any contributory and any trustee, receiver, banker agent or officer of the company to pay, deliver, surrender or transfer forthwith, or within such time as the court directs, to the official liquidator any money, property or documents in his hands to which the company is *prima facie* entitled.

(*iii*) At any time after making a winding-up order, the court may make an order on any contributory to pay any money due from him or from the estate of the person whom he represents to the company ecxlusive of any money payable by him or the estate by virtue of any call in pursuance of this Act.

(*iv*) At any time after making a winding-up order, and either before or after it has ascertained the sufficiency of the assets of the company, the court may make calls on and order payment thereof by all or any of the contributories, for payment of any money which the court considers necessary to satisfy the debts and tliabilities of the company, and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves.

In making the call as referred to above the court may take into consideration the probability that some of the contributories pay partly or wholly fail to pay the call.

(*v*) The Cout may fix a time or times within which creditors are to prove their debts or claims, or to be excluded from the benefit of any distribution made before those debts are proved.

(*vi*) The Court shall adjust the rights of the contributories among themselves, and distribute any surplus among the persons entitled thereto.

(*vii*) In the event of the assets being insufficient to satisfy the liabilities, the court may make an order as the payment out of the assets of the costs, charges and expenses incurred in the winding-up in such order of priority as the court thinks just.

(*viii*) When the affairs of a company have been completedly wound-up, the court shall make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly.

Note : The above-noted ordinary powers are in addition to the powers vested in the court to entertain and examine a petition for liquidation, to order a compulsory liquidation and to appoint and remove a liquidator and also to supervise his conduct and activities.

Extraordinary Powers :

(*i*) After making a winding-up order the court may summon before it any officer of the company or any person known or suspected to have in his possession any property of the company or supposed to be indebted to the company or any person whom the court deems capable of giving information concerning the trade, dealings, affairs or property of the company.

(*ii*) Upon an application made by an official liquidator, the court may order public examination either by itself or any court subordinate to it of any promoter, director or manager of the company against whom a charge of fraud in promoting the company or in conducting its affairs has been made by the said liquidator.

(*iii*) At any time either before or after making a winding-up order, the court may cause any contributory to be arrested and his books and papers and movable property seized, if the court has probable cause to believe that the contributory in question is about to quit Pakistan or may otherwise abscond or may remove or conceal his property for the purpose of evading payment of calls or of avoiding examination respecting the affairs of the company.

CHAPTER XI

MISCELLANEOUS

1. Company not for Profit :

Where it is proved to the satisfaction of the Central Government that an association capable of being formed as a limited company has been or is about to be formed for promoting commerce, art, science, religion, charity or any other useful object and applies or intends to apply its profits, if any, or other income in promoting its objects and **to prohibit the payment of any dividend to its members,** the Central Government may, by licence under the hand of one of its secretaries, direct that the association be registered as a company with limited liability, without the addition of the word "Limited" to its name, and the association may be registered accordingly.

On registration, such an association shall enjoy all the privileges of limited companies, and be subject to all their obligations, except those of using the word "Limited" as any part of its name and of publishing its name, and of sending lists of members to the registrar.

A licence under this section may at any time be revoked by the Central Government and upon revocation the registrar shall enter the world "Limited" at the end of the name of the association upon the registar, and upon this the association shall cease to enjoy the exemptions and privileges granted to it.

Before a licence is revoked, the Central Government must give to the association notice in writing of its intention and must afford the association an opportunity of submitting a represntation in opposition to the revocation (Sec. 26).

2. Registration of Unlimited Company as Limited :

Any company registered as unlimited may register under this Act as limited but the registration of an unlimited company as limited shall not affect any debts, liabilities, obligations of con-

tracts incurred or entered into by, to, with or on behalf of the company before the registration (Sec. 67).

An unlimited company having a share capital may, by its resolution for registration as a limited company in pursuance of the Companies Act, do either or both of the following things, namely:—

(*i*) Increase the nominal amount of its share capital by increasing the nominal amount of each of its shares but subject to the condition that no part of the amount by which its capital is so increased shall be capable of being called except in the event and for the purpose of the company being wound up;

(*ii*) provide that a specified portion of its unpaid share capital shall not be capable of being called up except in the event and for the purposes of the company being wound up. (Sec.6).

3. Unlimited liability of Directors:

Under the provision of Section 70(i) of the Companies Act, the liability of the directors or any director of a limited company may be unlimited if so provided by the memorandum.

Section 71 provides that "a limited company, if so authorized by its articles, may, by special resolution, alter its memorandum so as to render unlimited the liability of its directors or of any director".

Upon the passing of any such special resolution, the provisions thereof shall be as valid as if they had been originally contained in the memorandum.

4. Conversion of Private Company into Public Company.

Under Section. 154(1) of the Companies Act, a Private Company may be converted into a public company in the following way:—

If a private company alters its articles in such manner that they no longer include the provisions which, under Clause (XIII) of Sub-Section (i) of Section (2) are required to be included in the articles of a company in order to constitute it a private company, the company shall, **as on the date of alteration,** cease to be a private company and shall, within a period of fourteen days.

after the said date, file with the registrar a prospectus or a statement in lieu of prospectus in the form and containing the particulars set out in the form marked II in the second Schedule of the Companies Act.

Now, the Articles of a Company can be altered only by a Special Resolution (S. 20) and, as required by Section 82, the special resolution empowering, the change in the articles must be filed with the registrar. sub-section. 154(*i*) without going into the superfluity of mentioning it, requires that the special resolution effecting the change in the articles must also be filed with the Registrar.

As the company must have already been doing business, the filing of a declaration under Section 103 of the Act for obtaining a certificate for commencement of business is seldom necessary.

5. **Removal of Defunct Companies from the Register:**

(*i*) Where the registrar has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter enquiring whether the company is carrying on business or in operation.

(*ii*) If within one month of sending the letter the registrar does not receive any reply thereto, he shall, within fourteen days after the expiration of the month, send to the company by post a registered letter referring to the first letter and stating that no answer thereto has been received and also that if an answer to the second letter is not received within one month from the date thereof, a notice will be published in the local official gazette for the purpose of striking the name of the company off the register.

(*iii*) If the registrar either receives an answer from the company to the effect that it is not carrying on business or in operation or does not, within one month after sending the second letter, receive any answer, he may publish in the local official gazette and send to the company by post a notice that, at the expiration of three months from the date of that notice, the name of the company mentioned therein will, unless cause is shown to the contrary, be struck off the register and the company will be dissolved.

(*iv*) At the expiration of the time mentioned in the notice the registrar shall, unless cause to the contrary has been previously shown by the company, strike its name off the register and publish notice thereof in the local official gazette, and, on the publication of this notice in the gazette, the company shall be dissolved.

(*v*) Even after the company is dissolved, the liability, if any, of every director and member of the company shall continue and may be enforced as if the company had not been dissolved.

(*vi*) If a company or any member or creditor thereof feels aggrieved by the company having been struck off the register, the court, on the application of the company or any member or creditor, may, if satisfied that the company was at the time of the striking off carrying on business or in operation, or otherwise that it is just that the company should be restored to the register, order the name of the company to be restored to the register and, thereupon, the company shall be deemed to have continued in existence as if its name had not been struck off.

LAW OF INSOLVENCY

LAW OF INSOLVENCY

(Provincial Insolvency Act, 1920)

Introduction :

In English law, a distinction is maintained between the terms **'bankrupt'** and **'insolvent'** the former indicating a person who has committed an act of bankruptcy and who has, for that reason, been adjudged a bankrupt, and the latter meaning a person who is unable to pay his debts, i. e., whose liabilities exceed his debts. In our country, however, the word 'insolvent' is used all throughout, and the meaning given to it is that he who has committed any of the '*acts of insolvency*' as determined by the Insolvency Law of the country may be adjudged an insolvent. Thus in Pakistan not only he who is unable to pay his debts but also he who has committed an act of bankruptcy (as understood in English law) may be adjudged an insolvent. The distinction between 'bankrupt' and 'insolvent' is thus done away with and both the terms are treated as bearing the same significance.

2. Two Statutes :

Prior to independence, two statutes, namely, (*i*) The presidency Towns Insolvency Act, 1909, and (*ii*) Provincial Insolvency Act, 1920, governed the law relating to insolvency in the Indo-Pakistan sub continent, the first applying to the Presidency towns of Madras, Bombay and Calcutta and the second to the rest of the sub continent. Since the establishment of Pakistan, the Presidency-Towns Insolvency Act has become defunct as there is at present no presidency town in the country. The operative law of insolvency in Pakistan is, therefore, the Provincial Insolvency Act, 1920, as adapted in Pakistan and amended up to date. Under the Provisions of this Act, the District Courts and also the Subordinate Courts, if specially empowered by the Provincial Governments, are the proper courts to deal with insolvency matters.

3. Who May Be Adjudged Insolvent :

No one can be adjudged an insolvent unless (i) he is a debtor and (ii) he has committed an act of insolvency. A debtor means only a debtor who is subject to the laws of Pakistan and not a debtor all the world over. The position of the following categories of persons, however, calls for careful examination in the light of the two criteria set forth above.

Minors :

All agreements by a minor in Pakistan except those relating to the purchase and sale of his necessaries and those for his benefit (such as an apprenticeship agreement) are absolutely void *ab initio*. But even in the case of agreements relating to the minor's necessaries, no personal liability is attached to him. Besides, an agreement made by a minor cannot be ratified by him on his attainment of majority. It follows, therefore, that a minor cannot be adjudged an insolvent under any circumstances since all agreements by him for the repayment of money borrowed or for goods supplied are void.

The above protection available to a minor also extends to a partnership firm when a minor is admitted to the benefits of partnership. As a result when a firm consists of adult and minor partners, adjudication of insolvency can be made only against the adult partners and not against the minors. In any case, however on an order of adjudication being made, all the properties and assets of the firm including the minors' share will vest in the Receiver.

Foreigners :

A foreigner cannot be adjudged insolvent by any Pakistani court unless he has committed an act of insolvency as defined by the law in Pakistan. If the act is committed during the foreigner's personal residence in Pakistan, there is no exemption for him on the ground that he is not personally present in Pakistan at the time of presentation of the insolvency petition. The jurisdiction of the court arises not from the petition but from the act of insolvency.

Married women :

A married woman is perfectly entitled in our country to enter into a valid contract and her separate properties are always liable for the debts contracted by her. It naturally follows from this that in Pakistan a married woman may be adjudged insolvent for her debts and on an order of adjudication all her separate properties will vest in the Receiver.

Lunatics :

A lunatic is presumed to be incapable of committing an act of insolvency with the intent to defeat his creditors. But he can be adjudged insolvent on a debt contracted or an act committed prior to lunacy. In England if a person is found to be a lunatic by inquisition and then he commits an act of insolvency, the court in Lunacy grants leave to the committee in the name of the lunatic to consent to an order of adjudication against the lunatic or to present an insolvency petition, if it is for the benefit of the lunatic to do so. This principle of English law also applies to Pakistan.

Partners and Partnership :

Under the Provincial Insolvency Act no adjudication can be made against a partnership firm in the firm name ; it can be made against the partners individually. Under Section 99 of the Presidency Towns Insolvency Act, however, an adjudication order can be made against a firm in the firm name and such an order has the effect of adjudging each individual partner insolvent.

An insolvency petition may be presented by any creditor against any partner of a firm separately without including the others. A petition against two or more of the partners may be presented provided both or all have committed an act or acts of insolvency.

Joint Debtors :

Where two or more persons have contracted a debt jointly and the said debt is not satisfied by either or both of them a single insolvency petition against the joint debtors may be presented by the creditors provided they have each committed some act of

insolvency. The act of insolvency may be a joint act if it is shown to be the act of all.

Joint Hindu Family :

"A joint Hindu family cannot be adjudged insolvent as such. But the members of a joint Hindu family may be adjudged insolvent on a single petition by a creditor provided they are personally liable on a joint debt and have committed a joint act of insolvency, e. g., by jointly transferring family property in favour of a creditor by way of fraudulent preference.

"Where, however, the business of a joint Hindu family is carrie on by the manager of the family and debts are contracted by him, in the course of business, the shares of the other members in the family business only are liable for such debts and they are not personally liable for the same. Therefore, they can never be adjudged insolvent on such debts. It should also be noted that in no case can a minor be adjudged insolvent".

Companies :

A joint-stock company registered under the Companies Act cannot be adjudged insolvent but it may be wound up at the instance of the creditors under the provisions of the Companies Act, 1913.

4. **Acts of Insolvency :**

It has already been observed that a person can be adjudged an insolvent only if he is a debtor and has committed an act of insolvency. Under Section 6 of P. I. Act, a debtor is said to commit an act of insolvency in any of the following cases:—

(*a*) If, in Pakistan or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally.

(*b*) If, in Pakistan or elsewhere he transfers his property or any part thereof with intent to defeat or delay his creditors.

A fraudulent intention to delay or defeat creditors is generally inferred from surrounding circumstances and need not be specially proved. (*Yaramati* V. *Chandra Papayya*, 20 *Mad.* 326).

Where, therefore, a transfer is made by way of gift without consideration, such a gift will, by itself, be construed as done with

fraudulent intention. But where a transfer of property by a debtor is made for value and consideration, a creditor, who alleges tha the transfer was made to delay and defeat creditors, must prove that it was done with such intention. To that end, the financial position of the debtor at the time of the transfer and all other surrounding circumstances shall be required to be considered by the court.

(*c*) If, in Pakistan or elsewhere, he makes a transfer of any property or any part thereof which would be void as a *fraudulent preference* if he were adjudged as insolvent.

A debtor is said to transfer property by way of fraudulent preference if he makes a transfer of property exclusively to one creditor in order to pay such creditor in preference to all other creditors.

(*d*) If, with intent to defeat or delay his creditors,—

(*i*) he departs or remains out of Pakistan,

(*ii*) he departs from his dwelling-house or usual place of business or otherwise absents himself,

(*iii*) he secludes himself so as to deprive his creditors of the means of communicating with him.

(*e*) If any of his property has been sold or attached for a period of not less than 21 days in execution of the decree of any court for the payment of money.

(*f*) If he petitions to the court to be adjudged an insolvent whether the petition is rejected or granted.

(*g*) If he gives notice to any of his creditors that he has suspended or that he is about to suspend payment of his debts. Mere suspension of payment is not enough. The notice of such suspension must be communicated either verbally or in writing to any of the creditors.

(*h*) If he is imprisoned in execution of the decree of any court for the payment of money.

The explanation to Section 6 of the Provincial Insolvency Act lays down that "for the purposes of this section the act of an agent may be the act of the principal".

Insolvency Petition :

If a debtor commits any of the acts of insolvency, as enumerated

above, an insolvency petition may be presented either (i) by a creditor or creditors or (ii) by the debtor himself. (Sèc. 7 of P.I. Act).

*Creditor's petition.*Under Section 9 of the P.I. Act, a creditor can present a petition only if—

(*a*) the debt owing by the debtor to the creditor or, if two or more creditors join in the petition, the aggregate of debts owing to such creditors amounts at least to Rs. 500/00 and,

(*b*) the debt is an ascertained or liquidated sum payable either immediately or at some certain future time, and,

(*c*) the act of insolvency on which the petition is grounded has occurred within three months before the presentation of the petition.

Debtor's petition. Under Sections 10 of the P. I. Act, a debtor is entitled to present an insolvency petition if—

(*a*) he is unable to pay his debts and,

(*b*) his debts amont to five hundred rupees, or,

(*c*) he is under arrest or imprisonment in execution of the decree of any court for the payment of money, or,

(*d*) an order of attachment in execution of such a decree has been made, and is subsisting against his property.

Court. Under Section 11 of the P. I. Act, every insolvency petition shall be presented to a Court having jurisdiction under this Act in any local area in which the debtor ordinarily resides or carriees on business or personally works for gain, or if he has been arrested or imprisoned, where he is in custody. Under Sections 3 of the Act, "the court having jurisdiction under this Act' is the District Court or any court specially empowered by the Provincial Govern ment in that behalf.

Order of Adjudication : its effect :

On the presentation of the petition either by the debtor or by creditor, the court entertaining the petition may proceed immediately to pass an order of adjudication. In England, the first step taken is to order appointment of the official Receiver to take charge of the debtor's property, and after this order a general meeting of

creditors is called to consider whether a scheme for composition can be entertained or whether the debtor should be adjudged a bankrupt. But in our country the practice is to pass an order of adjudication on the petition from the very beginning.

The court may reject an insolvency petition if it is not satisfied with the proofs furnished by the creditors as to the acts of insolvency or as to the debt due to the petitioning creditor or 'creditors'. The petition will also be rejected if the debtor appears and satisfies the court that he is able to pay his debts. If, however, the debtor does not appear after the petition is served on him, the orders of adjudication will be made as a matter of course.

If the court does not dismiss the petition it shall make an order of adjudication and shall specify in such order the period within which the debtor shall apply for his discharge—a period which the court can extend if sufficient cause is shown therefor.

Effect of an order of adjudication. Under Sec 28 of the P. I. Act an order of adjudication has the following effects :—

(*i*) The whole of the property of the insolvent vests in the court or in a Receiver who may be appointed by the Court at the time of the order of adjudication or at any time thereafter and becomes divisible among his creditors.

(*ii*) All creditors whose debts may be proved to the receiver are debarred from instituting any suit against the insolvent without the leave of the Insolvency Court during the pendency of the insolvency proceeding, i.e., during the period the debtor remains an insolvent. If any suit is instituted without obtaining such leave, the court in which the suit is instituted may, on proof that an order of adjudication has been made against the debtor, either stay it or allow it to continue on such terms as the court thinks fit. But the court must not allow any such suit to continue unless there are special circumstances, e. g., that the suit was ripe enough for hearing at the time of insolvency, or that the suit, if stayed, would be barred by limitation or that the evidence whereby the debt is to be proved will be lost if the suit is stayed. Thus the above provision does not, however, bar the right of a secured creditor, i.e., a creditor whose debt is secured by mortgage, pledge or hypothecation, to institute a suit.

(*iii*) All the property which is acquired by or devolves on the insolvent after the date of an order of adjudication and before his discharge forthwith vests in the court or receiver.

(*iv*) The insolvent is deprived of all powers to enter into transactions which will bind his creditors in respect of his property. After adjudication the Receiver alone is entitled to deal with the insolvent's property and he alone can give a title to a purchaser. If a person pays a sum of money which he owed to the insolvent after the order of adjudication, he will have to pay it again to the Receiver. If, after adjudication, a person buys property from the insolvent, he acquires no title to it.

(*v*) During the period of insolvency, an insolvent suffers under certain disabilities, e. g., he cannot hold certain offices like that of a magistrate or a member of a local authority.

(*vi*) Unless made for valuable consideration or made before or in consideration of marriage, any transfer of property made by the insolvent within two years before the order of adjudication will not bind the Receiver and may be annulled by the court at the instance of the Receiver.

(*vii*) Any transfer of property made by the insolvent within three months before the order of adjudication, with the intent of benefiting one creditor at the expense of other creditors will be void as fraudulent preference.

Proceedings consequent on order of adjudication :

Under the Provincial Insolvency Act, the following are the usual proceedings after an adjudication order has been made against a debtor:—

1 *Schedule of creditors.* All persnos alleging themselves to be creditors of the insolvent in respect of debts provable under this Act shall tender proof of their respective debts by producing evidence of the amount and particulars thereof, and the court shall by order determine the persons who have proved themselves to be creditors of the insolvent in respect of such debts, and the amount of debts respectively and shall frame a schedule of such persons and debts. (Sec. 33).

2. *Protection order.* Any insolvent in respect of whom an

order of adjudication has been made may apply to the court for protection, and the court may, on such application, make an order for the protection of the insolvent from arrest and detention (Sec. 31)

3. *Arrest after adjudication.* At any time after an order of adjudication has been made, the court may, if it has reason to believe on the application of any creditor or the receiver that the debtor has absconded or departed from the local limits of its jurisdiction with intent to avoid any obligation which has been, or might be imposed on him by or under this Act, order a warrant to issue for his arrest, and on his appearing or being brought before it, may, if satisfied that he was absconding or had departed with such intent, order his release on such terms as to security as may be reasonable or necessary, or if such security is not furnished, direct that he shall be detained in the civil prison to a period which may extend to three months. (Sec 32).

4. *Power to require presence of or information from persons.* If specially empowered by an order of the Provincial Government the court or any officer of the court so empowered by a like order, may, on the application of the receiver or any creditor who has proved his debt, at any time after an order of adjucidation has been made, summon before it any person known or suspected to have in his possession any property belonging to the insolvent or supposed to be indebted to the insolvent or any person whom the court or such officer, as the case may be, may deem capable of giving information respecting the insolvent or his dealings or property, and the court or such officer may require any such person to produce any documents in his custody or power relating to the insolvent or to his dealings or property.

If any person so summoned, after having been tendered a reasonable sum, refuses to come before the court or such officer at the time appointed, or refuses to produce any such document without any lawful excuse, the court or such officer may, by warrant, cause him to be apprehended or brought up for examination.

During examination, any such person may be represented by a legal practitioner (Sec. 59A).

Proof of debts : Debts probable in insolvency :

When a person has become insolvent by any order of adjudication having been made against him, the creditors acquire a right to share equally and proportionately in the distribution of his assets already vested in the Receiver. The debts and claims in respect of which the creditors thus become entitled to share in the distribution of the assets are called '*debts provable in insolvency*' and the method by which debts and liabilities are established is called '*proof of debts*'. A creditor who fails to prove a debt or liability which is provable in insolvency, cannot, after the discharge of the insolvent, sue him for it.

Debts provable in insolvency. With certain exceptions the debts provable in insolvency include all debts and liabilities, present and future, certain and contingent, to which the debtor is subject at the date of the order appointing the receiver or to which he may become subject before his discharge by reason of any obligation incurred before the date of the adjudication. *The following debts and claims are, however, excepted:—*

(*i*) Demands in the nature of unliquidated damages arising otherwise than by reason of a contract or breach of trust. These are claims which a person may make on another for tort such as defamation, detention, malicious prosecution and so on. If, however, any decree of the court has been obtained in respect of such demands so that they have become crystallised into liquidated damages, such damages may be proved in insolvency.

(*ii*) Debts or liabilities contracted by the debtor with any person, who has had notice of the presentation of any insolvency petition by or against the debtor, cannot be proved in insolvency

(*iii*) Contingent debts and liabilities which, in the opinion of the Court, are incapable of being fairly estimated, e. g., alimony to be paid periodically, but which may not last and may be varied.

(*iv*) The untaxed costs are not provable.

(*v*) Debts which are against public policy are not provable. Debts due for stifling procesution or for assisting in the procurement of a official favour come under this category.

(*vi*) A debt barred by limitation is not provable.

(*vii*) The amount of deferred dower is not provable.

Mode of Proof :

Under Section 49 of the P.I. Act, a debt may be proved by delivering, or sending by post in a registered letter to the Court an affidavit verifying the debt.

The affidavit shall contain or refer to a statement of account showing the particulars of the debt and shall specify the voucher, if any, by which the same can be sustained. The court may at any time call for the production of the vouchers.

Proof by Secured Creditors :

A secured creditor usually stands outside the insolvency proceedings. He can take recourse to the ordinary law to realize his security. If he is a mortgagee and empowered by the mortgage deed to sell the mortgaged property without the intervention of the court, he may have the property sold even if the mortgagor becomes insolvent, and appropriate the proceeds of his sale in the satisfaction of his dues. The surplus of the sale proceeds, if any, is transferred to the Receiver. If, however, he has no power to sell the mortgaged property, he can bring a suit for its sale and have the same sold by a decree of the court.

Secured creditors may, however, come into insolvecy proceedings and that is usually the course taken by such a creditor where the security proves insufficient for his debts. If a secured creditor elects to come under the insolvency, the has the following three courses open to him, *viz* ;

(*i*) He may realize the security and then prove for the balance.

(*ii*) He may surrender his security and prove for the whole debt.

(*iii*) He may state in his proof the value at which he assesses his seeurity and prove for the balance after deducting the assessed value.

Fraudulent Preference :

In *Thompson* V. *Freeman* (1786), the doctrine of fraudulent preference was thus enunciated by Lord Mansfield : "A bankrupt,

when in contemplation of his bankruptcy, cannot by his voluntary act favour any one creditor". Where a creditor did so, the courts, on the authority of this pronouncement, regarded it as a fraud and the transaction was called **'Fraudulent Preference'.**

In 1870, the law was stated thus and more lucidly in *Marks* V. *Fieldman :* "If a man at a time when he contemplates bankruptcy delivers goods or money into the hands of a creditor whom he intends to benefit, the transaction is perfectly valid between the parties ; but if bankruptcy supervenes and there is an adjudication against the transferor or donor, it is a fraudulent preference and invalid as against the assignees".

Section 54 of the Provincial Insolvency Act has thus stated the law regarding **fraudulent preference :**

"Every transfer of property, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own money in favour of any creditor, with a view to giving that creditor a preference over the other creditors, shall, if such person is adjudged insolvent on a petition presented within three months after the date thereof, be deemed fraudulent and void as against the receiver and shall be annulled by the court."

An analysis of the above statement of law shows that five conditions must be fulfilled for the purpose of a transfer by a debtor to come within the compass of fraudulent preference. These are :

(*i*) The debtor must at the date of transfer or payment be unable to pay from his own money his debts as they become due.

(*ii*) The transfer or payment must be in favour of a creditor.

(*iii*) The transfer or payment must, in fact, prefer no creditor over others.

(*iv*) The transfer or payment must have been made with a view to giving such creditor a preference over other creditors.

(*v*) The debtor must be adjudged insolvent on a petition presented within three months after the date of the impunged trsanfer or payment.

All the five conditions laid down above must be satisfied at one and the same time. If any of them is wanting, the transaction will not be invalid as a fraudulent preference.

Divisible properties of the Insolvent :

As soon as a debtor is adjudged an insolvent, all his properties vest in the Receiver for the benefit of his creditors, who are entitled in law to share such properties proportionately. The question that now arises is : "What properties of the insolvent are divisible among the creditors and what are not" ?

Under Section 28 of the P. I. Act, the following are held divisible among the creditors of the insolvent :—

(*i*) All goods, being at the date of the presentation of the insolvency petition on which the order of adjudication is made, in the possession, order or disposition of the insolvent in his trade or business, by the consent and permission of the true owner under circumstances that he is the reputed owner thereof.

(*ii*) All properties which are acquired by or devolve on the insolvent after the date of the order of adjudication and before his discharge.

The Provincial Insolvency Act further provides that the divisible property of the insolvent shall not include any property which is exempted by the Code of Civil Procedure or any other enactment for the time being in force from liability to attachment and sale in execution of a decree. It should be noted that Section 60 of the Code of Civil procedure exempts from attachment and sale, (1) the debtor's tools of trade (2) his necessary wearing apparel : (3) bedding, cooking vessels and furniture of himself, his wife and children, to a value, inclusive of tools and apparel and other necessaries as aforesaid, not exceeding Rs. 300/00 in the whole.

True owner and reputed owner :

In the case of movable property, if goods are sold by a person on whom an order of adjudication is subsequently made before the buyer has taken delivery of them, such goods will generally vest in the Receiver and will be divisible for the benefit of the insolvent's creditors. In such a case the inolvent is deemed to be the reputed owner of the goods and the buyer, the true owner.

The following conditions, must, however, be satisfied to enable the Receiver to claim a property of the insolvent under the Reputed ownership clause :

(*a*) The property claimed must not be immovable property but goods.

(*b*) The goods must be in the possession, order or dispposittion of the insolvent in his trade or business at the commencement of insolvency. Goods not used for the insolvent's trade or business do not pass to the receiver. Thus, household furniture belonging to others but lying at the private residence of a trader who becomes insolvent do not pass to the Receiver.

(*c*) The goods must be in possession of the insolvent under such circumstances that he is a reputed owner thereof.

(*d*) The true owner must consent to the possession of goods by the insolvent and to the possession thereof in the insolvent's trade or business under such circumstances that the insolvent is the reputed owner of the goods.

Distribution of the insolvent's property :

Under Secion. 61 of the P. I. Act, the distribution of the property of the insolvent shall be made in the following order:—

1. There shall be paid in priority to all other debts:—

(*a*) all debts due to the Government or to any local authority ; and

(*b*) all salary or wages, not exceeding Rs. 20/00 in all for any clerk, servant or labourer, in respect of services rendered to the insolvent during 4 months before the date of presentation of the petition.

The above-mentioned debts shall rank equally between themselves and shall be paid in full, unless the property of the insolvent is insufficient to meet them, in which case they shall abate in equal proportions between themselves.

Subject to the retention of such sums as may be necessary for the expenses of administration or otherwise, the preferential debts specified above shall be discharged forthwith in so far as the property of the insolvent is sufficient to meet them.

In the case of partners, the partnership property shall be applicable in the first instance in payment of the partnership debts, and the separate propperty of each partner shall be applicable in the first instance in payment of his separate debts. Where there is a surplus

of the separate property of the partners, it shall be dealt with as part of the partnership property ; and shall be dealt with as part of the respective separate property in proportion to the rights and interests of each partner in the partnership property.

After the preferential debts mentioned above are satisfied in full, all debts which are entered in the schedule are to be paid rateably according to their respective amounts and they shall rank equally. If the debts are paid in full the surplus assets, if any, are to be applied in payment of interest on the debts at 6% per annum from the date of the order of adjudication.

Relation Back :

Under the P. I. Act, the insolvency begins from the date of presentation of the insolvency petition and not from the date on which the order of adjudication is made. This commencement of insolvency from an earlier period is known as 'relation back'

Protected transactions :

Protected transactions mean those transactions by an insolvent with a third party which cannot be impeached by the Receiver. Under this category come the following two types of transactions :

1. Transactions before the commencement of the insolvency except those that are without consideration or are by way of fraudulent preference.

2. Transactions between the commencement of the insolvency and the date of the order of adjudication if they are bona fide and if the person who deals with the insolvent has no notice at that time of any insolvency petition by or against the debtor.

As regards transactions after the order of adjudication, they are not protected in any case and the question of any notice of the presentation of insolvency petition does not arise.

RECEIVER

1. Appointment :

Under Section 56 of the P. I. Act, the court may at the time of the order of adjudication or at any time afterwards, appoint a receiver for the property of the insolvent, and such property shall thereupon vest in such receiver.

The Provincial Government may appoint such persons as it thinks fit as "Official Receivers" to act as receivers under the Provincial Insolvency Act within such local limits as it may prescribe. Where any official Receiver has been so appointed for the local limits of the jurisdiction of any court, he shall be the receiver for the purpose of every order appointing a receiver or an interim receiver issued by any such court, unless the court for special reasons otherwise directs.

Under Section 58 of the Act, where no receiver is appointed the Court shall have all the rights of, and may exercise all the powers conferred on, a receiver under the Act.

Powers and Duties of Receiver :

Powers. The following powers may be exercised by the Receiver without the leave of the court :—

(*i*) He may sell any or all the property of the insolvent by public auction or by private treaty.

(*ii*) He may give receipts for any money received by him.

The following powers may be exercised by the Receiver with the leave of the court :—

(*i*) He may carry on the business of the insolvent so far as may be necessary for the beneficial winding up of the same and for no other purpose.

(*ii*) He may institute, defend or continue any suit or legal proceedings relating to the property of the insolvent, and for that purpose employ a pleader or other agent.

(*iii*) He may accept as the consideration for the sale of any property of the insolvent a sum of money payable at a future time subject to such stipulations as to security and otherwise as the court thinks fit.

(*iv*) He may mortgage or pledge any part of the property of the insolvent for the purpose of raising money for the payment of his debts.

(*v*) He may refer any dispute to arbitration, and compromise all debts, claims and liabilities, on such terms as may be agreed upon.

(v*i*) He may divide in its existing form amongst the creditors, according to its estimated value, any property which, form its peculiar nature or other special circumstances, cannot readily or advantageously be sold.

Where the official Receiver is appointed the receiver in insolvency, the High Court with the sanction of the Government may, from time to time, direct that subject to the supervision of the High Court, the Receiver will have the following powers:—

(*a*) to frame schedules and to admit or reject proofs of debts,

(*b*) to make interim orders where necessary, and,

(*c*) to hear and determine any unopposed or *exparte* application.

Duties. (*i*) The receiver must furnish security required of him.

(*ii*) He must take all necessary steps for the discovery of the insolvent's property, to realize the property and to distribute it amongst the creditors.

(*iii*) He may also make a report on the conduct of the insolvent.

Composition :

A composition is an agreement between the compounding debtor and all or some of the creditors by which the compounding creditors agree with the debtor and (expressly or impliedly) with each to accept from the debtor payment of less than the amounts due to them in full satisfaction of their claims.

Under Section 38 of the P. I. Act, where a debtor, after the making of an order of adjudication, submits a proposal for a composition in satisfaction of his debts, or a proposal for a scheme of arrangement of his affairs, the Court shall fix a date for the consideration of the proposal, and shall issue a notice thereof to all creditors.

If, on the consideration of the said proposal, a majority in

number and three-fourths in value of all the creditors whose debts are proved and who are present in person or by pleader, resolve to accept the proposal, the same shall be deemed to be duly accepted by the creditors.

At the meeting, the debtor may amend the terms of his proposal if, in the opinion of the court, the amendment is calculated to benefit the general body of creditors.

Where the court is of opinion, after hearing the report of the receiver, if a receiver has been appointed, and after considering any objections which may be made by or on behalf of any creditor, that the terms of the proposal are not reasonable or not calculated to benefit the general body of creditors, the Court shall refuse to approve the proposal.

No composition or scheme shall be approved by the court which does not provide for the payment in priority to other debts of all debts directed to be so paid in the distribution of the property of an insolvent.

If the court approves the proposal the terms shall be embodied in an order of the Court, and the court shall frame a schedule in accordance with the provisions of Section 33, the order of adjudication shall be annulled and the provisions of Section 37 shall apply, and the composition or scheme shall be binding on all the creditors entered in the said schedule so far as it relates to any debts entered therein.

If default is made in the payment of any instalment due in pursuance of the composition or scheme, or if it appears to the court that the composition or scheme cannot proceed without injustice or undue delay, or that the approval of the court was obtained by fraud, the court may, if it thinks fit, readjudge the debtor insolvent and annul the composition or scheme but without prejudice to the validity of any transfer or payment duly made or of anything duly done under or in pursuance of the composition or scheme.

When a debtor is readjudged insolvent, all debts provable in other respects which have been contracted before the date of such re-adjudication shall be provable in the insolvency.

Discharge of the Insolvent :

Under Section 41 of the P.I. Act, a debtor may, at any time after the order of adjudication and shall, within the period specified by the court, apply to the court for an order of discharge, and upon such application the court shall fix a day for the hearing of the application. On the day of hearing, the application is heard in public. The court hears the report of the Receiver about the conduct and affairs of the insolvent. The court may also hear the debtor and the creditors. After hearing all the facts, the court may:—

(*a*) grant or refuse an absolute order of discharge ; or,

(*b*) suspend the operation of the order for a specified time ; or,

(*c*) grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the insolvent or with respect to his after-acquired property.

Refusal of discharge. The court shall refuse to grant an absolute order of discharge on proof of any of the following facts, namely:—

(*a*) that the insolvent's assets are not of a value equal to eight annas in the rupee on the amount of his unsecured liabilities unless he satisfiecs the court that the fact that the assets are not of a value equal to eight annas in the rupee on the amount of his unsecured liabilities has arisen from circumstances for which he cannot justly be held responsible ;

(*b*) that the insolvent has omitted to keep such books of account as are usual and proper in the business carried on by him and as sufficiently disclose his business transactions and financial position within the three years immediately preceding his insolvency ;

(*c*) that the insolvent has continued to trade after knowing ; himself to be insolvent ;

(*d*) that the insolvent has contracted any debt provable under this Act without having at the time of contracting it any reasonable or probable ground of expectation that he would be able to repay it ;

(*e*) that the insolvent has failed to account satisfactorily for loss of assets or for any deficiency of assets to meet his liabilities ,

(*f*) that the insolvent has brought on, or contributed to his

insolvency by rash and hazardous speculations, or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his business affairs ;

(*g*) that the insolvent has, within three months preceding the date of the presentation of the petition, when unable to pay his debts as they become due, given an undue preference to any of his creditors.

(*h*) that the insolvent has, on any previous occasion, been adjudged an insolvent or made a composition or arrangement with his creditors ;

(*i*) that he has removed his property or any part thereof, or has been guilty of any other fraud or fraudulent breach of trust.

For the purpose of refusing discharge, the report of the receiver shall be deemed to be evidence, and the court may presume the correctness of any statement contained therein.

The powers of suspending, and of attaching conditions to, an insolvent's discharge may be exercised concurrently.

Effect of an order of discharge :

Under Section 44 of the P. I. Act, an order of discharge releases the insolvent from all debts payable in insolvency except the following.

(*i*) any debt due to the Government ; or

(*ii*) any debt or liability incurred by means of any fraud or fraudulent breach of trust to which he was a party, or,

(*iii*) any debt or liability in respect of which he has obtained forbearance by any fraud to which he was a party ;

(*iv*) any liability under an order for maintenance made under Section 488 of the Code of Criminal Procedure, i. e., maintenance ordered by a magistrate on a person who neglects to maintain his wife and children in spite of sufficient means.

An order of discharge shall also not release any person who, at the date of the presentation of the petition, was a partner or co-trustee with the insolvent, or was jointly bound or had made any joint contract with him or any person who was surety for him.

ARBITRATION

ARBITRATION

(ARBITRATION ACT, 1940)

What is Arbitration ?

"Reference or submission to arbitration", says Halsbury, "is an agreement made by two or more parties between whom some difference has arisen, or may thereafter arise, whereby they appoint another person or persons to adjudicate upon such difference, and agree to be bound by his decision thereon".

Section ii (a) of the Arbitration Act, 1940, defines an arbitration agreement as "a written agreement to submit present or future difference to arbitration, whether an arbitrator is appointed or not".

The person appointed to adjudicate upon the difference is called an *Arbitrator.* Where two arbitrators are appointed and the submission provides that in the event of their disagreement, the matter in dispute shall be referred to the decision of a third person, such third person is called an *Umpire.*

The decision of the arbitrator or arbitrators is called an *award.*

Modes of submission :

A reference or submission to arbitration may be made in either of the following three ways :—

(*i*) by agreement between the parties without the intervention of the court; or,

(*ii*) through the intervention of the Court invoked by a joint petition of both the parties; or

(*iii*) by the operation of law.

Arbitration without intervention of the Court :

Section 3 of the Arbitration Act, 1940, provides that in every agreement for arbitration or submission the following terms are implied unless otherwise provided by the parties.

(*i*) The submission or reference is to a sole arbitrator unless the parties expressly provide otherwise.

(*ii*) If the reference is made to an even number of arbitrators, the arbitrators shall appoint an umpire not later than one month from the latest date of their respective appointments.

(*iii*) The arbitrators must give their award within four months after entering on the reference or after having been called upon to act by notice in writing from any party to the arbitration agreement or within such extended time as the court may allow.

(*iv*) If the arbitrators have allowed their time to expire without making an award, or have delivered to any party to the arbitration agreement or to the umpire a notice in writing that they cannot agree, the umpire shall forthwith enter on the reference in lieu of the arbitrators.

(*v*) The umpire must make his award within two months of entering on the reference or within such extended time as the court may allow.

(*vi*) The parties to the reference and all persons claiming under them must submit to examination by the arbitrators and produce before them all documents and papers relating to the dispute in question and do all other things which, during the proceedings on the reference, the arbitrators or the umpire may require.

(*vii*) The award shall be final and binding on the parties.

(*viii*) Cost of the reference and the award will be borne by the parties as the arbitrators may, in their discretion, direct.

Who can submit to arbitration :

Generally speaking, any person who can enter into a contract can submit to arbitration as long as he is interested in the subject-matter.

An agent duly authorized may enter into a submissive agreement and bind his principal.

A partner in a trading firm cannot submit to arbitration without the authority of all other partners.

Bankrupts cannot submit disputes in respect to which they are parties to arbitration so as to bind their estates. If they do

so, it will have the effect of binding themselves personally and not their estates or the Receiver.

Infants cannot submit to arbitration so as to be bound by the award. The guardian of a lunatic may consent on behalf of a lunatic to a submission to arbitration.

Attorneys and counsels can refer the case of their clients to arbitration with the consent of their clients, but not against their expressed consent.

Appointment of arbitrators :

An arbitrator or arbitrators are appointed in either of the following **two** ways :—

1. The parties to an arbitration agreement generally provides that the arbitrator or arbitrators will be appointed by consent of the parties. In such a case the parties appoint the arbitrator or arbitrators. But if, after differences have arisen, the parties do not agree to the appointment or appointments, or if any appointed arbitrator or umpire neglects or refuses to act, or is incapable of acting or dies, and the parties do not fill in the vacancy, or if the parties or the arbitrators are required to appoint an umpire and do not appoint him, any party may serve the other parties with a written notice to concur in the appointment or appointments or in filling up the vacancy.

If the other party does not so concur within fifteen clear days after the service of the said notice, the court may on the application of the party who gave the notice and after hearing the other parties appoint an arbitrator or arbitrators or an umpire as the case may be, who shall have power to act in the reference and to make an award (Sec. 8).

2. The parties to a submission may stipulate that the arbitrator or arbitrators will be appointed by a third person designated in the agreement, either by name, e. g., Sir G.M. Adamjee or as the holder for the time being of any office or appointment, e. g., the President of Chittagong Chamber of Commerce. (Sec.4).

Removal of arbitrators :

Section 11 of the Arbitration Act, 1940, lays down that arbitrators

cannot be removed except with the permission of the court save where the parties to the reference had reserved the right of revoking the authority of the arbitrators. On the application of any party to a reference, the court may remove an arbitrator or an umpire who fails to use all reasonable dispatch in entering on and proceeding with the reference and making an award or who has misconducted himself or the proceedings.

Under Section 12 of the Act, where the authority of an arbitrator or arbitrators or an umpire is revoked by leave of the court, or where the court removes an umpire or a sole arbitrator or all the arbitrators, the court may, on the application of any party to the arbitration agreement, either—

(*a*) appoint a person to act as sole arbitrator in the place of the person or persons so displaced; or,

(*b*) order that the arbitration agreement shall cease to have effect with respect to the difference referred.

Powers and duties of arbitrators and umpires :

The powers and duties of the arbitrators or umpires depend mainly on the terms of the submission under which they are appointed. Subject to such terms, the arbitrators and umpires, as laid down in Section 13 of the Act, have power to :—

(*a*) administer oath to the parties and witnesses appearing;

(*b*) state a special case for the opinion of the court on any question of law arising in course of the arbitration proceeding to the court for the latter's opinion thereon;

(*c*) administer to any party to the arbitration such questions as may, in the opinion of the arbitrators or the umpire, be necessary;

(*d*) make an award, which may be made conditional or in the alternative;

(*e*) correct in an award any clerical error arising from any accidental slip or omission.

Duties. The first and foremost duty of an arbitrator is to act with impartiality. He should have no personal interest in the matter in dispute. But if he happens to be an interested party of which the parties had notice at the time of appointment, the submission would be good. He should also see that he accepts no hospitality from any of the parties to the reference. If it is

proved to the satisfaction of the court that the effect of his accepting hospitality was to bias his mind in favour of the parties offering such hospitality, the court will interfere to set aside the award.

It is also the duty of an arbitrator to consult the convenience of the parties as far as possible. To that end, if the parties desire to be represented by a legal adviser, the arbitrator must permit them to do so and must also adjourn the proceedings to afford such opportunity to both the parties without distinction.

The arbitrator has also to see that all the proceedings go on in the presence of the parties or their legal representatives, except in cases where he is justified in acting *exparte* after due notice.

The Award :

The award is the written decision of the arbitrator or the umpire. Section 14(2) of the Act lays down as follows:—

1. When the arbitrators or the umpire have made their award, they shall sign it and give notice in writing to the parties of the making and signing thereof and of the amount of fees and charges payable in respect of their arbitration and award.

2. The arbitrators must also file the award or a signed copy of it to the court, at the request of any party to the arbitration or at the instance of the court, together with all the depositions and documents which may have been taken or proved before them, upon the payment of all fees and charges due in respect of the arbitration and award and of the costs and charges of filing the award.

Powers of the Court in respect of the award :

On the award being filed, the court may--

(*i*) modify or correct the award, or

(*ii*) remit the award, or,

(*iii*) set aside the award, or,

(*iv*) pronounce judgment in terms of the award.

1. *Modification or correction of the award.* Under Section 15 of the Arbitration Act, the court may modify or correct an award under any of the following circumstances :—

(*a*) When it appears that a part of the award is upon a matter not referred to arbitration and such part can be separated from the other part and does not affect the decision on the matter referred. For instance, A and B refer to arbitration a dispute between them regarding the amount of money A owes to B for the latter's construction of a house for A. The arbitrators find in their award the amount of Rs. 5000/- which A owes to B on account of the house. They also find in the award that A owes to B another sum of Rs. 2000/- on a separate transaction. Here the arbitrators give an award part of which is upon a matter not referred to arbitration, namely, A's debt to B on account of the separate transaction. The award can thus be split up —one part coming within the arbitration and the other part falling outside it. In a case like this, the court may modify the award by striking out the part which falls outside the arbitration.

(*b*) Where the award is imperfect in form or contains any obvious error which can be amended without affecting such decision.

(*c*) Where the award contains a clerical mistake or an error arising from an accidental slip or omission.

2. *Remittance of the award.* Under Section 16 of the Act, the court may remit, i. e., send back to the arbitrators or the umpire the award or any matter referred to arbitration for reconsideration upon such terms as it thinks fit. Remittance of the award or any matter referred to arbitration may be made in any of the following circumstances :

(*a*) Where the award has left undetermined any of the matters referred to arbitration, or where it determines any matter not referred to arbitration and such matter cannot be separated without affecting the determination of the matters referred to. For instance, A, B and C are members of a joint family carrying on a business. A demands accounts of past profits on the ground that the business is a partnership but B and C deny that the business is a partnership and also denies A's right to demand accounts of past profits on the plea that it is a joint family business. The dispute

is referred to arbitration for determination (i) whether the business is a partnership or not and (ii) whether A has a right to demand an account for past profits. The arbitrators make an award recognising A's right to demand the accounts but make no finding whether the business is a partnership or not. The right of A to an account being dependent on the business being a partnership, the court may remit the award to the arbitrators to determine the nature of the business.

(*b*) Where the award is so indefinite as to be incapable of execution. When confirmed by the court an award is executed like a decree of the court. It must, therefore, be sufficiently definite so that the court may execute it. For example, A and B, two brothers, refer to arbitration a dispute regarding the division of properties which their father had left. The arbitrators give an award that "all properties left by their father in the city of Dacca belong to A and all others belong to B". Here the award is too vague to be executed. The court may, therefore, remit the award for more definite ascertainment.

(*c*) Where an objection to the legality of the award is apparent upon the face of it. For instance, A pays B money for enticing a girl. An award made by arbitrators directing B to repay the money admitted by A to have been received for the above purpose must be remitted as the award given in favour of A is apparently illegal for he cannot recover money given for an immoral purpose.

Where the award is remitted as above the court must fix the time within which the arbitrators or the umpire must submit his decision to the court. The court may, however, extend this period subsequently. If the arbitrators or the umpire fails to reconsider the award on remittance and submit the decision within the time fixed, the award becomes void.

3. *Setting aside the award.* Under Section 30 of the Arbitration Act, the Court can set aside an award on one or more of the following grounds.

(*a*) That the arbitrator or the umpire has misconducted himself or the proceedings. To prove such misconduct, it must

be shown that the arbitrator or umpire has shown bias or has received bribe from one party or that he has ignored the principles of natural justice, e. g., by holding proceedings without affording opportunity to one party to appear and be heard.

(*b*) That the award has been made after the issue of an order by the Court superseding the arbitration or after arbitration proceedings have become automatically invalid under Section 35 of the Act on account of the whole subject-matter of the reference having been referred to regular legal proceedings in a court of law.

(*c*) That an award has been improperly procured or is otherwise invalid.

4. *Judgment according to award.* Under Section 17 of the Arbitration Act, where no cause has been made out before the court to remit the award or any of the matters referred to arbitration for reconsideration or to set aside the award, the court shall proceed to pronounce judgment according to the award, and upon the judgment so pronounced a decree shall follow, and no appeal shall lie from such decree except on the ground that it is in excess of, or not otherwise in accordance with, the award.

Effect of submission or reference to arbitration :

Submission or reference to arbitration puts a *prima facie* bar to the institution of a suit in a court of law by any party agreeing to the arbitration relating to any of the disputes that have been referred to arbitration.

If a party to a submission or reference institutes any such proceedings against the other party, the latter can apply to the court, before which the proceedings are pendings, to stay the proceedings and the court will grant an order staying such suit or proceeding, provided the following conditions are fulfilled.

1. Before an order can be made for staying the suit, the court must be satisfied that the suit has been instituted in respect of a matter agreed to be referred to arbitration. If, however, the suit relates to matters which are partly within the submission and partly

not covered by the submission, it depends on the discretion of the court to grant a stay order or not.

2. That the applicant was and is still ready and willing to do all things necessary for the proper conduct of the arbitration.

3. That there is no sufficient reason why the matter should not be referred in accordance with the arbitration agreement.

4. That the party instituting the suit was not induced to ente into the arbitration agreement by fraud.

5. That the party asking for the stay order has not filed a written statement by way of defence in the suit, sought to be stayed or taken any other steps in the proceedings.

If the Court is satisfied that the matter should be decided by arbitration, it stays the suit or proceeding. It does not dismiss the suit, for, in case the award is remitted or set aside, the stayed suit can be heard without the necessity of instituting it all over again.

Arbitration through the Court's intervention :

Arbitration through the intervention of the court takes place in **two** cases :

1. where there is no suit pending, or.
2. Where there is a suit-pending.

Where no suit is pending. Where two or more parties have agreed to refer to arbitration their future difference, they or any of them, instead of proceeding with the arbitration forthwith, may apply to the Court that the arbitration agreement be filed in court.

Upon such application being made the court shall direct notice thereof to be given to all parties to the agreement other than the applicants, requiring them to show cause within the time specified in the notice why the agreement should not be filed.

Where no sufficient cause to the contrary is shown, the Court shall direct the agreement to be filed and shall make an order of reference to the arbitrator appointed by the parties, whether in the agreement or otherwise, or where the parties fail to agree upon the appointment of an arbitrator, the court shall appoint and arbitrator to whom the reference shall be made.

During pendency of Suit. Under section 21 of the Act, where

all the parties interested in any suit agree that any matter in difference between them in that sut shall be referred to arbitration, they may at any time before judgment is pronounced apply in writing to the court for an order of reference.

Upon such an application being made, the court will appoint an arbitrator in such manner as may be agreed upon between the parties, and shall refer to him the matter in difference which he is required to determine and shall also specify such time as it thinks reasonable for the making of the award. (Sec.23).

Under Section 24 of the Act, where only some of the parties to a suit apply to have the matters in difference between them referred to arbitration in accordance with, and in the manner provided by Section 21 as above, the court may, if it thinks fit so refer such matters to arbitration, provided that the same can be separated from the rest of the subject-matter of the suit. But the suit shall continue so far as it relates to the parties who have not joined in the said application and to matters not contained in the said reference as if no such application has been made and an award made in pursuance of such a reference shall be binding only on the parties who have joined in the application.

Arbitration by the operation of law :

Certain statutes make it compulsory to refer disputes to arbitration. This type of arbitration is known as *Statutory Arbitration* and the procedure relating to such arbitration is generally laid down by the Acts, which enjoin such arbitration. Where, however, the Act concerned is silent as to the whole or part of the procedure, the relevant provisions of the Arbitration Act, 1940, shall apply.

MORTGAGE

MORTGAGE

Definition. Section 58 of the Transfer of Property Act defines mortgage thus : "A mortgage is a transfer of an interest in specific immovable property for the purpose of securing payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability". Thus, a mortgage may be (i) to secure a debt, or (ii) to secure the performance of an engagement.

The transferor of the interest as above is called the *mortgagor*, the transferee a *mortgagee*; the principal money and interest of which payment is secured for the time being are called the *mortgage-money* and the instrument, if any, by which the transfer is effected is called a *mortgage-deed.*

Classes of Mortgage :

Mortgages are of six kinds :—

(i) Simple mortgage (ii) Mortgage by conditional sale (iii) Usufructuary mortgage (iv) English mortgage, (v) Mortgage by deposit of title deeds, and (vi) Anomalous mortgage.

1. Simple Mortgage :

Where without delivering possession of the mortgaged property the mortgagor binds himself personally to pay the mortgage-money, and agrees, expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee shall have a righ to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money, the transaction is called a simple mortgage (Sec 58-b).

A simple mortgage must thus respond to three conditions: (i) a personal obligation, express or implied, to pay, (ii) the transfer of a right to Cause the property to be sold, and (iii) retention of possession by the mortgagor during the period of mortgage.

2. Mortgage by conditional sale :

Where the mortgagor ostensibly sells the mortgaged property on condition:—

(*i*) that on default of payment of the mortgage-money on a certain date the sale shall become absolute, or

(*ii*) that on such payment being made the sale shall become void, or

(*iii*) that on such payment being made the buyer shall transfer the property to the seller, the transaction is called a mortgage by conditional sale. (Sec. 58-C).

It is, however, expressly provided that "no such transaction shall be deemed to be a mortgage, unless the condition is embodied in the document which effects or purports to effect the sale".

3. Usufructuary mortgage :

Where the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee, and authorizes him to retain such possession until payment of the mortgage-money, and to receive the rents and profits accruing from such property or any part of such rents or profits and to appropriate the same in lieu of interest, or in payment of the mortgage-money, or partly in lieu of interest and partly in lieu of the mortgage money, the transaction is called a usufructuary mortgage. (Sec. 58-D).

The constituent elements of this form of mortgage is, therefore, that : (i) the mortgagor delivers or binds himself to deliver possession (ii) rents and profits are appropriated by the mortgagee in lieu of interest or principal money or both interest and the principal, (iii) there is no time-limit for the subsistence of the mortgage, (iv) the mortgagor has no personal liability and cannot be sued for the debt.

4. English Mortgage :

Where the mortgagor binds himself to repay the mortgage-money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will

retransfer it to the mortgagor upon payment of the mortgage-money as agreed, the transaction is called an English mortgage (Sec. 58-E).

An English mortgage is very similar to mortgage by conditional sale. But there are fundamental differences between the two, such as follows :—

(*a*) In English mortgage the mortgagor binds himself to repay the loan on a certain day. But such an undertaking is not necessary in a mortgage by conditional sale.

(*b*) In English mortgage there is an absolute sale of the property at the outset and the ownership of the mortgage is complete, only to be divested in case the mortgagor pays on the appointed date. But in a mortgage by conditional sale, the sale is complete only on default of the mortgagor to pay on the appointed date, and the ownership of the mortgagee is qualified which may become absolute if the mortgagor defaults.

5. **Mortgage by deposit of title deeds :**

Where a borrower borrows money by depositing title deeds of immovable property by way of security, the transaction is called a mortgage by deposit of title deeds. It is also called an *equitable mortgage*. In such a mortgage the following conditions must be satisfied:--

(*a*) there must be delivery of title deeds to the creditors ;

(*b*) there must be an intention to make the title-deeds security for the loan; and,

(*c*) the mortgage must be created in Karachi or in any other town notified by the Government.

No registration is necessary to create a mortgage by deposit of title deeds even if the fact of the deposit is recorded in writing.

6. **Anomalous mortgage :**

A mortgage is called anomalous when it does not belong to any of the above classes. Such a mortgage often includes combination of different classes of mortgage.

Registration. Under Sections 59 of T. P. Act, where the principal money secured is one hundred rupees or upwards, a mortgage other than a mortgage by deposit of title deeds can be effected only by a registered instrument signed by the mortgagor and attested by at least two witnesses.

Where the principal money secured is less than one hundred rupees, a mortgage may be effected either by a registered instrument signed and attested as aforesaid, or (except in the case of a simple mortgage) by delivery of the property.

Rights of the Mortgagor :

A mortgagor has the following rights in respect of the mortgaged property :

(*i*) At any time after the mortgage debt has become due, a mortgagor can redeem the mortgaged property provided he has paid or offered to pay the mortgagee the full amount of the mortgage debt. On such payment or offer of payment of the mortgage-money, the mortgagor can require the mortgagee (a) to deliver to the mortgagor the mortgage deed and all documents relating to the mortgaged property which are in the power or possession of the mortgagee, (b) where the mortgagee is in possession of the mortgaged property, to deliver possession thereof to the mortgagor, and (c) at the cost of the mortgagor either retransfer the mortgaged property to him or to such third person as he may direct, or to execute and (where the mortgage has been effected by a registered instrument) to have registered an acknowledgement in writing that any right in derogation of his interest transferred to the mortgagee has been extinguished.

This right of the mortgagor to get his property back is known as **the equity of redemption.** This right can never be destroyed even if the mortgagor contracts to give away his right.

(*ii*) Where the mortgagor has deposited to the mortgagee the documents of title relating to the mortgaged property he can inspect and make copies of the deeds at his own expense.

(*iii*) Where the mortgagee effects improvements on the mortgaged property while it is in his possession, the mortgagor is always entitled to the improvements. But the mortgagee can charge the

cost of such improvement on the mortgagor, provided the improvement was necessary for preserving the property and preventing waste.

(*iv*) A mortgagor who has executed two or more mortgages in favour of the same mortgagee shall, in the absence of a contract to the contrary, be entitled to redeem any one such mortgage separately or any two or more of such mortgages together.

(*v*) Where the mortgagee in possession of the mortgaged property makes additions to the property, the mortgagor, on redemption, becomes entitled to such accretion.

(*vi*) Where the mortgaged property is a lease and the mortgagee obtains a renewal of the lease, the mortgagor, upon redemption, shall have the benefit of the new lease unless there is a contract to the contrary.

Rights of the mortgagee :

The mortgagee is entitled to the following rights:—

(*i*) In the absence of any contract to the contrary, a mortgagee can obtain a decree for foreclosure against the mortgagor by which the mortgagor is deprived of his right of redemption and the mortgagee becomes the absolute owner of the property.

A decree for foreclosure is obtainable only in case of mortgage by conditional sale or an anomalous mortgage by the terms of which the mortgagee is entitled to foreclose, where the mortgagor fails or neglects to pay the debt after it has become due.

(*ii*) The mortgagee can sell the mortgaged property if the principal money with interest is not paid by the mortgagor after it has become due and his dues can be realized from the proceeds of the sole. This right of sale cannot, however, be exerciesd in case of usufructuary mortgage and mortgage by conditional sale.

(*iii*) The mortgagee has a right to sue for the mortgage-money but in the following cases and no other, namely—

(*a*) where the mortgagor, as in a simple mortgage, has bound himself personally to pay the money;

(*b*) where the mortgaged property has become insufficient to

pay for the debt without the fault of either the mortgagor, or the mortgagee;

(*c*) where the security, whether property or title deeds, has been partially or totally lost due to mortgagor's fault;

(*d*) where the mortgagee is entitled to possession of the mortgaged property, as in mortgage by conditional sale or English mortgage, and the mortgagor is denying him undisturbed possession.

(*iv*) In the absence of any contract to the contrary, if, after the date of a mortgage, any accession is made to the mortgaged property, the mortgagee shall, for the purpose of his security, be entitled to such accession. For instance, A mortgaged to B a certain field bordering on a river. The field is increased by alluvion. For the purposes of his security B is entitled to the increase.

(*v*) When the mortgaged property is a lease and the mortgagor obtains a renewal of the lease, the mortgagee in the absence of a contract to the contrary, shall, for the purpose of the security, be entitled to the new lease.

(*vi*) A mortgagee, in possession of the property, may spend such money as is necessary—

(*a*) for the preservation of the mortgaged property from destruction, forfeiture or sale;

(*b*) for supporting the mortgagor's title to the property;

(*c*) for making his own title thereto good against the mortgagor, and

(*d*) When the mortgaged property is a renewable leasehold, for the renewal of the lease;

and may, in the absence of a contract to the contrary, add such money to the principal money, at the rate of interest payable on the principal, and where no such rate is fixed, at the rate of nine per cent per annum.

Provided that the expenditure of money by the mortgagee under clauses (a) and (b) shall not be deemed to be necessary unless the mortgagor has been called upon and has failed to take proper and timely steps to preserve the property or to support the title.

(*vii*) A mortgagee has the right to receive proceeds of revenue sale of the mortgaged property and also compensation on the acquisition of the property.

Hypothecation :

Hypothecation means the mortgage of movable property. It does not require delivery of possession. (For details, see **Law of Contract**)

Lien :

In its primary sense, lien means "the right in one man to retain that which is in his possession but belonging to another, until certain demands of the person in possession are satisfied".

Lien is of two kinds, viz., *Possessory* and *equitable.* (For details, see **Law of Contract**)

INSURANCE

INSURANCE

CHAPTER I

INTRODUCTORY

Insurance Law :

There is, in fact, no statute relating to insurance law in Pakistan, with the Insurance Act, 1939 dealing only with the constitution, management, regulation and control of Insurance Companies. This Act does not embody any provision for governing the contract of Insurance which, therefore, is regulated by the English law relating to insurance subject to the provisions of the Contract Act, 1872.

What is Insurance ?

Insurance has been defined as "a co-operative form of distributing a certain risk over a group of persons who are exposed to it". Prof. Morgan has viewed Insurance as "the agreement of a community to consider the good of its individual members as common". "The aim of all insurance", says Porter in his '*Law of Insurance*', "is to make provisions against dangers which beset human life and dealings. Those who seek it endeavour to avert disaster from themselves by shifting possible losses on to the shoulders of others, who are willing, for pecuniary consideration, to take risk thereof, and in case of life assurance, they endeavour to assure to those dependent on them a certain provision in case of their death or to provide a fund out of which their creditors can be satisfied".

Insurance and Assurance :

Historically the term "Assurance" is of a much earlier inception than the term "Insurance". Until the end of the sixteenth century all types of provisions against risk, whether to life or property, were covered by the term assurance. Since the beginning of the 17th century, however, the following distinction is being sought to be made between the terms "Assurance" and "Insurance".

"According to some writers, the term assurance should be applied to those contracts in the case of which the insured amount becomes payable on the happening of an event which is bound to take place. The word insurance, on the other hand, should be used in connection with those contracts in the case of which the insured amount becomes payable on the happening of an event which may or may not take place". According to the above point of view, the term assurance should apply to life insurance while the term insurance should designate marine, fire and other miscellaneous insurances.

It has been held by some other writers that a person insur himself or his property while the insurance company assures him payment of the agreed amount upon the happening of the stipulated contingency or earlier if so stipulated. Yet another group of writers holds that assurance represents the principle, whereas insurance represents the practice.

It may be borne in mind in this connection that the aforesaid hair-splitting distinction between assurance and insurance is neither based on any scientific or logical basis nor such a distinction is profitable in theory or practice. On the other hand, a good deal of practical convenience lies in treating the two terms as synonymous and the trend of modern authority is towards such treatment.

Contract of Insurance :

A contract of insurance in the words of Justice Channel, is "a contract for the payment of a sum of money or for some corresponding benefit such as the rebuilding of a house or the repairing of a damaged ship, for some consideration, usually but not necessarily for periodical payments called premiums, to become due on the happening of an event which must have some amount of uncertainty about it and must be of a character more or less adverse to the interest of the person effecting the insurance."-(*Prudential Insurance Co.* V. *Inland Revenue*, 1904, 2 K.B.65-63).

Governed by the Contract Act, 1872, an Insurance Contract must satisfy the elements of an ordinary contract, as laid down in Section 100 of the Act which reads as follows:

"All agreements are contracts if they are made by the free

consent of the parties, competent to contract, for a lawful consideration and with a lawful object, and which are not hereby expressly declared to be void".

Besides the above, an insurance contract must also possess two other essentials in order to be enforceable in law. These are :—

(*i*) *Insurable interest.* Insurable interest may be defined as a financial or pecuniary interest in the subject-matter of insurance whereby the insured benefits financially by its safety and suffers financially by its loss or damage. Without insurable interest an insurance contract is not legally valid and cannot be enforced in a Court of Law. "By statute it is necessary that at the time of the making of the contract there should be an insurable interest in the assured" (*Prudential Insurance Co.* V. *Inland Revenue*). Without such an interest an insurance would become a wagering contract.

In the case of life insurance the insurable interest need not continue but must exist at the time when the policy is issued. In the case of marine insurance, however, the insurable interest must exist when the loss or damage takes place but it is not a all necessary that it should be present while taking the policy for, the subject-matter of insurance may change hands many a time during the period of insurance and, with the transfer of property, the insurable interest also changes hands. In the case of fire insurance, on the other hand, the insurable interest must be present both when the policy is taken out and when the loss or damage takes place. A fire insurance policy cannot, therefore, be assigned to any third party without the written consent of the insurance company and it is necessary that insurable interest must also exist when the claim under the policy arises, on the happening of the event which has been insured against.

(*ii*) *Disclosure of material facts.* Unlike ordinary contracts a contract of insurance is a contract *uberrimae fidei* requiring absolute good faith on both sides. Hence, each party to it is under an obligation to make a full disclosure of all material facts regarding the subject-matter of the insurance. A material fact is one which is likely to effect the judgment of the other party.

Thus, any concealment made fraudulently or negligently by the insured will entitle the insurer to rescind the contract and deprive the assured of the benefits thereof.

The duty to disclose is only upto the date of the complete contract. Any fact occurring or coming to the knowledge of the assured after the contract is made need not be disclosed.

The insurer has a general dut to put to the insured such queries as will elicit from him all material facts. In the absence of inquiry by the insurer the following circumstances need not be disclosed by the assured:—

(*a*) Any circumstance which diminishes the risk;

(*b*) Any circumstance which is known or presumed to be known to the insurer in the ordinary course of his business.

(*c*) Any circumstance as to which information is waived by the insurer.

(*d*) Any circumstance which is superfluous to disclose by reason of any express or implied warranty.

In certain cases, where the validity of a contract of insurance is conditional upon the truth of the statement made, an untrue statement, even though inadvertent and immaterial, will render the contract void. As Lord Mansfield observed : "Good faith forbids either party, by concealing what he privately knows, to draw the other into a bargain from his ignorance of the fact and his believing the contrary".

Kinds of Insurance Contracts :

Contracts of insurance are of two kinds : (i) *Contracts of indemnity* and (ii) *Life contracts.*

(*i*) *Contracts of indemnity.* A contract by which one party promises to indemnify the loss sustained by the other due to any particular cause is called a contract of indemnity. Within the scope of this definition come all insurance contracts except those where the subject-matter of insurance is human life and also contracts of personal accident insurances. Of those that are indemnity contracts, fire and marine insurance are the most important. Under such insurance contracts, the insurer undertakes, according to the terms of the agreement, to indemnify the insured against

the actual loss suffered by the latter in respect of the insured property through the risk or event insured against. "The contract of insurance contained in a marine or fire policy is a contract of indemnity only, and this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is a fundamental principle of insurance and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than full indemnity, the proposition must certainly be wrong". (*Castillion* V. *Preston*, 1883, 11 Q.B.D. 380-393).

(ii) *Life Contracts.* A life insurance contract does not come under the category of contract of indemnity. Here, the actual loss arising from the loss of human life, being difficult to be ascertained, it is impossible to make good the actual loss resulting from the death of a certain person. In a life contract, the assured gets the stipulated amount against which the particular life is insured. No limit is placed on the amount for which a life insurance policy may be taken and, therefore, under such a policy, the whole insured amount becomes payable in the case of death of the insured or on his or her attainment of a certain age as the case may be.

Contract of Insurance and Wager :

As observed by Justice *Willes in Wilson* V. *Jones* (I. L. R. 2 EX. 141), the chief distinction between a wagering contract and one which is not a wager depends upon whether the person making it has or has not an interest in the subject-matter of the contract. Since in an insurance contract, the insured must have an insurable interest, an insurance policy cannot be regarded as a wagering contract. Besides, an insurance contract contemplates the covering of some risk to life or property but in a wagering contract, which is a sheer betting on some future event, the parties do not contemplate the covering of any risk or indemnifying any loss in respect of any interest or property, for, the parties thereto have

no interset in the subject-matter of the contract apart from that created by the contract itself.

Re-insurance :

When an insurer or under writer wants to lighten the burden of risk shouldered by him, he can have a part of the risk reinsured with another insurer. As Arnold says, a re-insurance is "a contract by which, in consideration of a certain premium, the original insurer throws upon another the risk for which he has made himself responsible to the original assured, to whom, however, he alone remains liable on the original insurance".

The only consequence of a re-insurance contract is that if the original insured recovers the original insured sum from the original insurer, the latter can recover that amount which he has reinsured with the reinsurer. The original insured cannot, however, claim any amount from the reinsurer. For instance, A insures his mill with B for Rs. 1,00,000/00. B reinsures one fourth of the risk with C for Rs. 25,000/00. If the mill is destroyed by fire, A cannot claim any money from C, from whom the reinsured sum can be recovered by B alone.

Double Insurance :

If the same property is insured with more than one insurer, the case is one of double insurance. If an insured effects double insurance without any fraudulent intent, he can recover on all the policies so effected, provided the total value of all the policies does not exceed the actual value of the property insured. If, however, the total value of the policies exceeds the value of the property, the insured can recover only the actual value.

Different kinds of Insurance :

The most common forms of insurance contracts are the following:—

(*i*) Life Insurance,
(*ii*) Marine Insurance,
(*iii*) Fire Insurance,

(*iv*) Accident Insurance,
(*v*) Social Insurance,
(*vi*) other types of Insurance.

In the chapters that follow we shall discuss each of these types separately with rules and regulations governing them.

Before, however, we close this chapter it is necessary to state in brief the different kinds of insurance organizations obtaining in the present day world.

Different kinds of Insurance Organizations :

1. *Insurance Companies.* Incorporated under the companies Act, these organizations have their capital subscribed by the shareholders who are, therefore, the owners of the company and are entitled to the profits of the business. Like other companies, the management of an Insurance company is entrusted to a Board of Directors, elected by the shareholders from among themselves. Policy-holders are its customers, buying what the company sells, namely, the insurance protection, having nothing to do with the matter of profit and loss which are the concern of the shareholders.

The situation as outlined above is the situation as existing in law. Keen competition among various such companies have, however, effected material change in the actual state of things so that policy-holders are now invited by the company to represent themselves on the Board of Directors and also to share in the profits of the business.

2. *Mutual Associations.* When an Insurance Organization is formed by a certain group or number of persons with a view to insuring their own lives and covering the risk thereto by mutual contribution, the organization is known as a Mutual Association. The members of an association are both the insurers and the insured. As such they are entitled to the management of the organization and the whole profits resulting from its business.

3. *Lloyds Associations.* These associations are formed with individual insurers called under-writers. The special characteristic of a policy issued by such an association is that each policy is "underwritten" for a certain aggregate sum by different under-

writers, each holding himself responsible for only a part of the insured amount. For instance, if a Fire Insurance policy is taken for Rs. 100,000/00 and five underwriters underwrite the policy for Rs. 20,000/00 each, in the event of a loss, each underwriter will pay Rs. 20,000/00 to make up the amount of the policy. Each underwriter has to deposit a large amount as security with the association of which he is a member so that in case he fails to meet his liabilities on the policies underwritten by him, the association may pay it from that deposit. The Loyds Association was originally founded in England, chiefly for the purpose of carrying on marine insurance business.

4. *Self insurance.* Instead of purchasing an insurance policy a person, generally a business concern, may put aside a sum periodically in a fund so that if and when the contemplated event takes place, the loss may be made good out of this fund. Self-insurance may be quite feasible in the case of a large concern owning vast assets, for instance, a large shipping company owning a large number of ships, which has to pay a large sum of money as premiums in order to secure the indemnity of its assets.

5. *State Insurance.* When the state itself sells insurance policies, it is known as state insurance. The state generally chooses to conduct only a few types of insurance, most of which are of the nature of social insurance. In Pakistan, the postal Insurance scheme, under which the lives of Government employees are insured, is an instance of state insurance. In a scheme of state insurance, the rates of premium are generally lower than those of ordinary nsurance companies.

CHAPTER II

LIFE INSURANCE

Definition :

Life insurance may be defined as a contract whereby the insurer undertakes to the insured a certain sum of money on the latter's death or on his attaining a certain age in exchange for a cash compensation known as premium which may be paid in a lump sum or periodically. Life insurance is just like any other insurance contract with, however, the distinguishing feature that the subject-matter of insurance in this case being life, it is not an insurance of indemnity as loss resulting from the death of a person cannot be accurately assessed. Besides, the insured may not at all die during the subsistence of the insurance policy on his life.

Essentials of Life Contract :

In addition to the usual elements of a contract required to be present in a contract of life insurance, its validity rests upon two essentials, namely, (i) Disclosure of all the material facts and (ii) the existence of insurable interest of the insured in the subject-matter of the insurance at the time when the policy is issued (for elaborate discussion, see chapter I).

Distinction between life and other contracts of Insurance :

1. In life insurance the event on the happening of which the insured amount becomes payable is bound to take place but the risk insured in case of fire, marine or accident insurance may not happen at all. Thus, the insured must either die or attain the stipulated age during the subsistence of the life policy and must, therefore, get the insured amount unless the policy is allowed to lapse. But the assured under the fire or marine insurance may recover nothing as the contemplated contingency may not happen at all.

2. Fire, marine and accident insurances are contracts of indemnity. According to them, the insurer undertakes to indemnify the insured against a loss or damage of the subject-matter of insurance resulting from the risk or peril that has been covered. But in a life insurance, the question of loss or damage does not arise because the loss inflicted by death cannot be estimated and be compensated. There is, therefore, no question of indemnification.

3. A marine or fire policy is generally for a short period, for instance, one year in the case of fire and one single voyage in the case of marine. But a life policy is generally for a long term and may extend over the whole duration of the life of the assured.

4. In a fire or marine policy, the insurable interest of the assured in the subject-matter of the insurance is measurable in terms of money but no such monetary evaluation is possible in the case of a life assurance.

5. The classification of risks in life insurance is rather simple. Lives are either insurable or uninsurable and of the insurable lives, there are standard lives and sub-standard lives among different age-groups. But the classification of risks in the case of fire and marine insurance is rather complex. From the viewpoint of risk, each property differs materially from the other. It, therefore, becomes necessary to prepare special scheduled tables for each property and the degree of risk in each case is carefully considered on its own merit.

6. In fire and marine insurance, there is the element of protection only but in the case of life insurance, besides the element of protection, there is also the element of investment.

How Insurance Con'ract is made :

Like any other contract, a contract of life insurance is made by the offer of the assured and acceptance of the same by the insurer. The proposal or offer is generally contained in a printed form prepared by the Insurance company. It contains many queries concerning the age, occupation, health and so on of the insured to all of which the assured must answer. When the proposal

form is filled in, the proponent is subjceted to medical examination by a doctor appointed by the company. The medical report, which is a confidential document, and the proposal form duly filled in are then forwarded to the company by the company's agent. In consideration of these two documents the company either accepts or rejects the proposal. The acceptance is generally communicated to the assured by a letter requesting him to remit the first instalment of the premium, unless the payment thereof accompanied the proposal. The contract is concluded as soon as the acceptance of the proposal takes place.

Representation and Warranties :

"The statements and declarations made by the proponent in the proposal form and also before the doctor are known as representations. If any material representation turns out to be untrue the policy is voidable by the insurer. But if the representations are embodied in the policy, as usually they are, by expressly stipulating in the policy or in the conditions indorsed thereon, that the declarations are true and are to be taken as the basis of the contract, the representations become what are known as warranties. If any warranty, whether material or otherwise, turns out to be untrue, the contract is avoided."

Policy :

The policy is the document which contains the contract of insurance with the terms and conditions thereof. It shows such particulars as the names of the parties, the amount and the risk insured, commencement and duration of risk, the amount of premium to be paid and the manner of payment, e. g., whether annually, half yearly or quarterly. The policy also contains a clause showing the period of grace allowed for the payment of premium and also a clause providing for the revival of the policy after it so lapses on payment of all the arrears of the premium with interest.

Different kinds of life policies :

The following are the important kinds of life policies in vogue in Pakistan :—

(*i*) *Participating and non-participating policies.* Participating policies are those which entitle the insured to share in the profits of the company while non-participating policies are those without profits. The former is also called "with-profit policies" and the latter "without-profit policies". Other things remaining the same, the premium charged on a participating policy is higher than that on a non-participating policy.

The part of the profits accruing on a with-profit policy is known as *bonus.*

(*ii*) *Whole life policy.* This policy is one which requires the insured to pay the premiums during the whole of his life. The insured amount, with or without profits, is paid to his or her heirs or successors after the death of the insured. It's premium is also less than that of many other kinds of life policies.

(*iii*) *Endowment policy.* The kind of policy stipulates that the insured amount should be paid to the insured, with or without profits, after a certain number of years or, if he dies earlier, to his heirs and successors. The rate of premium of endowment policy is slightly higher than what it is for a whole-life policy.

(*iv*) *Single life and joint life policies.* A single life policy means one taken on the life of a single person. This is the most common practice in our country. But sometimes a policy on two or more lives is also issued. It is known as a joint life policy. In the case of a joint life policy, the insured amount is payable on the death of either of the insured to the survivor or survivors.

(*v*) *Longest life Insurance on last Survivor.* In this type of policy two or more lives are insured jointly but the sum insured becomes payable only on the death of the last survivor and not on the death of any one of the assured.

(*vi*) *Double Endowment policy .* Under this policy, if the insured survives the stipulated number of years, he gets double the insured amount, but if he dies while the policy is in force, only the insured amount becomes payable.

(*vii*) *Pure Endowment policy.* In the case of a pure endowment policy, the insured amount becomes payable only if the insured attains a certain age. If he happens to die earlier, he gets nothing. The rate of premium in pure endowment policy is lower than in ordinary endowment policy which, in fact, is an adulterated form of the former.

(viii) *Pure Endowment with return policy.* In this policy, premiums paid up-to-date, are returned to the heirs of the insured if the insured dies before the expiry of the term.

(*ix*) *Term Insurace policy.* According to this policy, the insured amount becomes payable if the insured dies within a certain period. In case he survives, he gets nothing. The term of such insurance is generally 1 to 7 years in foreign countries but sometimes found to be longer in our country. The rate of premium is very low for such a policy.

(*x*) *Family Protection Policy.* This policy is taken for a particular term. If death takes place before the agreed term certain annuities are paid to the beneficiary till the expiry of the said term. On its expiry the insured amount is paid. If death does not take place during the term, there is no annuity benefit but the insured amount is paid on the expiry of the term.

Premium :

Premium is the consideration of a contract of insurance. It is, in fact, the selling price of insurance protection. It is paid by the insured to the insurance company in return for the benefits provided by the latter under the terms of an insurance policy.

Premiums are calculated on an annual basis but with a view to making the payment convenient to the insured, they are generally permitted to be paid semi-annually, or quarterly or even monthly. If paid annually, the insured has the benefit of some rebate of the premium. Thus the quarterly premium is not exactly $\frac{1}{4}$ of the annual premium but slightly higher than that.

Factors governing premium rate:

Premium is equal to the cost of insurance plus profit. The cost is calculated on the basis of two important elements, viz

policy claims arising either through death or maturity. of the policy, and the claims arising either through death or maturity of the policy, and the expenses of management and profits. There is also a third factor playing vital role in the calculation of the premium. This is the rate of interest. One of the important sources of earning of the insurer is the interest he derives by investing its capital most of which comes from the premiums paid by the insured. If larger interest can be earned premiums can be correspondingly reduced. On the other hand, if the interest rate is low, the premium rate will increase in the corresponding proportion.

Assignment and Nomination :

The insured may nominate his successor to the policy claim in case he dies before its maturity, either during the proposal or at any time afterwards. Policies may also be assigned by way of gift or for valuable consideration.

Under Section 38(1) of the Insurance Act, 1938, the assignment of a policy can only be made by an endorsement upon the policy itself or by a separate instrument signed in either case by the transferor or assignor or by his duly authorized agent and attested by at least one witness, specifically setting forth the fact of transfer or assignment.

Section 38(2) of the Act lays down that the transfer or assignment is not to be operative as against an insurer until a notice in writing of the transfer or assignment together with either the said endorsement or instrument itself or a copy thereof certified to be correct by both the transferor and the transferee or theri duly authorized agent has been delivered to the insurer.

A valid assignment confers on the assignee all the rights attached to the contract and he can then sue the insurer in his own name.

Commencement of Risk :

Ordinarily, the risk under a policy commences from the date of the receipt of the first premium in full or from the date of the company's acceptance letter whichever is later. If the letter of

acceptance is issued subject to any condition, the risk of the company will commence after the fulfilment of such condition.

Suicide :

Suicide committed by the insured, whether sane or insame, renders the policy void if the suicide is committed within 12 months from the date of the issue of the policy. Some companies keep this period at two years. Suicide committed after that period does not vitiate the claim. When a policy is rendered void on account of suicide, all the premiums paid will be forfeited to the company.

Settlement of claims :

A claim under a policy arises when the insured dies before the termination of the stipulated period of the insurance. Steps are taken to settle claims as soon as the death of the insured is brought to the company's notice and payment on a claim is made immediately after the receipt of proof, to the satisfaction of the company, of the death of the insured and the title of the claimant or claimants.

Proof of death : Proof of death is required as under :

Form I : Application by the claimant.

Form II : Certificate from the doctor who attended the deceased on his last illness.

Form III : Certificate of burial, cremation, etc., to be filled up and signed by any well-known and competent person at the funeral and to be forwarded along with an extract from the Death Register or other public record.

Form IV. Certificate of identity to be filled up by some respectable person who was well-acquainted with the deceased and who has seen the dead body of the deceased.

Proof of title. In all cases where the policy has not been assigned or a nominee has not been appointed by the deceased, proof of the title of the claimant or claimants to the policy money is required. Such proof may be given in the following ways :—

1. Succession certificate, whether or not a will has been left, from the court of the District Judge having jurisdiction where the deceased resided.

2. Such other proof as the company may demand.

Who can claim . Under the Succession Act, all dues payable to a deceased dying intestate can be collected by his administrator alone. Section 212 of the Succession Act, however, relieves a Hindu or a Muslim heir amongst others of the necessity of obtaining letters of administration to establish his claim to any part of the property of an intestate. It seems, therefore, that the heirs of a Hindu or Muslim assured can collect the insurance money falling due on his death without obtaining letters of administration. It also seems that the heirs of the assured can collect the insured amount without obtaining a succession certificate, for, under Section 3 of the Succession Act, a succession certificate is only necessary to collect debts due to the deceased at the time of his death. Debts mean debts ascertained at the death of the deceased. But, as held in *Charusila Dasi V. Jyotish Chandra* (33,Ind. cases 157), the amount insured, payable on the death of the assured, is neither ascertained nor it is a debt due to the deceased at the time of his death.

Surrender value :

Prior to the Insurance Act, 1938, non-payment of any single premium due by the insured would entitle the company to forfeit all previous payments and render the policy void. But with the passing of the Insurance Act, 1938, such forfeiture is no longer possible. Section 113 of the Act provides that if premiums have been paid for three consecutive years, the policy will acquire a guaranteed surrender value. The policy will not, therefore, lapse for non-payment of any further premium and will remain alive to the extent of the paid-up value. The guaranteed surrender value is the paid-up value of the policy.

If a policy is kept alive to the extent of its paid-up value it will not be entitled to any profits after the policy is converted into a paid-up policy.

The aforesaid provisions with respect to surrender value and paid up policy does not apply to :—

(*a*) policies in respect of which the sum assured is payable only on the happening of a contingency which may not happen, e. g., where in a fire insurance no fire takes place, or,

(*b*) where the paid-up value is less than Rs. 100/00 ; or

(*c*) where the parties, after the occurrence of the default in the payment of the premium, agree in writing to some other arrangement; or

(*d*) to policies in which the surrender value is automatically applied under the terms of the contract to maintain the policy in force after it lapses through non-payment of premium.

Some forms of policies, however, do not entitle their holders to any surrender value whatsoever. For instance, in temporary or term insurance, no surrender value is given as the fund value is almost negligible.

Revival of Lapsed policy :

A policy ordinarily lapses if premium is not paid within the days of grace, except where the policy is guarded by an automatic non-forfeiture clause in which case it lapses only if it has not acquired surrender value. Permission is generally given to revive a lapsed policy at any time during the life time of the insured on payment of the outstanding premiums with interest thereon at fixed rate calculated from the dates on which the unpaid premiums were due to be paid. Revival is, however, subject to evidence of good health and eligibility in other respects to the satisfaction of the company.

Generally no medical examination is necessary if the policy is revived within six months or so from the date of lapse, but a declaration by the insured of his continued good health is required to be filed.

The insurance company is, however, at liberty to decline to revive a policy without giving any reasons.

Automatic non-forfeiture clause :

This clause provides that if a policy is two or three years old and has acquired a surrender value, then this surrender value together with any bonus, will be applied automatically towards the payment of premiums when due. The insured even need not advise the company on this and the company will do so of its own accord. When, however, the whole surrender value is thus spent up and the policy is not in the meantime revived by the payment of premiums due, then the policy will lapse, subject to the provisions of lapsed policies clause.

"If the insured dies or the event on the happening of which the policy will become a claim takes place during the period when the policy is thus kept alive by the operation of this caluse, the assured amount becomes payable in full after the deduction of advances made and the interest thereon calculated at a moderate rate of interest".

CHAPTER III

MARINE INSURANCE

Definition :

Section 1 of (the English) Maritime Insurance Act, 1906 defines a contract of marine insurance as "a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed against marine losses, that is to say, losses incidental to marine adventure". Marine insurance is thus a contract of indemnity the insurer undertaking to indemnify the insured against losses resulting from and in connection with a maritime adventure.

The document in which a contract of maritime insurance is generally embodied is called a policy. The insurer is called the underwriter, the thing or property insured, the subject-matter of insurance, the interest which the assured has in the subject-matter, his insurable interest and the payment in consideration of which the insurer undertakes to indemnify the assured is called the premium.

The Subject-Matters of Marine Insurance :

Marine insurance is generally contracted with regard to the following three subject-matters :—

(*i*) *Insurance on cargo.* It means the insurance of goods carried by a ship. A marine insurance of the cargo indemnifies the loss that may result from the loss of or damage to cargo.

(*ii*) *Hull Insurance.* It means the insurance of ships carrying the cargo. A hull insurance covers the various risks to which a ship is exposed.

(*iii*) *Freight Insurance.* A policy may be purchased to protect the freight of the cargo. If the freight has been paid in advance, the cargo owner would sustain loss if the goods are lost or destroyed while on the sea. Hence a wise cargo owner usually obtains insurance for the amount of the freight by adding it to the value of the goods. The ship-owner also often obtains an insurance

policy on the freight where it is payable at the port of destination, for, otherwise he will lose the freight in case the cargo does not reach the destination on account of its being lost on the way.

Requisites of a valid Marine Insurance Policy :

Section 7 of the stamp Act, 1899 , enjoins the following requirements for the validity of a marine insurance :—

(*i*) No contract of sea-insurance (other than such insurance as is referred to in Section 506 of the Merchant Shipping Act, 1894) shall be valid unless the same is expressed in a Sea-policy.

(*ii*) No sea-policy made for time shall be made for any time exceeding twelve months.

(*iii*) No sea-policy shall be valid unless it specifies the particular risk or adventure, or the time, for which it is made, the names of the subscribers or underwriters, and the amount or amounts insured.

It should, however, be noted that in Pakistan marine insurance contracts, by practice, specify the particulars required by English law over and above those required by the Stamp Act. These particulars required by the English law are as follows:—

(*i*) The name of the assured or some person who affects the insurance on his behalf must be specified.

(*ii*) The subject-matter insured and the risk insured against must be specifically stated.

(*iii*) The voyage or period or period of time or both, as the case may be, covered by the insurance must be mentioned.

(*iv*) The sum or sums insured must be specified.

(5) The name or names of the insurers must be specifically stated.

A marine insurance policy must also be stamped both in England and Pakistan.

How the Contract is made :

Like any other contract, a contract of marine insurance is effected by offer and acceptance—the offer of the assured as accepted by the insurers and underwriters. The offer of the insured is

usually communicated through an insurance broker who on receiving instructions from the insured prepares what is commonly known as a "slip" containing rough notes showing the terms of the proposed insurance. He takes it round to different underwriters. Those who are willing to accept it do so by signing the slip for the amounts for which they are willing to become insurers. If the accepting underwriters are Lloyd's underwriters, the broker prepares a policy for them to which they subscribe. But insurance companies prepare their own policies.

The insurance slip forms the contract and once it is accepted both the parties are bound by it. But the insured cannot sue the insurer unless a proper policy is issued fulfilling the requirements of the Stamp Act in Pakistan (*Surajmaull* V. *Triron Insurance Co.*, 29 C.W.N 893 P. C.). The remedy of an injured party after the "slip" has been accepted lies, however, in instituting a suit for the issue a policy and for its specific performance.

Essentials of Marine Insurance Contract :

In addition to the usual elements of a valid contract as required by the Contract Act, a marine insurance contract must also possess two more elements which are necessary for the validity of any insurance contract. These are (i) existence of insurable interest and (ii) maintenance of absolute good faith. Further, sea-worthiness of the vessel, legality of the venture and non-deviation are three special requirements of a valid marine insurance contract. The additional essentials noted here are known as implied warranties.

1. *Insurable interest.* A person is said to have an insurable interest in a particular subject-matter when he stands in such a relationship to it that he will profit by the safety or due arrival of the subject-matter and be prejudiced by its destruction or damage. A contract of insurance is void as being a wagering contract if the insured has no insurable interest in the subject matter of the contract. In a marine insurance, however, the insured must necessarily have insurable interest in the subject-matter when the loss takes place, though he may have no such interest at the time when he takes out the policy.

Speaking specifically, the following persons have insurable in the respective subject-matter noted against them:—

(*i*) a cargo-owner has insurable insterest in the cargo belonging to him.

(*ii*) a ship-owner has such interest in his ship ;

(*iii*) a shipping company which expects to receive freight has insurable interest in the freight thus receivable when the goods arrive at the port of destination ;

(*iv*) an insurer has sufficient insurable interest in the risk underwritten by him to re-insure it ;

(*v*) captain and crew of a ship have insurable interest in respect of their wages and salaries ,

(*vi*) lenders of money on bottomry bonds and respondentia have insurable interest to the extent of their loan ,

(*vii*) where the subject-matter insured is mortgaged, the mortgagor has insurable interest in the full value thereof and the mortgagee has an insurable interest in respect of any sum due or to become due under the mortgage , and,

(*viii*) trustees and bailees have insurable interest in the goods entrusted to their care.

2. **Good Faith.** A marine insurance contract is a contract *uberrimmae fidei,* i. e., one requiring utmost good faith from the parties thereto. Hence each party to a marine insurance contract must observe utmost good faith and disclose to the other party all the material facts. If either party fails to observe such good faith, the policy is voidable at the option of the party not at fault.

3. **Implied Warranties.** A warranty is an undertaking on the part of the insured guaranteeing certain condition of the subject-matter of the insurance or certain conduct of his in connection with the insurance. Certain warranties are always implied in a contract of marine insurance. These need not be definitely expressed. Hence such warranties are called implied warranties.

The insured alone pledges the warranties and must also comply with them. If any warranty is broken, the contract becomes void and the underwriter is automatically freed from his liability from the date of such breach. Though in the case of an ordinary contract,

the breach of warranties gives rise only to a right of damage, it renders a marine insurance entirely void and unenforceable at law.

As noted above, three warranties are considered by practice as implied. These are :—

(*a*) **Seaworthiness.** It means all-round fitness of the ship at the port of start and at all other ports which she touches and stays at, so that she may prove equal to the perils of the sea in the adventure insured against. As the perils of the sea vary according to the nature of the vayage, the standard of sea-fitness to be required of the vessel also varies from voyage to voyage. Seaworthiness does not, however, mean the physical fitness of the vessel but also that she must be properly equipped, manned, supplied and documented.

(*b*) **Legality of the venture.** The adventure insured against must be a lawful one and so far as the insured can control the matter, the voyage shall be conducted in a lawful manner. If the voyage is meant for an unlawful purpose such as for smuggling, the underwriter is not bound by the contract of the insurance into which he has entered. But if the adventure is legal but the master and the crew indulge in smuggling without the knowledge of the ship-owner, the insurance is not void. It is a case of barratry and is usually covered by the terms of a marine insurance policy.

(*c*) **Non-deviation.** It requires that the ship will follow the scheduled course and will not deviate from the course contemplated by the policy.

In certain cases deviation is excused by law. But if not excused deviation renders the underwriter free from his liability under the policy from the time when the deviation takes place. In modern times, deviation is usually excluded from the list of implied warranties.

Express warranties :

Express warranties are those that are clearly expressed in order to make them effective. The most common of them are with regard to the following:—

(*a*) *Time of sailing.* A warranty as to the time of sailing must state that the ship will sail or has sailed on a particular day.

(*b*) The safety of the ship for a given period of time.

(*c*) *Limits of the vessel's navigation.* Generally in time policies, warranties prohibiting the ship from entering into some danger zones either at any time or at certain times, are inserted in order to minimize the risks of the insurer. If loss occurs on account of the entry of the ship into the prohibited zone within the prohibited time, the insurer is not liable for such loss.

(*d*) *To depart with convoy.* This warranty is usually inserted in times of war with a view to protecting the insurer from the hazards of enemy action.

(*e*) *The neutrality of the property.* This warranty is also inserted in times of war. As enemy property is likely to be seized during war, neutrality of the property is made a condition of the insurance in order to protect the insurer from total loss.

LLoyd's Policy :

The ordinary form of a policy of marine insurance which is generally used in England and Pakistan is what is known in the insurance world as "LLoyd's Policy". The principal parts of this policy are :—

(*i*) the name of the insured or his agent,
(*ii*) the name of the ship,
(*iii*) the subject-matter of insurance,
(*iv*) the voyage insured,
(*v*) the perils insured against,
(*vi*) the date and subscription,
(*vii*) the valuation,
(*viii*) the sue and labour clause.
(*ix*) the common memorandum,
(*x*) the running down or collision clause,
(*xi*) the stamp.
(*xii*) warranties.

Some of the above clauses require some amount of explanation.

1. **Name of the ship.** It is necessary that the name of the ship in which the insured goods are carried must generally be specified so that the goods the loss or damage of which the insurers undertake to indemnify may easily be identified.

Where the assured does not know on what ship or ships the insured goods have been or may be loaded, he may take an insurance of the goods without specifying the ship or ships. When such is the case, the policy is known as **a floating policy.** Section 29 of the Marine Insurance Act, 1906, has defined a floating policy as "a policy which describes the insurance in general terms and leaves the name of the ship or ships and other particulars to be defined by subsequent declaration".

2. **The Voyage : Commencement and Termination of Risk.** In connection with the voyage, two terms "At and From the Port and "From the Port" must be distinguished. "A policy insuring a subject-matter at and from the port covers it while it is lying at the port of departure and from the time it sets off therefrom. A policy covering risk 'from the port', on the other hand, protects the subject-matter only from the time of its departure from the port of start".

So far as the ship or vessel is concerned, the commencement of the risk is determined by the "At and From" the clause discussed above. The policy continues to cover the vessel "until she hath moved at anchor for 24 hours in good safety" in the port of destination. From this it follows that if a ship is destroyed or damaged before the expiry of the 24 hours after its arrival at the port of destination, the loss resulting therefrom will be covered by the marine insurance policy taken in respect of the marine insurance policy then completed. In some voyage policies (as distinguished from time policy discussed later), the period of coverage extends to 30 days after her safe arrival at the port of destination and, in the absence of a stipulation to the contrary, this period of 30 days is counted after the expiry of the above-mentioned 24 hours.

In the case of goods and freight, the risk commences from the moment goods are placed on board the vessel unless there is a stipulation to the contrary. Such a risk terminates after the goods and merchandises are "discharged and safely landed".

3. **Perils of the Seas.** This term does not cover every casualty which may happen to the subject-matter of insurance on the sea.

As observed by Lord Herschell in Kantho (1887), it includes those perils which happen to the vessel or the goods carried by it otherwise than in the usual course of things. Thus, if the subject-matter of insurance be the ship, no loss due to ordinary wear and tear or any injury to machinery or engine due to mishandling shall be covered by the term. Likewise, if the subject-matter be the goods, it will not cover any damage arising solely from corruption of the subject-matter as when fruits perish due to excessive heat or from death or destruction of the subject-matter as when living animals die from natural causes. The insurers will be liable to indemnify if the damage or loss is the proximate result of some fortuitous action of wind and waves on the sea. The Marine Insurance Act, 1906, therefore, lays down that the ordinary action of winds and waves is excluded from the scope of the term "peril of the sea".

Among other perils occurring on the sea, loss resulting from *fire* is also covered by the policy. But if the fire is caused by any cause for which the insured is responsible, it will not come under the policy. Loss resulting from the *capture* by the enemy in times of war is also covered by this clause. Danger from *pirates, rovers* and *thieves* who carry on plundering activities for their own private ends and not under the authority of the Governments also come under the policy. Pirates include passengers, mutineers and rioters who attack from the shore. Theft does not cover secret theft by the crew or passengers. But robbery with violence by strangers is a loss by robber and thieves. Losses by *jettison* can also be recovered under the policy. Jettison includes the throwing overboard of cargo or goods or the cutting away of masts or some other parts of the ship for lightening her. The risk of *barratry* is also covered by the policy. Derived from an Italian word the term means cheating and refers to any act committed by the master or the crew in violation of his or their duty, wrongly and wilfully. *Barratry* extends to a large number of unauthorised activities committed to the prejudice of the owners or charters, such as, sailing out of port without paying port dues, or in breach of an embargo or wilful breach of blockade whereby the vessel is seized or fraudulent sale of the ship or the cargo.

4. **Sue and Labour Clause.** This clause authorizes the insured to take steps to safeguard the insured property from losses or damages. Under this clause, therefore, if the insured or his agent incurs expenses by employing labour or otherwise, for preventing a loss to the insured property, the insurers are liable to repay such expenses proportionately. It should, however, be noted that the insured must act reasonably and prudently and the property insured must be in real danger.

5. **Memorandum.** This clause is found at the foot of the policy. Its purpose is to protect the underwriter against small claims which may arise due to the perishability of the cargo. The memorandum clause provides that :—

(*i*) the underwriter shall not be liable for partial loss on corn, fish, salt, fruit, flour, and seed, all of which are extremely perishable in their nature.

(*ii*) the insurer shall not be liable for partial loss below 5% on sugar, tobacco, hemp, hides and skins which are presumably less perishable than the articles coming under the first category above.

(*iii*) the underwriter shall not be liable for any partial loss below 3% on all other goods including the ship and the freight.

But the insurer remains liable in the case of general average loss or if the ship is stranded.

6. **Valuation.** This clause lays down the value of the subject-matter insured. The valuation is to be inserted only in the case of a valued policy. Though an unvalued policy is rare these days, when one such is taken, the value is assessed when the loss has taken place.

7. **Waiver Clause.** The waiver clause supplements the "sue and labour clause" and provides that "no acts of the insured or the insurer recovering, saving or preserving the property of the insured shall be considered as a waiver or acceptance of abandonment".

Kinds of Insurance Policies :

The variation of the risk or risks sought to be insured against depending upon such factors as the type of the ship, the nature of the cargo, the character of the voyage, the general climate of the

region through which the vessel has to ply, the existence of warfare has led to the evolution of different kinds of marine insurance policies. The most common of them are the following :—

(*i*) *Voyage Policy.* It is one which is taken to cover the risks of a particular voyage, for instance, from Chittagong to Calcutta. This policy is generally effected on the cargo shipped.

(*ii*) *Time Policy.* When the contract is to insure the subject-master for a fixed period of time, the policy is called a "time policy. The maximum period for which a time policy can be issued is 12 months, policies of longer duration than one year being invalid. Time policy is generally effected on ships and freight.

(*iii*) *Mixed Policy.* It is one which combines the features of a voyage as well as a time policy. Under it, insurance is contracted with regard to a certain subject-matter from one certain port to another port for a certain period of time. A mixed policy is generally taken on ships sailing between certain fixed ports.

(*iv*) *Valued Policy.* It is one in which the value of the subject-matter is declared in the policy itself. The value so declared is known as the insured value and is equal to :—

(*a*) cost of the goods ; and,
(*b*) freight and shipping charges, etc ; and,
(*c*) a 10% or 15% margin for anticipated profits.

Under a valued policy, the insured value is the measure of indemnity.

(*v*) *Unvalued Policy.* It is one in which the value of the subject-matter of insurance is not declared in the policy but is left to be determined as and when the claim arises. The measure of indemnity in such a case is not the insured value but the insurable value which is found out by adding freight and shipping charges only to the cost of goods.

(*vi*) *Open Policy.* It is one which is taken for a round sum to cover several shipments. The name of the ship and other particulars about shipments are declared as and when the shipments are made till the total insured amount "opened" is exhausted. This type of policy is also known as 'declaration policy' or 'open policy'.

(*vii*) *Interest Policy.* An interest policy is one under which the insured has an insurable interest in the subject-matter of insurance.

Though the existence of insurable interest is a condition for the validity of very insurance contract, some marine insurance policies are sometimes taken by persons having no interest in the subject-matter or having one which is doubtful. Hence it is usual to treat interest policies as a class in order to distinguish them from what are known as wager policies.

(*viii*) *Wager Policy.* It is one under which the insured does not have any insurable interest in the subject-matter of insurance or in which the underwriter dispenses with any proof of interest. A wager policy cannot be enforced in a court of law. But usually the underwriter honours his promise, made under the policy, for the sake of his reputation. Hence a wager policy is also known as 'Honour Policy'.

(*ix*) *Block Policy.* Specially of African origin, block policy is very common in the gold mining region of South Africa. It covers the risks attaching to the yellow metal from the time of its recovery from the mine until it reaches its destination for sale.

(*x*) *Currency Policy.* Policies issued in foreign currency are known as currency policies. English underwriters issue policies to persons of almost every country of the world. They, of course, use the pound-sterling standard but on account of fluctuation of foreign exchange rates, foreigners hesitate to purchase policies from British underwriters or insurers. To overcome this difficulty, English underwriters issue policies in foreign currencies also.

Liability of the Insurer : Doctrine of Causa Proxima :

The general rule with regard to the insurer's liability is that in case of loss due to the perils insured against, the insurer must indemnify the insured to the extent he has undertaken to indemnify under the policy. But in order to hold the insurer liable to pay, it must be found that the loss is the proximate result of one or other of the perils insured against. If the loss is due to a combination of causes operating at or about the same time, the doctrine of *Causa proxima* will apply, and the insurer will be liable only if the proximate cause of the loss is one of the perils insured against. Thus where a ship was scuttled by her crew, it was held by the House of Lords that the proximate cause of the loss was not the

entry of sea-water into the ship, but the act of the crew and hence the insurer was not liable. (*Samuel* V. *Dumas*, 1924, A.C. 431).

Assignment of Marine Policy :

A marine insurance policy can be assigned either before or after loss unless, of course, assignment is specifically prohibited. The mode of assignment of an insurance policy is usually that of endorsement and delivery. The only statutory requirement for assignment is Section 130-A of the Transfer of Property (Amendment) Act, 1944.

On a valid assignment the assignee becomes entitled to all the benefits under the contract and can sue the insurer on the contract in his own name.

Kinds of Marine Losses :

Marine Losses are broadly classifiable into total and partial, the former being sub-divided into actual total loss and constructive total loss.

Actual total loss. Where the subject-matter insured is destroyed or damaged beyond identity, or if it is irretrievably lost to the insured, an actual total loss is said to have taken place. Thus, if a ship is wrecked and dismantled and becomes a mere congeries of planks and materials so as to completely lose her character as a ship, there is an actual total loss. (*Cambridge* V. *Anderton* 1924, 2 B & C, 691). Similarly, if the ship founders in mid-ocean and there is no chance of salvaging her or the goods on board her, there is also an actual total loss.

Constructive total loss. A constructive total loss is said to have taken place if the subject-matter insured is originally abandoned on account of its actual total loss appearing to be unavoidable or because it could not be preserved from actual total loss without an expenditure equal to or even more than its value. For example, suppose a ship is stranded with a cargo valued at Rs. 20,000/-. The cost of saving the cargo seems to be on a reasonable estimate, to be Rs. 25,000/-. In such circumstances, it would be quite reasonable to abandon the cargo treating the loss as contructive total loss.

Where there is a constructive total loss the assured may either treat the loss as a partial loss or abandon the subject-matter insured to the insurer and treat the loss as if it were an actual total loss. (Sec. 61 of Marine Insurance Act, 1906).

Notice of Abandonment :

In the event of a constructive total loss, the assured must choose between partial loss or total loss. If he want to claim total loss, he must abandon all claims on the insured property and serve on the insurer a notice of abandonment.

The law relating to the notice of abandonment is contained in Sections 62 and 63 which run as follow.

(*i*) Where the assured elects to abandon the subject-matter insured to the insurer, he must give notice of abandonment. If he fails to do so, the loss can be treated only as a partial loss.

(*ii*) Notice of abandonment may be given in writing or by word of mouth, or partly in writing and partly by word of mouth, and may be given in any terms which indicate the intention of the assured to abandon his insured interest in the subject-matter insured unconditionally to the insurer.

(*iii*) Notice of abandonment must be given with reasonable diligence after the receipt of reliable information of the loss, but where the information is of a doubtful character the assured is entitled to a reasonable time to make enquiry.

(*vi*) The acceptance of an abandonment may either be express or implied from the conduct of the insurer. The mere silence of the insurer after notice is not acceptance.

(*v*) Where notice of abandonment is accepted the abandonment is irrevocable. The acceptance of the notice conclusively admit liability for the loss and the sufficiency of the notice. Thus, the old law that the assured cannot recover total loss if the insured property were restored to him before he brought his action is no longer good.

(*vi*) Notice of abandonment is unnecessary where at the time when the assured receives information of the loss, there would be no possibility of benefit to the insurer if notice were given to him.

(*vii*) Where the insurer has reinsured his risk, no notice of abandonment need be given by him to the re-insurer.

Where there is a valid abandonment, the insurer is entitled to take over the interest of the assured in whatever may remain of the subject-mater insured and all proprietory rights incidental thereto.

Upon the abandonment of a ship, the insurer thereof is entitled to any freight in course of being earned, and which is earned by her subsequent to the casualty causing the loss, less the expenses of earning it incurred after the causalty ; and, where the ship is carrying the owner's goods the insurer is entitled to a reasonable remuneration for the carriage of them subsequent to the casualty causing the loss.

Partial Loss :

Partial loss, technically known as "Average", arises in two ways: (*i*) where the subject-matter insured is partly lost or damaged by a peril insured against ; (ii) where the assured has to contribute rateably towards the general loss concerning the whole adventure. The former is known as "*Particular Average*" and the latter as "*General Average*".

Let us now discuss both in some detail.

1. **Particular Average.** It may be defined as "a partial loss of a particular interest as the ship alone or cargo alone accidentally and proximately by a peril insured against". For instance, a cargo consisting of 1,000 bags of wheat was insured. Part of the said cargo is burnt by fire. The loss thus resulting is 'particular average'. Likewise, A insures his ship with B. The mast is broken by high winds. The loss is 'particular average'.

2. **General Average.** It may be defined as "a loss caused by, or directly consequential on, a general average act which implies any extraordinary sacrifies or expenditure undertaken voluntarily and reasonably in the time of peril for the general safety of the property. From an analysis of this definition the following are found to be the chief characteristic features of general average :

(*i*) The loss must be the direct result of a general average act.

(*ii*) The sacrifice for expenditure made or incurred must be of

extraordinary nature. It should not be one which is ordinarily and necessarily undertaken in the course of the voyage.

(*iii*) The sacrifice or expenditure must not be accidental and must necessarily be voluntary and intentional.

(*iv*) The sacrifice or expenditure must be reasonable.

(*v*) The sacrifice or expenditure must be done in the time of peril which must be "substantial and threatening and something more than the ordinary perils of the sea".

(*vi*) It should not be the safety of any one particular interest but of the entire property, which should be the object of sacrifice or expenditure.

(*vii*) The sacrifice or expenditure must result in the preservation of the ship and some part of the cargo.

(*viii*) The common danger, which is the cause of general average, must not be due to the default of the person whose interest has been sacrificed and who makes a claim for general average contribution.

Kinds of General Average. There are, in general, two kinds of general average. It may either be a sacrifice of some property, or the expenditure of a sum of money. The former is illustrated by the acts of jettison, i. e., intentional throwing overboard of some cargo with a view to lightening her or the burning of some cargo as fuel in the engine. An example of the latter may be found in the expenditure incurred, for instance, in placing a part of the cargo in lighters or in towing a damaged vessel to a port of safety.

General Average contribution. When a general average loss arises, the party who suffers it may require, unless the peril causing the loss has been occasioned by his own or his servants' fault, the other parties interested in the adventure to pay a rateable contribution, subject to the provisions of maritime law. Such contribution is known as general average contribution.

General average loss is most usually incurred to protect the interests of the ship-owner, the cargo-owners and the receiver of the freight. Naturally, therefore, these should be the parties to bear the general average loss, each at the ratio at which his interests are at stake. These persons constitute what are known as contributing interests.

General Average Adjustment. When a ship suffers a general average loss, her captain, on her arrival at the port of destination or at any intermediate port if the voyage is broken up, makes a declaration known as protest in the presence of a Notary Public, wherein he states the circumstances in justification of his course of action. This declaration is followed by adjustment of the contribution of each party concerned to the general average loss for which purpose the captain has to employ the services of professional experts called the Average Adjusters.

Rights of the Insurer :

The insurer in a marine policy is entitled to the following rights:

1. He is entitled to receive the premium stipulated in the policy.

2. He can avoid the contract if there is any fraud, misrepresentation, or non-discloseare of material facts or any breach of the warranties or any unauthorized alteration of any material term of the policy without his consent.

3. The insurer is subrogated to the rights of the insured whereupon he becomes entitled to all the rights and privileges of the assured on his indemnifying the assured, in the following manner :—

(*a*) Where the loss is total, whether actual or constructive, and the assured has abandoned the property insured, the insurer is entitled to all the materials salvaged or to the property if and when restored. He is also entitled to all claims in damages which the assured may have against third parties in respect of negligence or loss due to which the total loss is caused. Thus if a ship insured is totally lost as a result of collision with another ship caused by the negligence of the owner of the other ship or his servants, the owner of the insured ship has a claim for damages against the latter ship owner. If he is indemnified by his insurer, the insurer is entitled to the damages which he may recover against the latter.

(*b*) Where a general average loss occurs as a result of general average sacrifice the insurer of the party on whom the loss falls indemnifies for the entire loss. But the insurer is subrogated to the rights of the assured and he is entitled to general average contribution which the other parties interested in the adventure are liable to make.

Avoidance of contract :

Under Section 18 (1) of the Marine Insurance Act, a contract of marine insurance may be avoided by the underwriter on the ground of fraud, misrepresentation and non-disclosure of material facts by the assured. A contract of marine insurance being essentially a contract *uberrimae fidei,* absolute good faith must be maintained by the assured. Where, therefore, fraud, misrepresentation or concealment of material facts which might have otherwise influenced the judgment of the insurer, is found to have been practised by the assured, there is at once a breach of good faith giving rise to a ground for avoiding the contract.

Bottomry :

The captain of the ship is at times forced by pressure of circumstances to borrow money at a foreign port. When so doing on the security of the ship, he has to execute what is called a *Bottomry Bond.* Sometimes the cargo and the freight are also offered as security together with the ship. The captain has to pledge his personal credit as well, thus making himself personally liable for the debt.

The bottomry bond must satisfy the following three important essentials :

(*i*) That the money was borrowed only when it was impossible to continue the voyage without borrowing it.

(*ii*) That no other means of borrowing money was available than the execution of the bottomry bond ; and.

(*iii*) That the amount borrowed is the minimum that is necessary to reach the destination.

The chief characteristic of the borrowing through bottomry bond is that it includes insurance in the process. The repayment of the debt is conditional on the arrival of the ship at the port of destination. If the ship does not reach the port of destination, the money borrowed under the bottomry bond need not be paid.

Another important feature of bottomry bond is that if the captain borrows money at various ports during the course of the voyage, the last lender gets the first claim and the first lender the the last.

Respondentia :

Sometimes, in the matter of borrowing money by the captain of a ship at a foreign port, the borrower has not to offer the ship as security but can do so by simply offering the cargo as security. The bond executed for such borrowing is called a *Respondentia Bond.*

The validity of a respondentia bond depends upon the satisfaction of the following three requirements :—

(*i*) The money borrowed should be exclusively for the benefit of the cargo.

(*ii*) No other means of obtaining money short of selling the cargo should be available.

(*iii*) The captain has taken the consent of the cargo-owners or such of them, as were within the reach of contract.

As in the bottomry bond, so in the respondentia bond, the amount borrowed becomes payable only on the condition that the ship reaches the destination. Should the ship fail to arrive at the port of destination, the debt need not be repaid.

CHAPTER IV

FIRE INSURANCE

Definition :

A contract of fire insurance has been defined as "a contract by which the insurer agrees, for a valuable consideration, usually called premiums, to indemnify the assured, upon a certain amount and subject to certain terms and conditions, against loss or injury by fire which may happen to the property insured during a specified Period". (*Halsbury : Laws of England*, P. 516).

The contract of fire insurance is usually contained in a policy pissuel by the insurer on payment of the first premium. But the contract may also be concluded by the mere acceptance of the proposal by the insurer before any premium has been paid or policy issued. In such an event, the insurer may be compelled to issue a policy even if the fire has already destroyed or damaged the subject-matter of insurance. (*Bugwandas V. Netherlands India Sea and Fire Insurance Co. of Batavia*, 1888, 14 A. C. 83 P.C.).

Formation of Fire Contract :

A fire contract is initiated by the assured filling in a printed from supplied by the agent of the insurer. When the proposal is thus made, the insured sends the premium or some part of it to the insurer on receipt of which the latter issues what is known as "deposit receipt" or "interim protection note" often called a "*cover-note*" whereby undertaking is given to indemnify the assured for a limited period until the proposal of the assured is accepted or rejected. If, therefore, the insured property is destroyed by fire during the validity of the cover-note, the insurer must compensate the loss. Where the insurer accepts the proposal, a regular policy is issued to the assured containing all the terms and conditions governing the policy.

Fire, Life and Marine Insurance :

Fire and Life . (i) A contract of fire insurance is a contract of indemnity but a life contract is not so. Consequently, while

in the case of a life policy the whole of the insured amount becomes realizable, in the case of a fire policy the claim must be confined to the actual market value of the goods or property destroyed by fire.

(ii) Fire insurance provides for protection only while life insurance combines both protection and investment.

(iii) The period of coverage by a fire policy varies from 10 days to 12 months, subject to renewal from time to time, but a life policy covers a much longer duration.

(iv) A fire insurance policy does not acquire any surrender value but a life insurance policy acquires a surrender value after the lapse of two or three years from its commencement.

(v) In the case of life insurance it is enough if the insured has an insurable interest in the subject-matter of insurance at the time when the policy is issued ; but the assured in a fire policy must have some interest in the subject-matter both when the policy is issued and when it becomes a claim.

(vi) The assignment of a fire policy can be made only with the permission of the insurance company. No such prior permission is, however, necesssry for assigning a life policy. It is sufficient if the fact of the assignment is notified to the insurer.

Fire ond Marine. Both the Fire and the Marine Insurance being contracts of indemnity, there is a good deal of similarity between the two. But there are also certain differences between them.

In the first place, a fire insurance policy stipulates only the realization of the actual market value of the property destroyed by fire ; it does not provide for any profit. But in the case of a marine policy, not only the cost of goods lost or destroyed but also the shipping charges together with a 10 to 15 per cent margin of anticipated profits are payable by the insurer. Secondly, in the case of a fire policy the presence of insurable interest is essential both when the policy is issued and when it becomes a claim but the marine insurance policy requires its presence only at the time of the occurrence of the loss.

Essential Principles of Fire Insurance :

The leading principles of fire insurance are *three* namely,—

(*a*) *Indemnity*. The very basis of fire insurance is that the insurer undertakes to place the insured in the same position in which he had been before his property was damaged or destroyed by fire neither better nor worse but the very same. The insured cannot, therefore, make profit out of the occurrence of fire nor can he suffer any loss due to the fire after the given property has been insured. As Lord Brett observed in *Castellain* V. *Preston* (1883) : "The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified. This is the fundamental principle of insurance, and if ever a proposition is made which is variance with it that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than a full indemnity the proposition must certainly be wrong."

(*b*) *Good Faith*. Like all insurance contracts, a contract of fire insurance is a contract *uberrimae fidei*. Hence, while entering into the contract, the insured must maintain absolute good faith and must disclose all material facts to the insurer. The observance of good faith is also necessary throughout the whole term of the contract. Any change in the nature of the risk during the currency of the policy must be communicated to the insurer. The insured and his agent are also in duty bound to take such steps as may be reasonable for the purpose of averting or minimizing a loss. Any contrary behaviour on the part of the insured will be considered to be a breach of good faith.

So far as the disclosure of material facts is concerned, the rules applicable to marine insurance including those relating to facts which need not be disclosed are equally applicable to fire insurance subject, however, to the express terms of the policy.

(*c*) *Insurable Interest*. The insured must have an insurable interest in the subject of the contract both at the time when the policy is issued and when the insured occurrence takes place.

It has been held that the following persons have an insurable

interest in the following subject-matters so as to enable them to effect valid insurance thereon:—

(*a*) a vendor of goods in respect of which the property and risk have not passed.

(*b*) the mortgagor and mortgagee of any property, movabe and immovable.

(*c*) the trustee and beneficiary of any property.

(*d*) the lessor and lessee of any property.

(*e*) the bailor or bailees of any property.

Representations and Warranties :

Statements and answers made by the proposer in response to questions contained in the proposal form are called representations. If such statements and answers are enbodied in the policy itself, they are called warranties.

If any representation material to the risk is not substantially true, the insurer is entitled to avoid the contract. But the waranties must be strictly and literally true whether they are material to the risk or not. Otherwise, the insurer will not be liable for the loss. Thus, if a mill insured is warranted as "conformable to the first class of mill rates", and, in fact, the mill is not so exactly conformable, the policy will be held void, although it be clearly proved that the deviation from the warranty did not at all increase the risk. (*New Castle Fire Insurence Co.* V. *Macmorran & Co.*, 1815, 3 DOW. 255 H.L.) But it has been held that a reasonable construction should be given even to a warranty. Thus where a policy was on premises warranted as "one where no fire is kept", it was held that the word '*kept*' meant '*habitually kept*'. A fire caused, therefore, by making a fire would not stand against the assured from claiming his loss. (*Mayal* Vs. *Milford*, 1837).

Different Kinds of Fire Policy :

Fire insurance policies are of various types varying with the nature of protection sought for. The most important among them are the following:—

1. *Valued Policy*. A valued policy is one in which the value of the subject-matter of insurance is agreed upon and specified in

advance. In the case of total loss to the property, the insurer must pay the agreed amount to the insured.

(*ii*) *Unvalued Policy.* An unvalued or open oplicy is one which does not specify the subject-matter of insurance but leaves it open to be determined subsequently.

(*iii*) *Floating Policy.* It is one which does not attach to any specific or ascertained property but insures goods lying at different places, for instance, goods of the insured lying partly in the godown, partly on the docks and partly on the railway station and so forth. By the very nature of the policy, the quantity of property covered by a floating policy is subject to daily fluctuations resulting from sales, removals, replacements or additions.

(*vi*) *Specific Policy.* It is one which is taken for a certain specific amount and the insurer is bound to compensate the insured upto any amount not exceeding this maximum limit.

(*v*) *Average Policy.* This policy is contra-distinguished from the specific policy. It is one which stipulates that in case the property is undervalued, the insured can realize only such proportion of the loss which is borne by the actual value of the property to the insured amount. This is called "rateable proportion". An average policy is constituted by inserting the "average clause". Floating policies also generally contain average clause.

Conditions precedent in a Fire Policy :

Certain essential conditions must be fulfilled for enabling the assured to recover loss or damage caused by fire. They are as follows, as stated by Bunyon in his book on Fire Insurance:—

(*i*) If anything is done in respect of the property insured whereby the risk to it is increased, notice thereof must be given by the assured to the insurer.

(*ii*) The assured must give the particulars of the property and risk covered.

(*iii*) The assured must give notice of loss without unreasonable delay and deliver his claim giving all the necessary particulars with sufficient proofs thereof within a prescribed time.

(*iv*) Any fraudulent claim, as when it is deliberately false in

any substantial respect, by the assured would cause forfeiture of all benefits under the policy.

(*v*) In case of difference in respect of the amount of any loss or damage such difference is to be referred to arbitration as a condition precedent to any action by the assured, within prescribed period.

Assignment of Fire Policy :

"A contract of fire insurance", says Halsbury, "is personal with the assured, and is not a contract passing with the property insured". The transferee of an insured property, therefore, acquires no interest in the fire policy, unless the policy is expressly or inpliedly assigned to him. So strict is this rule that where the vendor of an insured house contracts to sell it, and between the date of the contract and its completion the house is burnt by fire, and the insurance company not being aware of the contract, pays the amount of the loss to the vendor, the purchaser cannot as against the vendor recover the insurance money as an abatement of the purchase money (*Raynor* V. *Preston*, 1883,18 Ch. D.I.C.A.). In such a case the insurer can compel the vendor to refund the purchase money, the reason thereof being that fire insurance being a contract of indemnity, the insured cannot recover anything where he has suffered no loss (*Castellion* V. *Preston*, 1883).

Unless assignment is expressly prohibited, a fire insurance policy may be assigned by writing either by endorsement on the policy or in any other customary manner. Before loss occurs, the policy can be assigned only to a person who has acquired some interest in the property, e. g. a purchaser or a mortgagee. After loss, however, the policy may be assigned to any person. But at the time of assignment the insured must have some insurable interest in the property ; otherwise an assignment by him will be of no effect.

Under the English law, a fire insurance policy is not assignable without the consent of the insurer. But in Pakistan, the sole requirement of a valid assignment is that it must be by an endorsement or any other writing. Notice to the insurer of the assignment

is necessary only to make him liable to the assignee if he pays the money due to the assured even after such notice.

When a valid assignment has been made, the assignee becomes entitled to all the benefits under the contract and can sue the insurer on the contract in his own name.

Liability of the insurer :

In a fire policy the assured is entitled to recover only that loss or damage which has been caused by fire, that is, by ignition. It does not include loss caused by heating or by smoke where no ignition has taken place. The assured has, therefore, to establish in setting up his claim that the loss or damage has been caused by fire.

As in marine policy, so in fire policy, the doctrine of *Proxima Causa* applies. That is to say, in establishing his claim the assured must prove that the fire causing the loss was the *proximate cause* of the loss. Proximate cause means the "dominant" or "direct" cause and not necessarily the last cause in a chain or combination of causes. Thus it has been held that where damage is caused to the insured property as a result of explosion of gunpowder, at a distance of half a mile from the premises, the loss and damage is not to be regarded as caused by fire (*Event* V. *London Assurance* Co., 1865).

The assured cannot, however, recover any loss caused by his own wilful misconduct, e.g. when he voluntarily sets fire to the property insured. But this does not include wilful acts of the servants of the assured or of any third party (*Busk* V. *Royal Exchange Assurance Co.*, 1818).

The cause of the fire is immaterial and it is no defence for the insurer that the fire would not have been caused but for the negligence of the assured or his servants (Jameson V. Royal Insurance Co., 71 R.C.L. 126).

In all cases, however, the liability of the insurer is subject to the conditions precedent to a fire policy as enumerated above.

Rights and Duties of Insurers :

Under a fire insurance policy the insurer has the following rights and duties :—

(*i*) *Entry on the premises.* In the event of loss or damage to the insured property, the insurers have the right, by custom or specific stipulation, to enter upon the premises, which are insured or in which the subject-matter of insurance is situated, for the purpose of ascertaining the damage and protecting it from furher damage or loss and to that end, hold it in possession for a reasonable time. But if the insurer's possession lasts for an unreasonable time and the insured suffers loss or damage thereby, he becomes liable for damages to the assured. (Old field V. Price, 1869).

(*ii*). *Reinstatement.* It is generally stipulated in a fire contract that in the event of disagreement between the insurer and the insured as to the amount of cash compensation, the insurer may elect to reinstate the property damaged at his own cost. Once the company elects or becomes bound to reinstate the property, it cannot thereafter force the insured to accept cash compensation.

(*iii*) *Subrogation.* It means that when the insurer has compensated the insured in respect of any damage or destruction to the insured property, he steps into the shoes of the insured and can avail himself of any rights and remedies possessed by the insured against the third party in connection with the fire which gave rise to the compensation. In such a case the insured is bound to do and concur in doing and permit to be done all such acts and things as are found necessary by the company for the purposes of enforcing any rights and remedies against a third party.

It should, however, be noted that it is only on payment of the whole of the loss that the insurer is entitled to subrogation, so that if the amount insured is less than the amount of the loss, this right would not be available to the insurer even though he has paid the amount insured. In such a case the assured alone can bring suits against third parties who may be liable to pay for the loss.

(*iv*) *Salvage.* The right of salvage, which is incidental to the right of subrogation, entitles the insurer to salvage, that is, to the value and all that remains of the property after the fire.

(*v*) *Contribution.* When the same property is insured with two or more insurers, the loss resulting from the fire or other peril insured against has to be shared by all. In such a case each

insurer has to bear the loss in some ratable proportion and this kind of payment in such ratable proportion is called contribution.

The condition of contribution deals with the proportions in which the co-insurers will have to contribute. The ratable proportion has been defined to be "such a proportion of the loss as the amount of the policy in question bears to the total amount of all the insurance policies taken in respect of the property suffering damage or destruction". For instance, A insures his house against fire with X and Y for Rs. 10,000/00 and Rs. 6,000/00 respectively. After some time the property catches fire and loss to the extent of Rs. 8,000/00 takes place. In such a case, the contribution of X would be Rs. 5000/00 and that of Y, Rs. 3,000/00.

CHAPTER V

SOME MODERN INSURANCES

Personal Accident Insurance :

The chief features of an accident insurance contract are :

(*a*) Payment of a certain sum to the representatives of the assured in the event of his death by accident ; or,

(*b*) Payment of a certain sum to the assured in case of disablement, total or partial, the sum to be so paid being smaller than the one payable in case of his death ; or,

(*c*) Payment of a certain weekly allowance to the insured during the period he is prevented by the accident from attending his normal avocation.

An accident insurance is not, therefore, a contract of indemnity inasmuch as it provides for the payment of a specified sum on the happening of a certain event. The insurance company has, therefore, no right of subrogation.

Accident defined. The term 'accident' is not easy to be defined. It generally denotes a mishap which could not be anticipated, e.g., a motor car collision or an injury sustained by a pedestrian by being knocked down by an automobile. Hence death or injury caused by common maladies, even though unanticipated, such as chloera or sunstroke is not to be regarded as an accident (*Sinclair* V. *Maritime Insurance Co,.* 1861). Accident must necessarily imply some violence to the person injured or killed, caused by a fortuitious event to which no human agency has any contribution. Thus, death caused after being knocked down by a motor car is an accidental death but death caused by a sudden blow received from an assailant is not so, even though the blow was unanticipated and the death is instantaneous.

Liability of the insurer . Under an accident insurance policy the insurer is liable for death or injury of the assured which may be shwon to have been caused proximately by accident. In some cases, the proximate cause of death or injury is taken to be

accident even though certain intermediate stages may intervene between the accident and the death or injury. Thus, where the assured is knocked down by a car and one of his legs is amputed to save him, the amputation of his leg is regarded as caused by accident though the surgical operation intervened.

The insurers may, however, limit their liability by inserting exceptions as follows:—

1. If the death is caused by some disease arising within the system of the assured before, or at the time of, or following the injury, the insurers are not liable.

2. The insurance is against death, the sole and immediate cause of which should be "bodily injury caused by violent, accidental, external and visible means". Thus if death is caused by straining of the heart in performing any strenuous job the insurers are not liable. (Re Searr & General Accident Assurance Corporation, 1905, 1 K.B. 387).

Liability Insurance :

Definition. Where the insurer undertakes to indemnify the assured against any specified liability which he may incur in relation to a third party, the contract is called a **liability Insurance.** An example of such insurance is furnished by an employer insuring against his liability to pay compensation to his workmen under the Workmen's Compensation Act, 1923, in case they sustain injury by accident in course of employment.

Nature. Liability insurance is a contract of indemnity and on payment of the loss suffered by the assured, the insurer is subrogated to all the rights of the assured. A liability insurance policy usually contains stipulations to that effect.

Guarantee Insurance :

A guarantee insurance is one under which the insurer undertakes to indemnify the assured for loss caused due to the default, negligence, fraud or misconduct of a third party. This kind of insurance is mainly of three kinds:

(*i*) *Fidelity Insurance.* Under this kind of insurance, the insurer undertakes to indemnify the assured against loss suffered

by the latter through the fraud, dishonesty, or unfaithfulness of a third party, usually the servant or agent of the assured. The amount to be paid does not, however, exceed the amount of the policy.

Generally effected for a fixed period, the amount of premium under this insurance is payable in a certain number of instalments, yearly or half-yearly.

(*ii*) *Commercial Insurance.* Under this kind of insurance, the insurer agrees to indemnify the assured, in consideration of certain payments known as premium, to the extent of amount insured against loss arising out of the breach of contract on the part of a third party who stands in a contractual and not fiduciary relationship to the assured. Commercial insurance is of the following three kinds:—

(*a*) *Contract Insurance.* Under this branch of commercial insurance, the insurer undertakes to indemnify the assured to the extent of the sum insured for loss or damage arising out of the breach of contract by third parties in respect of contracts entered into by such parties with the assured. A policy of contract insurance is commonly known as an indemnity bond and is issued to cover the obligations of persons like contractors, common carriers, warehousemen, apprentices and bankers.

(*b*) *Credit Insurance.* It is that form of commercial insurance which "purports to compensate manufacturers, wholesalers and jobbers against extraordinary losses in credits suffered as a result of the insolvency of their customers". It is, therefore, called '*Solvency insurance*' or '*insurance of debts*'.

It should be clearly understood that credit insurance does not seek to indemnify expected losses but only gives protection against unexpected or extraordinary losses, i.e., losses in excess of the average.

(*c*) *Title Insurance.* It is that branch of commercial insurance which purports to protect the owner of a property or a lender of money against the security of a property in regard to a loss that may arise out of a defect in the title or because of its unmarketability or because of unknown liens or encumbrances on the property at the time the policy is issued. Title insurance policy

does not cover defects in title that may arise after the insurance has been obtained.

(*iii*) *Judicial Insurance.* "Under this kind of insurance, the insurer agrees to indemnify the assured to the extent of the amount insured, for loss caused through the misconduct or negligence of a court officer, e.g., a receiver or through the failure of a litigant or a party to any judicial proceeding to carry out his obligations and undertakings. Administration bonds furnished by executors, administrators, guarandians and receivers are instances of judicial insurance".

CHAPTER VI

INSURANCE ORGANISATION

(INSURANCE ACT, 1938)

The law governing insurance organization in Pakistan is "The Insurance Act, 1938", as adapted and amended up-to-date. Prior to that, there were two acts prevalent in the Indo-Pakistan Sub-continent, namely 'The Life ns urance Act, 1912' and 'The Provindent Insurance Societies Act, 1912,' both of which were repealed by 'The Insurance Act, 1938'.

By the Insurance Act, 1938, provisions have been made in respect of registration, compulsory deposits, investments, inspection, and commission payable to agents. But the Insurance Act, 1938, does not affect the liability of insurance companies to comply with the provisions of the Companies Act, 1913, in matters not otherwise specifically provided for by this Act. Important changes have also been effected in insurance organisation by the Insurance (Amendment) Act, 1958. Insurance companies are, therefore, governed by the Insurance Act, 1938, as amended by the Insurance (Amendment) Act, 1958 as well as by the Companies Act, 1913, in matters not covered by the former Act.

Insurer :

Under Section 2 (9) of the Insurance Act, 1938, an insurer means—

(a) any individual or partnership or company incorporated under the law of any country other than Pakistan, carrying on insurance business [other than a person mentioned in clause (c) below] which—

(i) carries on business in Pakistan, or

(ii) has its or his principal business or is domiciled in Pakistan,

(b) any company [other than a person mentioned in clause (c) below] carrying on business of insurance, which is incorporated under the law of Pakistan or which is a subsidiary company of any such incorporated Company,

(c) any person who in Pakistan has a standing contract with underwriters who are members of the Society of Lloyd's whereby such person is authorized within the terms of such contract to issue protection notes, cover notes, or other documents granting insurance cover to others on behalf of the underwriters but does not include a licensed insurance agent or a provident insurance society.

Registration :

Every insurer desiring to commence business must obtain a certificate of registration from the Controller of Insurance as a condition precedent to his commencing insurance business, which shall be issued only after the requirements laid down by Section. 3 (2) of the Act have been fulfilled.

Under Section 3 (6) of the Act, the Controller of Insuranc e must withhold registration or cancel the same if already granted in the following cases :—

(*a*) If the insurer is a foreign company having its principal place of business or domicile outside Pakistan and the Controller of Insurance is satisfied that in the country of its principal business or domicile Pakistani concerns are debarred from carrying on the business of insurance ; or,

(*b*) if the insurer is a foreign company and it fails to satisfy such conditions as are imposed on it by the Government of Pakistan ; or,

(*c*) if the insurer fails to make initial deposit with the State Bank of Pakistan as required by the Act ; or,

(*d*) if the insurer is in liquidation or is adjudged an insolvent ; or,

(*e*) if the business is transferred or amalgamated ; or,

(*f*) if the initial deposit has been returned because the insurer has ceased to do business ; or,

(*g*) if the insurer has a standing contract with the underwriters who are members of the Lloyd's Society and such a standing contract is cancelled ;

(*h*) if the insurer makes default in complying with any requirements of the Insurance Act or Rules or Orders made thereunder or acts in contravention of any one of them.

(*i*) if any claim upon the insurer under any policy remains unpaid for 3 months after the judgment in a court of law.

(*j*) if the insurer carries on any business other than the insurance business.

Under section 3 (5) of the Act, if the controller of Insurance cancels or withholds the grant of the cartificate of registration to an insurer he must give a notice of his decision to the insurer in writing and the decision shall become effective as from the date specified by him in the notice which must not be less than one month or more than two months from the date of the receipt of the notice.

Under section 110 (1), an order of the Controller of Insurnce cancelling or withholding registration may be appealed against to the court of competent jurisdiction.

Requirements as to Capital :

No incorporated insurer shall be registered unless he has as working capital not less than Rs. 50,000/C0 exclusive of the deposit to be made prior to registration under the Act and also exclusive in the case of a company of any sums payable as preliminary expenses in the formation of the Company.

Requirements as to Deposit :

Before the enactment of the present Insurance law, many insurance companies used to starn their business without securing adequate capital, with the result that after some time such companies had to seek liquidation. The Insurance Act, 1938, has provided against this kind of eventuality and made it a condition precedent to registration that besides showing the possession of the minimum working capital of Rs. 50,000/00 every insurance company must make some initial deposit with the State Bank of Pakistan. This deposit can be made either in cash or in the shape of approved securities or partly in cash and partly in approved securities.

The exact amount of this initial deposit depends upon the class or classes of insurance business transacted by an insurance company. For instance, the amount required for life insurance

only, is Rs. 200,000/00, for fire or marine insurance only, Rs. 150, 000/00 for life and one other class of insurance Rs. 3,00,000/00. It has been found on calculation that a company doing all the various kinds of insurance has to deposit Rs. 10,00,000/00.

The initial deposit can only be used for the discharge of any liability of the insurer arising out of the insurance policies issued by him. For instance, the initial deposit in respect of life insurance can be used only for meeting the liability of the insurer regarding any life insurance policy or policies issued by him. The deposit thus made can neither be assigned nor given as security. Nor can the creditors claim this amount.

Where an insurer ceases to carry on in Pakistan any insurance business or any class of insurance business in respect of which a deposit has been made under the Act and his liabilities in respect of his insurance business or of that branch of insurance business have been satisfied or are otherwise provided for, the court may, on the application of the insurer, order the return of the whole of the deposit in case the insurer has stopped all business or so much of it as does not relate to the classes of insurance which he continues to carry on in case the insurer ceases to do a particular class of insurance only and continues other classes.

Investments :

Right from the start the Insurance Act imposed strict control over the investment of the life insurance fund. Thus, this law required every life insurance company to invest 25% of its life insurance fund in Government Securities and 30% in Government Securities or in approved Securities or in the Securities of the United Kingdom. Insurance companies were at liberty to invest the remaining 45% of their life insurance fund as they deemed proper. But amendments effected in the Act in the post-independence period has introduced drastic curtailment in the investment liberty of the insurance companies. Under the law as it now stands, insurance companies have to invest their funds only in Government Securities or approved Securities or investments approved by the Government. Thus an Insurance Company can buy National Savings Certificates

and subscribe to loans floated by the Government and also purchase shares of a Company, if such purchase is approved by the Government.

Prohibition of Loans :

Under Section 29 of the Insurance Act, 1938, no insurer can grant loans or temporary advances to (a) any director, managing agent, manager, auditor, actuary or officer of the insurer where the insurer is a company or (b) to any partner of the insurer where the insurer is a partnership or (c) to any other company or firm, excepting a Banking concern in which any such director, manager, managing agent, actuary, officer or partner holds the positions of a director, manager, managing agent, actuary, officer or partner, either on hypothecation of property or on personal security or otherwise excepting where the loan or advance is given on life policies issued by the insurer to the extent of the surrender value of such policies.

So far as any agent is concerned loans or temporary advances can be granted to facilitate the carrying out of his functions provided they do not exceed in the aggregate the commission earned by him in the year immediately preceding.

Management :

The Insurance Act, 1938, prohibits the appointment of a managing agent for the conduct of the business of an insurer. If the insurer is a Company, it must be managed by a Board of Directors, to be elected periodically by the shareholders or by the joint participation of shareholders and policy holders.

Audit :

Under Section 12 of the Insurance Act, 1938, the balance-sheet, profit and loss account, revenue account, and profit and loss appropriation account of every Company or every insurer having his place of business or domicile in Pakistan, in respect of all insurance business transacted by it or him, and of every non-Pakistani insurer, in respect of the insurance business transacted

by him in Pakistan, must be audited **annually** by an auditor, unless in the case of a Pakistani company, it is already subject to audit under the Companies Act, 1913. The auditor auditing the accounts of an Insurance Company is to enjoy the same rights and liabilities as provided for in Section 145 of the Companies Act, 1913.

Actuarial Report and Abstract :

Under Section 13 of the Insurance Act, 1938, every insurer carrying on life insurance business must, once at least in five years cause an investigation to be made by an actuary into the financial condition of the life insurance business carried on by him including a valuation of his liabilities in respect thereto and shall cause an abstract of the report of such actuary to be made in accordance with the regulations and requirements contained in parts I and II of the Fourth Schedule to the Act. Such abstract must be accompanied by a certificate signed by the principal officer of the insurer that full and accurate particulars of every policy under which there is a liability, actual or contingent, have been furnished to the actuary for the prupose of investigation. The valuation report of the actuary must also specify the life insurance business in force at the date.

Controller of Insurance : His Powers and Duties :

The Controller of Insurance is the officer appointed by the Central Government to exercise control and supervision over Insurance Companies as provided for by the Insurance Act, 1938, as amended up-to-date. He is the most important figure in the Scheme of the Act . The Controller of Insurance has the following powers and duties :—

(*i*) He grants the certificate of registration to an insurer.

(*ii*) He has the power to cancel or withhold registration subject to his decision to either effect being appeallable to the court of competent jurisdiction.

(*iii*) To him are to be furnished the certified copies, audited balance-sheet, profit and loss account, revenue account and the actuarial report and abstract of very insurer. If it appears to

the Controller that any return so furnished is inaccurate or defective in any respect, he may :

(*a*) require, from the insurer such further information, certified if he so directs by an auditor or actuary, as he may consider necesary to correct or supplement such return.

(*b*) call upon the insurer to submit for his examination at the principal place of business of the insurer in Pakistan any book of account, register or other document or to supply any statement which he may specify in a notice served on the insurer for the purpose ;

(*c*) examine any officer of the insurer on oath in relation to the return ;

(*d*) decline to accept any such return unless the deficiency has been supplied before the expiry of one month from the date on which the requisition for correcting the inaccuracy or supplying the deficiency was delivered to the insurer and on his declining to accept such return, the insurer is to be deemed to have failed to comply with the provisions of the Act.

(*iv*) If it appears to the controller that an investigation and valuation of the business of an insurer by an actuary does not properly indicate the condition of the affairs of the insurer by reason of the faulty basis adopted in the valuation, he may, after giving notice to the insurer and giving him an opportunity of being heard, cause an investigation and valuation to be made at the expense of the insurer by an actuary appointed by the insurer for this purpose and approved by the Controller.

(*v*) If the controller has reason to believe that the interests of the policy-holders of an insurer are in danger or that an insurer is unable to meet his obligations or has defaulted in complying with any of the provisions of the Act, or if he receives a requisition signed by a number of share holders as prescribed by the Act, he may, after giving notice to the insurer and giving him an opportunity of being heard, appoint an auditor or actuary or both to investigate the affairs of the insurer and may himself make such investigation. The Controller may require the insurer to comply within a specified time with any directions he may issue to remedy

the defects disclosed by such investigation. If the insurer fails to comply with such direction or if as a result of the investigation, the controller is of opinion that the business of the insurer should be wound up in the interests of the policy-holders, the controller may, after giving notice to the insurer and giving him an opportunity of being heard, apply to the court to have the business of the insurer wound up.

(*vi*) The Controller has the power to prosecute insurers or where the insurer is a company, its directors or principal officers for non-compliance with the provisions of the Act.

(*vii*) The controller may take such steps as he may consider necessary to inspect and verify that the assets of an insurer are invested as required by the Act.

Winding up :

In the matter of winding-up of Insurance Companies, the provisions of Sections 161 and 163 of the Companies Act apply. Besides under the Insurance Act, 1938, liquidation may be ordered by the Court on the following grounds as embodied in Section 53 of the Insurance Act.

(*i*) If with the sanction of the court previously obtained, a petition is presented by not less than one-tenth of all the shareholders holding not less than one tenth of the whole share capital or by not less than fifty policy-holders holding policies which have been in force for not less than three years and are of the total value of not less than Rs. 50,000/00 or,

(*ii*) If the Controller of Insurance applies in this behalf to the court to wind up the Company which, however, he is entitled to do only on any of the following grounds :

(*a*) that the company has failed to keep deposited with the State Bank of Pakistan the amount required to be so kept ;

(*b*) that the Company has failed to comply with any requirement of the Insurance Act and has continued such failure for a period of three months after notice of such failure has been conveyed to the Company by the Controller of Insurance ; or,

(*c*) that it appears from the returns furnished under the provi-

sions of the Act or from the results of any investigation made thereunder that the company is insolvent ; or,

(*d*) that the continuanace of the Company is prejudicial to the interests of the policy-holders.

An insurance company cannot be wound up voluntarily except for the purpose of effecting an amalgamation or reconstruction of the Company or on the ground that by reason of its liabilities it cannot continue its business. (Sec. 54)

Winding-up of secondary companies. When an insurance business or any part thereof is transferred to another insurance company under any arrangement, the transferor company is known as the "*secondary company*" and the "*transferee company*" is known as the "*Principal company*".

"If the principal company is being wound up by or under the supervision of the court, the court must also order the secondary company to be wound up in conjunction with the principal company and may appoint the same person to be the liquidator for both the companies and may also make provision for such other matters as may be necesssry in view of the companies being wound up as if they were one company."

An application may also be made in relation to the winding up of the secondary company in conjunction with the principal company by any creditor of, or person interested in, the principal or the secondary company. Unless otherwise ordered the winding-up of the secondary company will commence at the same time as that of the principal company. Before ordering the winding-up of the secondary company the court must hear all objections relating thereto where the winding-up of the secondary company does not commence at the same time as that of the principal company.

Valuation of Liabilities. When an insurnce company is being wound up or in the insolvency of any other insurer, the ascertainment of the assets and liabilities of the insurer must be made in such manner as the liquidator or the receiver things fit subject to such directions as the court may give. In the case of current contracts of life insurance business, such ascertainment is to be

make according to the method and basis to be determined by an actuary approved by the ourt.

Application of Surplus Assets of Life Insurance Fund. In the winding up of an insurance company or in the insolvency of any other insurer, the value of the assets and liabilities of the insurer in respect of life insurance business must be ascertained separately from the value of any other assets or any other liabilities of the insurer and no such assets can be applied to the discharge of any liabilities other than those in respect of life insurance business except when there is a surplus of assets over liabilities in respect of life insurance business.

Reduction of Contracts of Insurance. Under Section 61 of the Insurance Act, 1938, when an insurance company is being wound up or any other insurer is passing through insolvency proceeding, the court may reduce the amount of insurance contracts of all classes of the company or the insurer upon such terms and subject to such conditions as the court thinks just. Under Section 55 of the Act supplemented by the 6th Scheduled, for the purpose of any such reduction of contracts the value of the assets and liabilities of the company and all claims in respect of policies issued by it must be ascertained according to the directions of the court, if any, and subject to the rule that the liabilities on all current con tracts effected in the course of life insurance business including annuity business are to be calculated by the method and upon the basis to be determined by an actuary approved by the court.

Partial Winding-up. Section 58 of the Insurance Act provides for partial winding-up of a Company, that is, winding-up of any class of business comprised in the whole undertaking of the company If, therefore, at any time it appears expedient that the affairs of an insurance company (not any other insurer) in respect of and particular class of business should be wound up, a scheme to that end may be prepared and submitted to the court and, on its being sanctioned by the court, it will become effective.