Intermediate Course
Study Material
(Modules 1 to 2)

Paper 2

Corporate and Other Laws

Module – 1

BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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Edition	:	July, 2019
Website	:	www.icai.org
E-mail	:	bosnoida@icai.org
Committee/ Department	:	Board of Studies
ISBN No.	:	
Price (All Modules)	:	₹
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002, India.
Printed by	:	

BEFORE WE BEGIN ...

Evolving role of a CA - Shift towards strategic decision making

The traditional role of a Chartered Accountant restricted to accounting and auditing, has now changed substantially and there has been a marked shift towards strategic decision making and entrepreneurial roles that add value beyond traditional financial reporting. The primary factors responsible for the change are the increasing business complexities on account of plethora of laws, borderless economies consequent to giant leap in e-commerce, emergence of new financial instruments, emphasis on Corporate Social Responsibility, significant developments in information technology, to name a few. These factors necessitate an increase in the competence level of Chartered Accountants to take up the role of not merely an accountant or auditor, but a global solution provider. Towards this end, the scheme of education and training is being continuously reviewed so that it is in sync with the requisites of the dynamic global business environment; the competence requirements are being continuously reviewed to enable aspiring Chartered Accountants to acquire the requisite professional competence to take on new roles.

Skill requirements at Intermediate Level

Under the Revised Scheme of Education and Training, at the Intermediate Level, you are expected to not only acquire professional knowledge but also the ability to apply such knowledge in problem solving. The process of learning should also help you inculcate the requisite professional skills, i.e., the intellectual skills and communication skills, necessary for achieving the desired level of professional competence.

Corporate and Other Laws: Dynamic & Interesting

Laws and rules, in general, regulate the relationship between business and profession. In specific, an accounting student should have knowledge of the legal framework, which influences business transactions. This paper intends to make the students aware of legal provisions of the selected laws and to analyse and apply the related provisions addressing issues in moderately complex scenarios.

Paper 2 on Corporate and Other Laws is comprising of Company Law and Other Laws. The syllabus of Corporate and Other Laws has been segregated into two parts covering the following topics:

Part I: Company Law (60 Marks)	Part II: Other Laws (40 Marks)
The Companies Act, 2013 – Sections 1 to 148	(1) The Indian Contract Act, 1872 (2) The Negotiable Instruments Act, 1881 (3) The General Clauses Act, 1897 (4) Interpretation of statutes

These laws of the country undergo significant changes through the amendments/ notifications /circulars which are issued from time to time by their respective governing authorities. Owing to the dynamic nature of the specified Acts especially the Companies Act, 2013, learning, understanding and applying the provisions of law in problem solving is very interesting and challenging.

The study material has been revised on the basis of the legislative developments made up till 30th April, 2019. Also incorporated explanations, diagrams, examples and changed the representations of the contents wherever required to bring more clarity and understanding of the concepts.

Further, the legislative amendments (if any) which will be notified after 30th April, 2019 and which are relevant for a particular attempt, would be informed to the students through Revisionary Test Paper (RTP) relevant for that particular attempt. Students are advised to check the Board of Studies Knowledge Portal regularly for further development.

Framework of Chapters – Uniform Structure comprising of specific components

Efforts have been made to present the complex laws in a lucid manner. Care has been taken to present the chapters in a logical sequence to facilitate easy understanding by the students. The Study Material has been divided into two modules for ease of handling by students.

The various chapters/units of each subject at the Intermediate level have been structured uniformly and comprises of the following components:

	Components of each Chapter	About the component
1.	**Learning Outcomes**	Learning outcomes which you need to demonstrate after learning each topic have been given in the first page of each chapter/unit.
2.	**Chapter Overview**	As the name suggests, the flow chart/table/diagram given at the beginning of each chapter would give a broad outline of the contents covered in the chapter
3.	**Introduction**	A brief introduction is given at the beginning of each chapter/unit which would help you get a feel of the topic.
4.	**Content**	The concepts and provisions of specified Acts are explained in student-friendly manner with the aid of examples/ diagrams/flow charts. Diagrams and Flow charts would help you understand and retain the concept/provision learnt in a better manner. Examples would help you understand the application of provisions. These value additions would, thus, help you develop conceptual clarity and get a good grasp of the topic.
5.	**Summary**	A summary of the chapter is given at the end to help you revise what you have learnt.
6.	**Test Your Knowledge**	I. **Multiple Choice Questions:** It comprises of Multiple Choice Questions which test the breadth and depth of your understanding of the topic. II. **Question and Answer:** The exercise questions and answers would help you to apply what you have learnt in problem solving. In effect, it would sharpen your application skills and test your understanding as well as your application of concepts/provisions.

We hope that these student-friendly features in the Study Material makes your learning process more enjoyable, enriches your knowledge and sharpens your application skills.

Happy Reading and Best Wishes!

SYLLABUS

PAPER – 2: CORPORATE AND OTHER LAWS

(One paper – Three hours - 100 Marks)

PART I – COMPANY LAW (60 MARKS)

Objective:

To develop an understanding of the provisions of company law and acquire the ability to address application-oriented issues.

Contents:

The Companies Act, 2013 – Sections 1 to 148

1. Preliminary
2. Incorporation of Company and Matters Incidental thereto
3. Prospectus and Allotment of Securities
4. Share Capital and Debentures
5. Acceptance of Deposits by companies
6. Registration of Charges
7. Management and Administration
8. Declaration and payment of Dividend
9. Accounts of Companies
10. Audit and Auditors

PART II- OTHER LAWS (40 MARKS)

Objectives:

(a) To develop an understanding of the provisions of select legislations and acquire the ability to address application-oriented issues.

(b) To develop an understanding of the rules for interpretation of statutes

1. **The Indian Contract Act, 1872** (Specific contracts covered from section 123 onwards): Contract of Indemnity and Guarantee, Bailment, Pledge, Agency
2. **The Negotiable Instruments Act, 1881**: Meaning of Negotiable Instruments, Characteristics, Classification of Instruments, Different provisions relating to Negotiation, Negotiability, Assignability, Right and Obligation of parties, presentment of Instruments, Rules of Compensation
3. **The General Clauses Act, 1897:** Important Definitions, Extent and Applicability, General Rules of Construction, Powers and Functionaries, Provisions as to Orders, Rules, etc. made under Enactments, Miscellaneous
4. **Interpretation of statutes**: Rules of Interpretation of statutes, Aids to interpretation, Rules of Interpretation/construction of Deeds and Documents

Note: ***If new legislations are enacted in place of the existing legislations, the syllabus would include the corresponding provisions of such new legislations with effect from a date notified by the Institute. Similarly, if any existing legislation ceases to have effect, the syllabus will accordingly exclude such legislation with effect from the date to be notified by the Institute.***

The specific inclusions/exclusions in the various topics covered in the syllabus will be effected every year by way of Study Guidelines, if required.

SIGNIFICANT ADDITIONS/MODIFICATIONS IN 2019 EDITION OVER 2017 EDITION

Division of syllabus	Chapters	Amendments
Part I	**Company Law (Chapters 1-10)**	• Relevant amendments from 1st May, 2017 to 30th April, 2019 • Changes in Presentation through insertion of flowchart, table, diagram. • Addition of examples • Insertion of explanation of the provisions (wherever required) for better understanding • Addition of more questions for practice under the heading "test your knowledge".
Part II	**Other Laws (Chapters 1- 4)**	• Changes in Presentation through insertion of flowchart, table, diagram. • Addition of more examples • Insertion of explanation of the provisions (wherever required) for better understanding • Addition of more questions for practice under the heading "test your knowledge". • Amendments to the Negotiable Instruments Act, 1881 through the Negotiable Instruments (Amendment) Act, 2018. • Addition of more case laws and examples in the chapter of General Clauses Act, 1897.

CONTENTS

DETAILED CONTENTS: MODULE – 1

CHAPTER 1 : PRELIMINARY

CHAPTER 2 : INCORPORATION OF COMPANY AND MATTERS INCIDENTAL THERETO

CHAPTER 3 : PROSPECTUS AND ALLOTMENT OF SECURITIES

CHAPTER 4 : SHARE CAPITAL AND DEBENTURES

CHAPTER 5 : ACCEPTANCE OF DEPOSITS BY COMPANIES

CHAPTER 6 : REGISTRATION OF CHARGES

CHAPTER 7: MANAGEMENT & ADMINISTRATION

CHAPTER 8: DECLARATION AND PAYMENT OF DIVIDEND

CHAPTER 9 : ACCOUNTS OF COMPANIES

CHAPTER 10 : AUDIT AND AUDITORS

CHAPTER 1

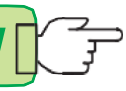
PRELIMINARY

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- To know about the extent and commencement of the Companies Act, 2013.
- Know about the application of the Act.
- Gain Familiarity with the definition clause given in the Act.

CHAPTER OVERVIEW



Preliminary chapter of the Act covers

- Short title, extent and commencement
- Application
- Definitions

1. INTRODUCTION

The Companies Act, 2013 is an Act to consolidate and amend the law relating to companies. The legislation was necessitated to meet changes in the national and international economic environment and for expansion and growth of economy of our country.

The Companies Act, 2013 received the assent of the Hon'ble President of India on 29th August, 2013 and was notified in the Official Gazette on 30th August, 2013 for public information stating that different dates may be appointed for enforcement of different provisions of the Companies Act,2013, through notifications.

Example: Section 1 came into force on 30th August, 2013; 98 sections came into force on 12th September, 2013; 143 sections were enforced from 1st April, 2014 and so on.

The Companies Act, 2013 is rule based legislation with 470 sections and seven schedules. The entire Act has been divided into 29 chapters. Each chapter has at least one set of Rules. The Companies Act, 2013 aims to improve corporate governance, simplify regulations and strengthen the interests of investors. Thus, the enactment making our corporate regulations more contemporary.

2. SHORT TITLE, EXTENT, COMMENCEMENT AND APPLICATION

This Section 1 of the Companies Act, 2013 deals with the title of the Act. According to which this Act may be called as the Companies Act, 2013.

Further, section deals with the extent to the applicability of the Act. It says that the Act shall extend to the whole of India.

This section also specifies the date of commencement of this Act. Accordingly, this section shall come into force at once and the remaining provisions of this Act shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint and different dates may be appointed for different provisions of this Act and any reference in any provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

This Section furthermore states of the applicability of the Act. The provisions of this Act shall apply to-

(a) companies incorporated under this Act or under any previous company law*;

(b) insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;

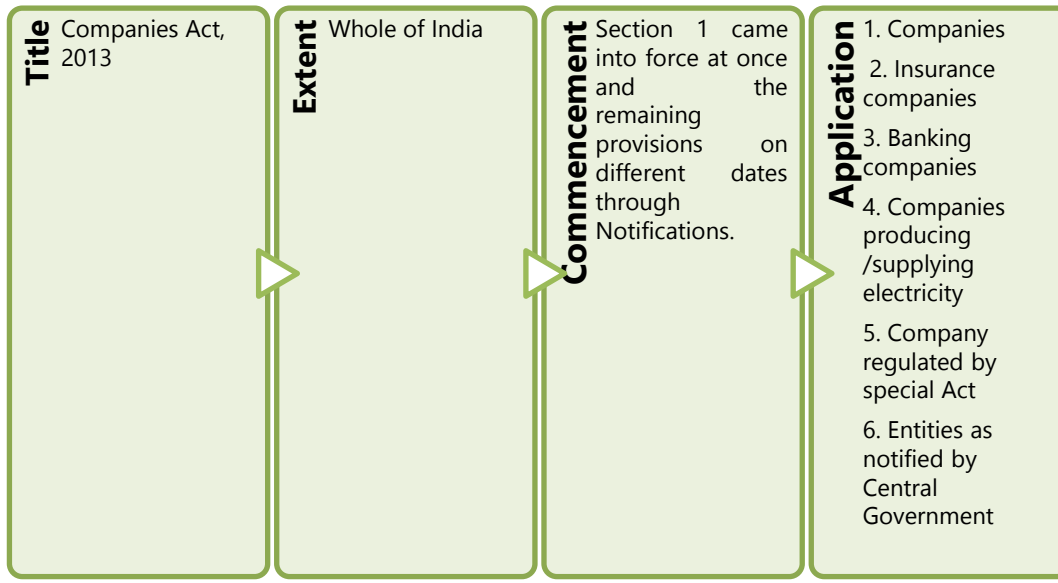
(c) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;

(d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;

(e) any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act, and

(f) such body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification. **Example**: Food Corporation of India (FCI), National Highway Authority of India (NHAI) etc.

*__For example__: ABC Ltd. was incorporated on 1.1.1912 under the Indian Companies Act, 1882. So, the Companies Act, 2013 shall also be applicable on ABC Ltd.



3. DEFINITIONS

Section 2 of the Companies Act, 2013 is a definition section. It provides various terminologies used in the Act. Definitional Sections or Clauses, are known as 'internal aids to construction' and can be of immense help in interpreting or construing the enactment or any of its parts.

Also, according to clause 95 of section 2, words and expressions used and not defined in this Act but defined in the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 shall have the meanings respectively assigned to them in those Acts.

When a word or phrase is defined as having a particular meaning in the enactment, it is that meaning alone which must be given to it while interpreting a Section of the Act unless there be anything repugnant in the context.

Section 2[1] states that- In this Act, unless the context otherwise requires,—

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

[1] The number given in brackets i.e. **( )** at the start of definition**,** denotes the clauses to section 2.

(2) **Accounting standards** means the standards of accounting or any addendum thereto for companies or class of companies referred to in section 133;

Section 133 of the Act deals with the Central Government to Prescribe Accounting Standards. As per the section, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

Section 133 is to be read with Rule 7 of the *Companies (Accounts) Rules, 2014*. Accordingly,

(i) The standards of accounting as specified under the Companies Act, 1956 shall be deemed to be the accounting standards until accounting standards are specified by the Central Government under section 133.

(ii) Till the National Financial Reporting Authority is constituted under section 132 of the Act, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India in consultation with and after examination of the recommendations made by the National Advisory Committee on Accounting Standards constituted under section 210A of the Companies Act, 1956.

Further, in exercise of the powers conferred by section 133, the Central Government in consultation with the National Advisory Committee on Accounting Standards prescribed that *Companies (Accounting Standards) Rules, 2006* and the *Companies (Indian Accounting Standards) Rules, 2015* may be followed.

(3) **Alter or Alteration** includes the making of additions, omissions and substitutions;

(5) **Articles** means-

- the articles of association of a company as **originally** framed, or
- as altered from **time to time**, or
- applied in pursuance of any **previous company law**, or
- applied in **pursuance of this Act**;

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

Explanation.—For the purpose of this clause,—

(a) the expression "significant influence" means control of at least twenty per cent. of total voting power, or control of or participation in business decisions under an agreement;

(b) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement;

Vide Circular dated 25/06/2014 it has been clarified that the shares held by a company in another company in a fiduciary capacity shall not be counted for the purpose of determining the relationship of associate company.

Students may please note that the definition of Associate company as defined under AS 23/ Ind AS 28 (Accounting for Investments in Associates in Consolidated Financial Statements/ Investment in Associates and Joint Ventures) is slightly different from the above definition as given in the Companies Act, 2013.

(7) **Auditing standards** means the standards of auditing or any addendum thereto for companies or class of companies referred to in sub-section (10) of section 143.

[*]**Section 143 of the Companies Act, 2013 deals with the Powers and Duties of Auditors and Auditing Standards.** Sub-section (10) to section 143 provides that the Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority:

Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

[*] Just for information of the students

(8) **Authorised capital** or **Nominal capital** means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company;

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

(11) **Body corporate** or **Corporation** includes a company incorporated outside India, but does not include—

(i) a co-operative society registered under any law relating to co-operative societies; and

(ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf;

(12) **Book and Paper** and **Book or Paper** include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form;

As per the *Companies (Specification of definitions details) Rules, 2014*, "e-Form" means a form in the electronic form as prescribed under the Act or the rules made thereunder and notified by the Central Government under the Act;

(13) "**Books of account**" includes records maintained in respect of—

(i) **all sums of money received and expended by a company** and matters in relation to which the receipts and expenditure take place;

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

(iii) the **assets and liabilities** of the company; and

(iv) the **items of cost** as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

Section 148 of the Companies Act, 2013 authorises Central Government to Specify Audit of Items of Cost in Respect of Certain Companies.

(14) **Branch office**, in relation to a company, means any establishment described as such by the company;

(15) **Called-up capital** means such part of the capital, which has been called for payment;

(18) **Chief Executive Officer (CEO)** means an officer of a company, who has been designated as such by it;

(19) **Chief Financial Officer(CFO)** means a person appointed as the Chief Financial Officer of a company;

These definitions of CEO & CFO should be read with section 2(51) and 203 which deals with the definition and appointment of Key Managerial Personnel (KMP) of the Companies Act, 2013.

(20) **Company** means a company incorporated under this Act or under any previous company law;

[Refer clause 67 of section 2 (Previous Company Law) along with the above definition]

(21) **Company limited by guarantee** means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up;

(22) **Company limited by shares** means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them;

(27) **Control** shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

It is an inclusive definition and relevant for the provisions relating to subsidiary and holding companies. This definition is also relevant for the definition of subsidiary given under section 2(87).

(30) **Debenture** includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not;

Provided that— (a) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

(b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company,

shall not be treated as debenture;

(34) **Director** means a director appointed to the Board of a company;

(36) "**Document**" includes summons, notice, requisition, order, declaration, form and register, whether issued, sent or kept in pursuance of this Act or under any other law for the time being in force or otherwise, maintained on paper or in electronic form;

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

(38) **Expert** includes an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force;

(40) **Financial statement** in relation to a company, includes—

(i) **a balance sheet** as at the end of the financial year;

(ii) a **profit and loss account**, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

(iii) **cash flow statement** for the financial year;

(iv) a statement of changes in **equity**, if applicable; and

(v) any **explanatory note** annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement;

Exemption: For private companies, the proviso to section 2(40) shall be read as follows:

"Provided that the financial statement, with respect to one person company, small company, dormant company and private company (if such private company is a start-up) may not include the cash flow statement;

Explanation. - For the purposes of this Act, the term "start-up" or "start-up company" means a private company incorporated under the Companies Act, 2013 or the Companies Act, 1956 and recognised as start-up in accordance

with the notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry."

The exceptions, modifications and adaptations shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.

Note: Students may note that 'Profit and Loss Account' may also be referred as 'Statement of Profit and Loss' under the Act at some places. **For example**: Schedule III.

(41) **Financial year**, in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:[2]

Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year:

Provided also that any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Ordinance, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement.

Provided also that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause.

(43) **Free reserves** means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

[2] With respect to specified IFSC public company & specified IFSC Private company, a proviso has been inserted vide *notification dated 4th January, 2017* stating that above stated company which is subsidiary of a foreign company, the financial year of the subsidiary may be same as the financial year of its holding company & approval of Tribunal shall not be required.

Provided that—

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves;

(45) **Government company** means any company in which **not less than 51%** of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company;

Example: X is a company in which 50% of shareholding is held by Central Government. Here X is not a government company as there is no compliance of minimum holding of paid-up share capital i.e. at least 51 % by the Central Government, or by any State Government or Governments.

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

Explanation.—For the purposes of this clause, the expression "company" includes any body corporate.

For meaning of "subsidiary company" refer the definition given in section 2(87) of the Companies Act, 2013.

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

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

(i) the Chief Executive Officer or the managing director or the manager;

(ii) the company secretary;

(iii) the whole-time director;

(iv) the Chief Financial Officer;

(v) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and

(vi) such other officer as may be prescribed;

Note: However, till now no other officer has been prescribed.

(52) **Listed company** means a company which has any of its securities listed on any recognised stock exchange;

(55) **Member**, in relation to a company, means—

(i) **the subscriber to the memorandum** of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members even if the subscription money has not been paid to the company;

(ii) **every other person who agrees in writing** to become a member of the company and whose name is entered in the register of members of the company;

(iii) **every person holding shares of the company** and whose name is entered as a beneficial owner in the records of a depository;

(56) **Memorandum** means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act;

(57) **Net worth** means the aggregate value of the paid-up share capital and all reserves created out of the profits, securities premium account and debit or credit balance of profit and loss account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

(59) **Officer** includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act;

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

(i) whole-time director (WTD);

(ii) key managerial personnel (KMP);

(iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

(iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

(v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;

(vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;

(vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer;

Example: In a company, a default was committed with respect to the allotment of shares by the officers. In company there were no managing director, whole time director, a manager, secretary, a person charged by the Board with the responsibility of complying with the provisions of the Act, and neither any director/directors specified by the board. Therefore, in such situation, all the directors of the company may be treated as officers in default.

(62) **One Person Company** means a company which has only one person as a member;

(63) **Ordinary** or **special resolution** means an ordinary resolution, or as the case may be, special resolution referred to in section 114 (Ordinary and Special Resolution);

(64) **Paid-up share capital or share capital paid-up** means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;

(65) Postal ballot means voting by post or through any electronic mode;

This definition is related to section 110 to be read with Rule 22 of the *Companies (Management and Administration) Rules, 2014* specifying the procedure to be followed for conducting of business through postal ballot and provides the list of items of business which should be transacted only by means of voting trough a postal ballot.

[3]**(68) Private company** means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that—

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased,

shall not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company;

The requirement of having a minimum paid up share capital shall not apply to a section 8 company *vide notification dated 5th June 2015*.

The above- mentioned exemption shall be applicable to a section 8 company which has not committed a default in filing its financial statements under section 137 of the Companies Act, 2013, or annual return under section 92 of the said Act with Registrar. [Vide amendment notification G.S.R. 584(E) dated 13th June, 2017.]

*Since nothing has been prescribed so far. Thus, there is no minimum paid up share capital to form a private company.

[3] Exemptions given to specified IFSC private company *vide notification dated 4th January, 2017*.

(69) Promoter means a person—

(a) who has been **named as such in a prospectus** or is identified by the company in the annual return, or

(b) who has **control over the affairs of the company**, directly or indirectly whether as a shareholder, director or otherwise; or

(c) in accordance with whose **advice, directions or instructions** the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity;

(70) Prospectus means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate;

[4]**(71) Public company** means a company which—

(a) is not a private company; and

(b) has a minimum paid-up share capital as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles ;

Example: A Pvt. Ltd. is wholly owned subsidiary of AB Ltd. A Pvt. Ltd. wanted to avail exemptions as provided to private companies. In this case since A Pvt. Ltd.is subsidiary of AB Ltd., which is a public company, therefore A Pvt. Ltd. will be deemed to be a public company and will be not allowed to avail exemptions provided to a private company.

The requirement of having a minimum paid up share capital shall not apply to a section 8 company *vide notification dated 5th June 2015*.

Since nothing has been prescribed so far. Thus, there is no minimum paid up share capital to form a public company.

(74) Register of companies means the register of companies maintained by the Registrar on paper or in any electronic mode under this Act;

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[4] Exemptions given to specified IFSC public company *vide notification dated 4th January, 2017*.

(75) Registrar means a Registrar, an Additional Registrar, a Joint Registrar, a Deputy Registrar or an Assistant Registrar, having the duty of registering companies and discharging various functions under this Act;

(76) Related party, with reference to a company, means—

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager or his relative is a member or director;

(v) a public company in which a director and manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;

(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

[5](viii) any body corporate which is-

(A) a holding, subsidiary or an associate company of such company;

(B) a subsidiary of a holding company to which it is also a subsidiary; or

(C) an investing company or the venturer of the company;

Explanation.- For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

[5] The above clause (viii) shall not apply with respect to section 188 to a Specified IFSC Public company vide Notification no. G. S.R. 08(E) dated 4th January, 2017

Exemption - This Clause (viii) shall not apply with respect to section 188 to a private company *vide Notification No. G.S.R. 464(E) dated 5th June, 2015*.

(ix) such other person as may be prescribed;

As per Rule 3 given in the *Companies (Specification of Definitions Details) Rules, 2014*, for the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director (other than an independent director) or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

Example: (1) XYZ Pvt. Ltd has two subsidiary companies, Y Pvt. Ltd and Z Pvt. Ltd. Here as per the section 2(76)(viii)(B), Y Pvt. Ltd and Z Pvt. Ltd. are related parties. However, as per the Notification No. G.S.R. 464(E) dated 5th June, 2015, clause (viii) shall not apply with respect to section 188 to a private company. Therefore Y Pvt. Ltd and Z Pvt. Ltd are not related parties for the purpose of section 188. However, if Y Pvt. Ltd and Z Pvt. Ltd. have common directors, then they will be deemed to be related parties because of section 2(76)(iv).

(2) Now suppose, XYZ Ltd. a public company, has two subsidiary companies, Y Pvt. Ltd and Z Pvt. Ltd. Here as per section 2(71), a private company which is a subsidiary of a public company will deemed to be a public company, so Y Pvt. Ltd and Z Pvt. Ltd will not be eligible to avail exemption under the Notification No. G.S.R. 464(E) dated 5th June, 2015. Therefore, as per section 2(76)(viii)(B), Y Pvt. Ltd and Z Pvt. Ltd are related parties. In addition XYZ Ltd. will also be related Party to Y Pvt. Ltd and Z Pvt. Ltd.

(77) Relative, with reference to any person, means anyone who is related to another, if—

(i) they are members of a Hindu Undivided Family;

(ii) they are husband and wife; or

(iii) one person is related to the other in such manner as may be prescribed;

Rule 4 given in the *Companies (Specification of Definitions Details) Rules, 2014* provides of the List of Relatives in terms of Clause (77) of section 2. Accordingly, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:-

(1) Father: Provided that the term "Father" includes step-father.

(2) Mother: Provided that the term "Mother" includes the step-mother.

(3) Son: Provided that the term "Son" includes the step-son.

(4) Son's wife.

(5) Daughter.

(6) Daughter's husband.

(7) Brother: Provided that the term "Brother" includes the step-brother;

(8) Sister: Provided that the term "Sister" includes the step-sister.

(84) **Share** means a share in the share capital of a company and includes stock;

(85) **Small company** means a company, other than a public company,—

(i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; **and**

(ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to—

(A) a holding company or a subsidiary company;

(B) a company registered under section 8; or

(C) a company or body corporate governed by any special Act;

Example: P Ltd. is a company registered under the Companies Act, 2013 with paid up capital of ₹ 10 Lacs and turnover 2 crore rupees. According to section 2(85) a small company is a company other than a public company with the paid up of capital not exceeding fifty lakh rupees and turnover not exceeding two crore rupees. Since, P Ltd. is a public company though complying with other requirements, it cannot avail the status of a small company.

(86) **Subscribed capital** means such part of the capital which is for the time being subscribed by the members of a company;

(87) **Subsidiary company** or **Subsidiary**, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation—For the purposes of this clause,—

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries;

As per the notification dated 27th December 2013, Ministry clarified that the shares held by a company or power exercisable by it in another company in a fiduciary capacity shall not be counted for the purpose of determining the holding –subsidiary relationship in terms of the provision of section 2(87) of the Companies Act, 2013.

Students may please note that the definition of Associate company as defined under AS 21/ Ind AS 110 (Consolidated Financial Statement) is slightly different from the above definition as given in the Companies Act,2013.

(88) **Sweat equity shares** means such equity shares as are issued by a company to its **directors or employees** at a **discount** or for consideration, **other than cash**, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;

(89) **Total voting power**, in relation to any matter, means the total number of votes which may be cast in regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes;

(91) **Turnover** means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year;

(92) **Unlimited company** means a company not having any limit on the liability of its members;

(93) **Voting right** means the right of a member of a company to vote in any meeting of the company or by means of postal ballot;

CHAPTER 2

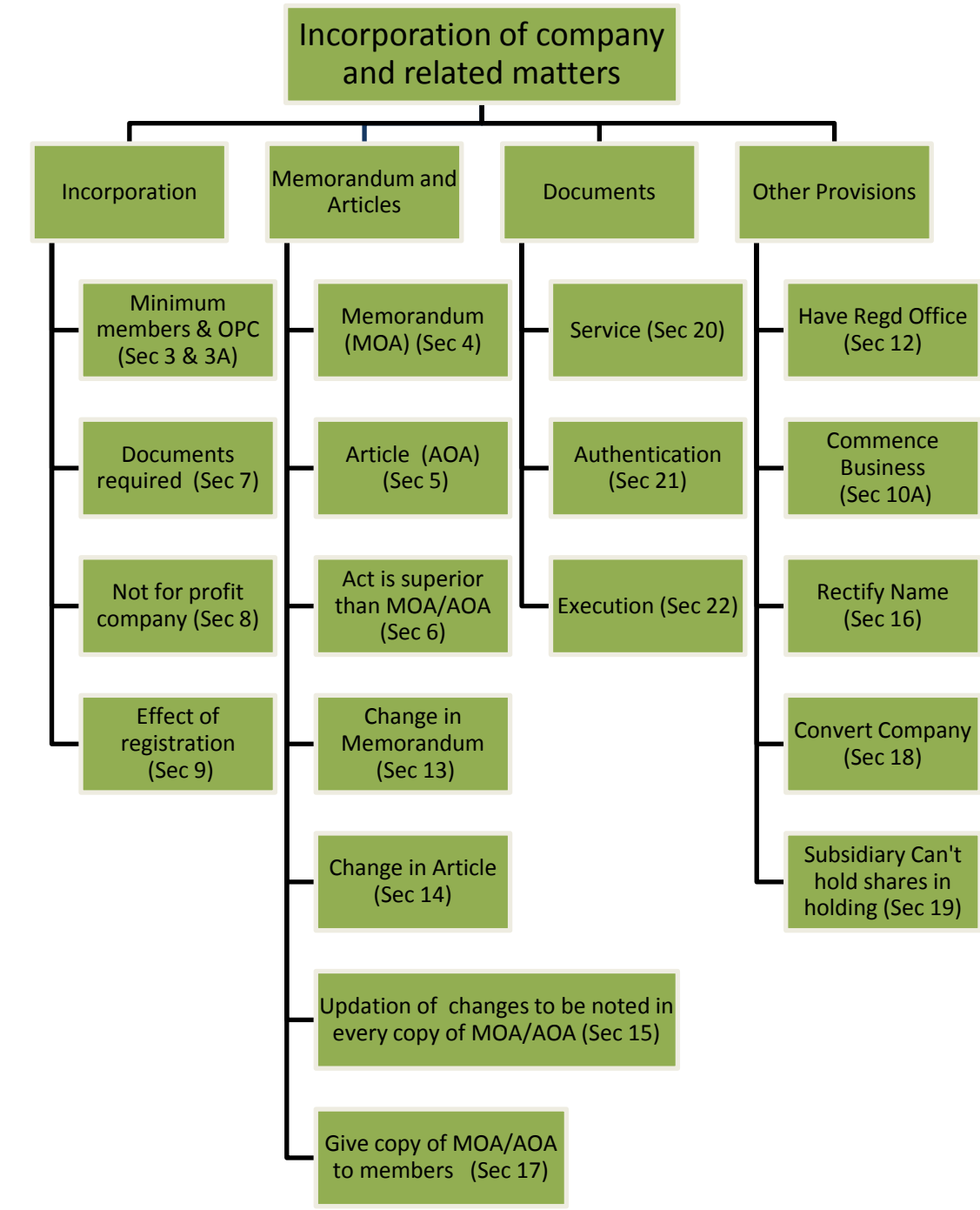
INCORPORATION OF COMPANY AND MATTERS INCIDENTAL THERETO

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Explain the Formation & Incorporation of company, One person company and the formation of not for profit organization.
- Identify the need for Memorandum and Articles of Association and changes incidental thereto.
- Know the effect of registration.
- Explain and identify the concepts related to registered office of company.
- Know how the Service of documents is effected
- Know about Authentication of documents, proceedings and contracts and Execution of bills of exchange, etc.

CHAPTER OVERVIEW



1. INTRODUCTION TO INCORPORATION OF COMPANIES

A company is a **separate** legal entity with **perpetual** succession for **lawful** purpose. Development of this concept is equally significant in economic terms as invention of steam engine is for the industrial revolution.

Persons who initiate promotion of a company are known as **promoters.** All persons who take steps for the registration of a company e.g., those associated with the **preparation of a prospectus** or in drawing up the **Memorandum of Association** of the company and assisting in its **registration** are regarded as promoters.

The Companies Act, 2013 defines the term **"Promoter"** under section 2(69) which means a person—

(a) who has been named as such in a **prospectus** or is identified by the company in the **annual return** referred to in section 92; or

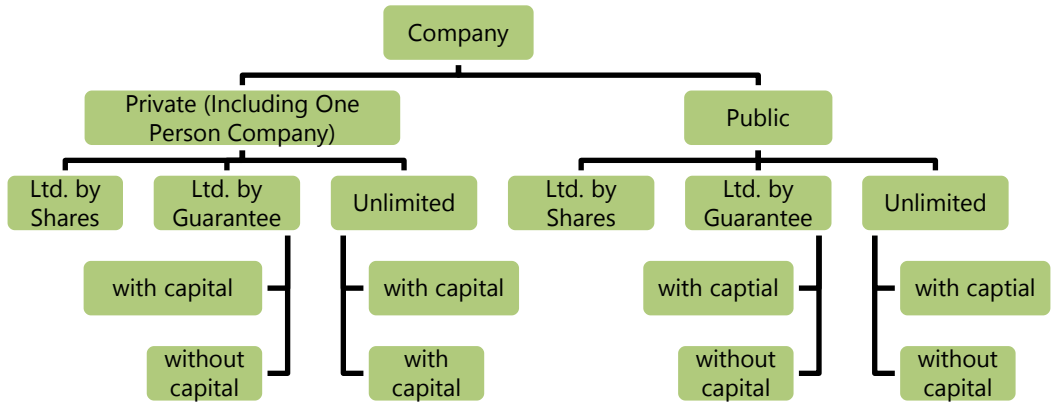
(b) who has **control** over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

(c) in accordance with whose **advice**, **directions or instructions** the Board of Directors of the company is accustomed to act.

However, a person who is **acting merely in a professional Capacity**, shall not be regarded as promoter [under (c)], e.g., the solicitor, banker, accountant etc. are not regarded as promoters.

2. FORMATION OF COMPANY (SECTION 3)

Companies are broadly of below types:



As you can observe in above chart that companies could be with limited liability (by shares or guarantee) or with unlimited liability.[1]&[2]

Note: For **Government Companies, suffix "Pvt. Ltd / Ltd." not required** (*Notification dated 5th June 2015*). This exception shall be applicable to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar [*Notification dated 13th June 2017]*.

Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a **public** company with or without limited liability any **7** or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration. In exactly the same way, **2** or more persons can form a **private** company and **1** person where company to be formed is **one person company.**

However, that one person company need to specify the **name of one nominee** in the **Memorandum of Association (MOA)** who would take his place in case of his death or his incapacity to contract. The **nominee could be changed** as per the process and this will **not attract** process for alteration of the Memorandum of Association.

Extract of Act [Section 3]

"(1) A company may be formed for any lawful purpose by—

(a) seven or more persons, where the company to be formed is to be a public company;

(b) two or more persons, where the company to be formed is to be a private company; or

(c) one person, where the company to be formed is to be One Person Company that is to say, a private company,

by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration:

Provided that the memorandum of One Person Company shall indicate the name

[1] Provided that a Specified IFSC public or Specified IFSC Private company shall be formed only as a company limited by shares.

[2] IFSC company means a company incorporated in any International Financial Services Center in India, like in Gujarat International Finance Tec-City.

of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles:

Provided further that such other person may withdraw his consent in such manner as may be prescribed:

Provided also that the member of One Person Company may at any time change the name of such other person by giving notice in such manner as may be prescribed:

Provided also that it shall be the duty of the member of One Person Company to intimate the company the change, if any, in the name of the other person nominated by him by indicating in the memorandum or otherwise within such time and in such manner as may be prescribed, and the company shall intimate the Registrar any such change within such time and in such manner as may be prescribed:

Provided also that any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

(2) A company formed under sub-section (1) may be either—

(a) a company limited by shares; or

(b) a company limited by guarantee; or

(c) an unlimited company.**"**

Maintain minimum number of members [Section 3A]

If at any time the number of members of a company is **reduced,** in the case of a public company, **below seven**, in the case of a private company, **below two**, and the company carries on business for **more than six months** while the number of members is so reduced, **every person** who is a member of the company during the time that it so carries on business after those six months and is **cognizant** (aware) of the fact that it is carrying on business with less than seven members or two members, as the case may be, shall be **severally liable** for the payment of the whole debts of the company **contracted during that time (after six months)**, and may be severally sued therefore.

3. INCORPORATION OF COMPANY [SECTION 7]

I. INCORPORATION OF COMPANY: Section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

- **STEPS FOR INCORPORATION**
1. Reservation of name by filing e- apllication
2. Drafting & signing of MOA & AOA and its submission to ROC. These documents have to be e- filed and e- stamped
3. Consent of persons nominated as directors to act as directors to be submittted electronically
4. Submission of 'statutory declaration of compliance' and other declarations
5. Pay fees & amount of stamp duty electonically
6. Obtain certificate of incorporation digitally signed by ROC
7. File declaration about address of Registered office

Note: New requirement of submitting declaration that 'all subscribers have paid the value of shares agreed to be taken by him' and 'verification of Registered office has been filed' has beeen inserted vide section 10A. This requirement is needed to be complied with before the commencement of business.

(1) Filing of the documents and information with the registrar: For the registration of the company following documents and information are required to be filed with the **registrar** within whose jurisdiction the registered office of the company is proposed to be situated—

- the **memorandum** and **articles** of the company duly signed by all the subscribers to the memorandum.
- a **declaration by** person who is engaged in the formation of the company

(an **a**dvocate, a **chartered accountant**, **c**ost **a**ccountant or **c**ompany **s**ecretary in practice), and by a person named in the articles (**director**, **m**anager or **s**ecretary of the company), that all the **requirements** of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with.

- a **declaration** from each of the **subscribers** to the memorandum and from persons named as the **first directors**, if any, in the articles stating that—
  - he is **not convicted** of any offence in connection with the promotion, formation or management of any company, or
  - he has **not** been found **guilty** of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the last **five years**,
  - and that all the **documents** filed with the Registrar for registration of the company contain information that is **correct** and complete and true to the best of his knowledge and belief;
- the **address** for correspondence till its registered office is established;
- the particulars (**names**, including **surnames** or family names, residential **address**, **nationality**) of every **subscriber** to the memorandum along with proof of **identity**, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.
- the particulars (**names**, including **surnames** or family names, the Director Identification Number **(DIN)**, residential **address**, **nationality**) of the persons mentioned in the articles as the **first directors** and such other particulars including proof of **identity** as may be prescribed; and
- the particulars of the interests of the persons mentioned in the articles as the **first directors** of the company in **other firms** or bodies corporate along with their **consent** to act as directors of the company in such form and manner as may be prescribed.

(2) Issue of certificate of incorporation on registration: The **Registrar** on the basis of documents and information filed, shall register all the documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

(3) Allotment of Corporate Identity Number (CIN): On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

(4) Maintenance of copies of all documents and information: The company shall maintain and preserve at its registered office copies of all documents and information as originally filed, till its **dissolution** under this Act.

(5) Furnishing of false or incorrect information or suppression of material fact at the time of incorporation (i.e. during incorporation process): If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action for fraud under **section 447.**

(6) Company already incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact (i.e. post Incorporation): where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any **false** or incorrect information or representation or by **suppressing** any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any **fraudulent** action, the **promoters**, the persons named as the **first directors** of the company and the persons making declaration under this section shall each be liable for action for fraud under **section 447.**

(7) Order of the Tribunal[3] : Where a company has been got incorporated by furnishing **false** or incorrect information or representation or by **suppressing** any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any **fraudulent** action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants—

(a) pass such orders, as it may think fit, for regulation of the management of the company including **changes**, if any, in its **memorandum and articles**, in public interest or in the interest of the company and its members and creditors; or

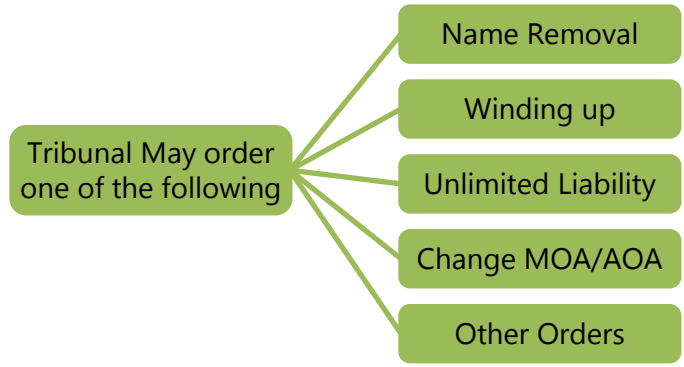
(b) direct that liability of the members shall be **unlimited**; or

(c) direct **removal** of the name of the company from the register of companies; or

(d) pass an order for the **winding up** of the company; or

[3] "Tribunal" means the National Company Law Tribunal (NCLT) constituted under section 408 of the Companies Act, 2013. The NCLT is a quasi- judicial body in India that adjudicates issues relating to companies in India. The NCLT was established under the Companies Act, 2013 and was constituted on 1st June, 2016.

(e) pass such **other orders** as it may deem fit:



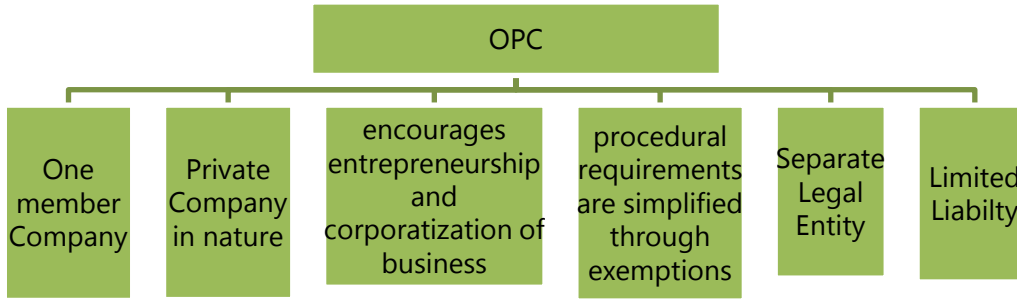
Provided that before making any order,—

- the company shall be given a reasonable **opportunity of being heard** in the matter; and
- the Tribunal shall take into consideration the **transactions entered** into by the company, including the obligations, if any, contracted or payment of any liability.

Simplified Proforma for Incorporating Company Electronically (SPICe)

The Ministry of Corporate Affairs has taken various initiatives **for ease of business**. In a step towards easy setting up of business, MCA has simplified the process of filing of forms for incorporation of a company through Simplified Proforma for incorporating company **electronically**.

4. INCORPORATION OF ONE PERSON COMPANY



Law with respect to formation of OPC provides that—

- The **memorandum** of OPC shall indicate the name of the other person **(nominee)**, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
- The other person **(nominee)** whose name is given in the memorandum shall give his **prior written consent** in prescribed form and the same shall be **filed** with **Registrar** of companies at the time of incorporation along with its Memorandum of Association and Articles of Association.

- Such other person (nominee) may be given the **right to withdraw his consent**
- The **member** of OPC may at any time **change the name** of such other person **(nominee)** by giving notice to the company and the company shall intimate the same to the Registrar
- Any such change in the name of the person shall **not** be deemed to be an **alteration of the memorandum**.
- Only a **natural person** who is an **Indian citizen** and **resident in India**-

  (a) shall be **eligible** to incorporate a One Person Company;

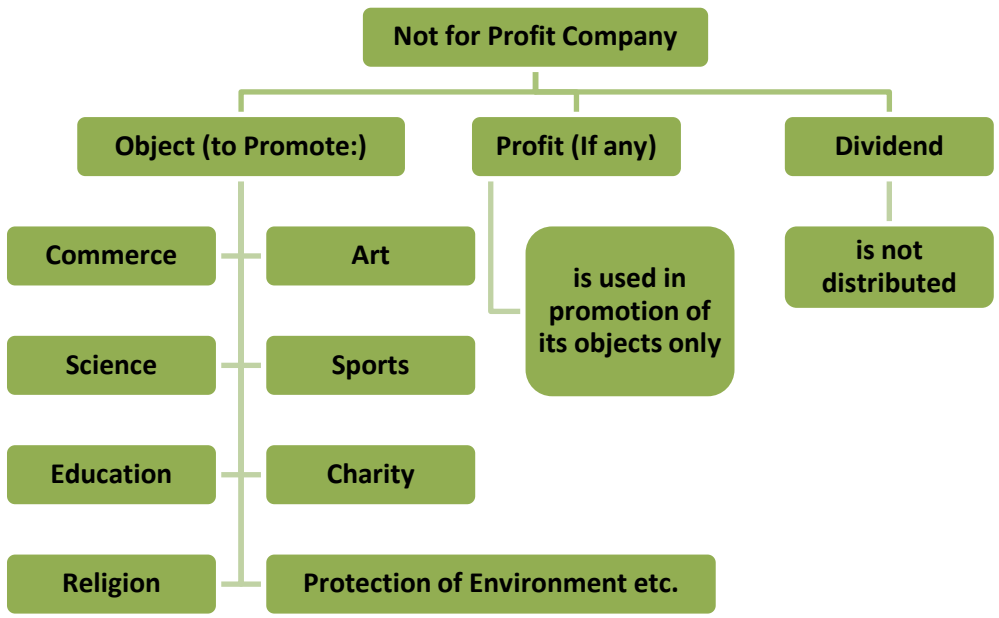
  (b) shall be **a nominee** for the sole member of a One Person Company.

  Explanation I - For the purposes of this rule, the term **"resident in India"** means a person who has stayed in India for a period of not less than **182 days** during the immediately preceding financial year.
- A natural person shall **not** be a **member of more than one** OPC at any point of time and the said person shall not be a **nominee of more than one** OPC.
- Where a natural person being member in OPC **becomes member in another** such company by virtue of his being a nominee in that OPC, such person shall **meet eligibility criteria** (as given in point above) within a period of **182 days**.
- **No minor** shall become member or nominee of the OPC or can hold share with beneficial interest.
- Such Company **cannot** be incorporated or **converted** into a company under **section 8** of the Act. Though it may be **converted** to **private or public companies** in certain cases. The procedure of conversion is given in the rules 6 & 7 of Chapter II.

- Such Company cannot carry out **Non-Banking Financial Investment** activities including investment in securities of anybody corporate.
- OPC can**not convert voluntarily** into any kind of company unless **two years** have expired from the date of incorporation, **except** where the paid up share capital is increased **beyond fifty lakh rupees or** its **average annual turnover** during the relevant period **exceeds two crore rupees.**

5. FORMATION OF COMPANIES WITH CHARITABLE OBJECTS, ETC. [SECTION 8]

1. [4]**Object of formation of Section 8 Company :** Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed **to promote** the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc. Such company intends to **apply its profit** in promoting its objects and **prohibiting** the payment of any **dividend** to its members.



[4] The power of Central Government to register a Section 8 company has been delegated to ROC [S.O. 1353(E), dated 21st May, 2014]. Under the said notification, the Central Government has delegated to the Registrar of Companies, the power and functions vested in it under the said section of the said Act, subject to the condition that the Central Government may revoke such delegation of powers or may itself exercise the powers and functions under the said sections, if in its opinion, such a course of action is necessary in the public interest.

2. **Power of Central government to issue the license:** This section allows the Central Government to register such person or association of persons as a company with limited liability **without the addition of words 'Limited' or 'Private limited'** to its name, by issuing licence on such conditions as it deems fit. The registrar shall on application register such person or association of persons as a company under this section.

   'Where it is proved to the **satisfaction** of the Central Government[5] that a limited company registered under this Act or under any previous company law has been formed with any of the **objects** and with the **restrictions** and prohibitions it may, by **licence**, allow the company to be registered under section subject 8 to such **conditions** as the Central Government deems fit and to change its name by omitting the word —Limited, or as the case may be, the words —Private Limited from its name and thereupon the Registrar shall, on application, in the prescribed form, register such company under this section and all the provisions of this section shall apply to that company'.

3. **Privileges of limited Company:** On registration the company shall enjoy **same** privileges and obligations as of a limited company.

4. A **firm may be a member** of the company registered under section 8.

5. **Alteration of Memorandum and Articles:** A company registered under this section shall not alter the provisions of its memorandum or articles except with the **previous approval** of the **Central Government**[6]. [7]

6. **Conversion into any other kind of Company:** A company registered under this section may **convert** itself into company of any other kind only after complying with such conditions as may be prescribed.

   A company registered under section 8 which intends to convert itself into a company of any other kind shall pass a **special resolution** at a general meeting for approving such conversion.

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[5] Power of Central Government has been delegated to ROC [S.O. 1353(E), dated 21st May, 2014].

[6] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]

[7] Power has been delegated to ROC, except for alteration of memorandum in case of conversion into another kind of company [S.O. 1353(E), dated 21st May, 2014.]

7. Revocation of license

(i) The [8]Central Government may by order **revoke the licence** of the company where the company **contravenes** any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violation of the objects of the company or **prejudicial to public interest**, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a **written notice** of its intention to revoke the licence and **opportunity** to be heard in the matter.

(ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be **wound up** under this Act or **amalgamated** with another company registered under this section.

However, no such order shall be made unless the company is given a reasonable opportunity of being heard.

(iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be **amalgamated** with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

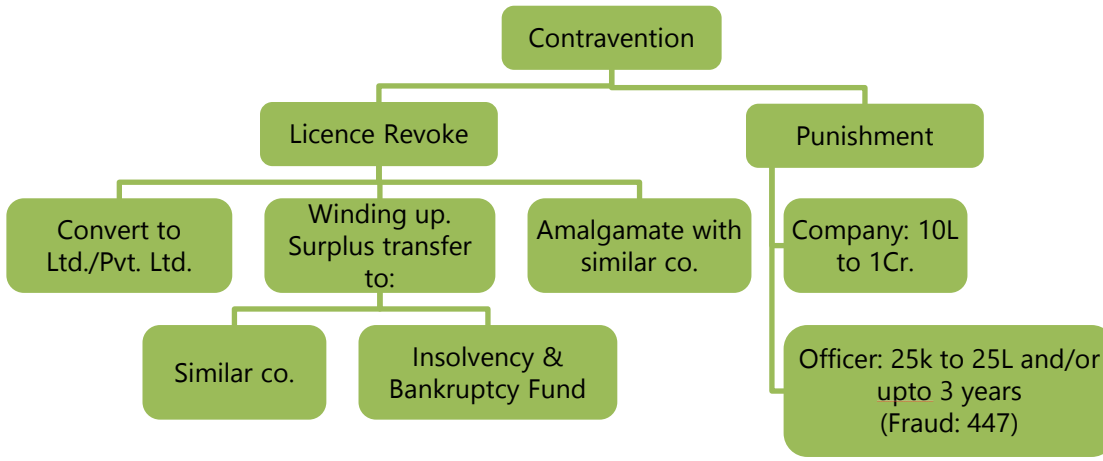
(iv) If on the **winding up** or **dissolution** of a company registered under this section, there remains, after the satisfaction of its debts and liabilities, any asset, they may be transferred to another company registered under this section and having similar objects, subject to such conditions as the **Tribunal** may impose, or may be sold and proceeds thereof credited to the **Insolvency and Bankruptcy Fund** formed under section 224 of the Insolvency and Bankruptcy Code, 2016.

[8] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]

(v) A company registered under this section shall **amalgamate only with** another company registered under this section and having similar objects.

8. Penalty/ punishment in contravention: If a company makes any default in complying with any of the requirements laid down in this section, the company shall, be **punishable with fine** varying from ten lakh rupees to one crore rupees and the directors and every officer of the company who is in default shall be punishable with **imprisonment** for a term which may extend to three years or with fine varying from twenty-five thousand rupees to twenty-five lakh rupees, or with both.

And where it is proved that the affairs of the company were conducted **fraudulently**, every officer in default shall be liable for action under **section 447.**



9. Exceptions:

(i) Can call its general meeting by giving a clear **14 days notice** instead of 21 days.

(ii) Requirement of **minimum number of directors**, independent directors etc. does not apply.

(iii) Need **not constitute** Nomination and Remuneration Committee and Shareholders Relationship Committee.

Formation
- To promote Charitable objects

Application of profits
- To promote its objectives
- No payment of dividends out of profits

Type of Co.
- Limited Liabilty
- Without the addition of words "Ltd." or "Pvt Ltd."

How status is granted
- The CG can grant such status
- However, CG has delegated the power to grant licence to ROC

Revocation of licence
- CG may revoke licence
  - If conditions of section 8 are contravened, or
  - affairs of the company are conducted fraudulently, or prejudicial to public interest

Effect of revocation of licence
- Co. has to use words "Ltd." or "Pvt Ltd."

6. EFFECT OF REGISTRATION [SECTION 9]

Section 9 of the Companies Act, 2013 provides for the effect of registration of a company.

According to section 9, from the date of incorporation (mentioned in the certificate of incorporation), the subscribers to the memorandum and all other persons, who may from time to time become members of the company, shall be a **body corporate** by the name contained in the memorandum. Such a registered company shall be capable of exercising **all the functions** of an incorporated company under this Act and having **perpetual succession** with power to acquire, hold and dispose of **property**, both movable and immovable, tangible and intangible, to **contract** and to sue and be sued, by the said name.

From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators; and there comes into existence a **binding contract** between the company and its members as evidenced by the Memoran-dum and Articles of Association **[***Hari Nagar Sugar*

Mills Ltd. vs. S.S. Jhunjhunwala]. It has **perpetual** existence until it is dissolved by liquidation or struck out of the register. A shareholder who buys shares, **does not** buy any interest in the **property** of the company but in certain cases a writ petition will be maintainable by a company or its shareholders.

A legal personality emerges from the moment of registration of a company and from that moment the persons subscribing to the Memorandum of Association and other persons joining as members are regarded as a body corporate or a corporation in aggregate and the legal person begins to function as an entity. A company on registration acquires a **separate existence** and the law recognises it as a legal person separate and distinct from its members *[State Trading Corporation of India vs. Commercial Tax Officer]*.

It may be noted that under the provisions of the Act, a company may **purchase** shares of another company and thus become a controlling company. However, merely because a company purchases **all shares of another company** it will **not** serve as a means of putting **an end** to the corporate character of another company and each company is a separate juristic entity *[Spencer & Co. Ltd. Madras vs. CWT Madras]*.

As has been stated above, the law recognizes such a company as a juristic person separate and distinct from its members. The mere fact that the **entire share** capital has been contributed by the **Central Government** and all its shares are held by the **President of India** and other officers of the Central Government does not make any difference in the position of registered company and it does not make a company an agent either of the President or the Central Government *[Heavy Electrical Union vs. State of Bihar]*.

7. MEMORANDUM OF ASSOCIATION – MOA [SECTION 4]

As per **section 2(56)** — memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act;

It is the base **document for the formation of the company** and alongwith the Articles of Association (AOA) is regarded as the Constitution of the Company.

The **MOA and AOA**, similar to other company agreements and resolutions is subject to the Companies Act, 2013 (Section 6) and the law of the land and therefore all its contents need to be in compliance of the Companies Act 2013 and other applicable legislations.

Section 4 of the Companies Act, 2013 seeks to provide for the requirements with respect to memorandum of a company.

I. Object of registering a memorandum of association:

- It contains the **object** for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go.
- It enables **shareholders, creditors** and all those who deal with company to **know** what its powers are and what activities it can engage in.
- A memorandum is a **public document** under Section 399 of the Companies Act, 2013. Consequently, every person entering into a contract with the company is **presumed to have the knowledge** of the conditions contained therein.
- The **shareholders** must know the **purposes** for which his money can be used by the company and what risks he is taking in making the investment.

A company **cannot depart** from the provisions contained in the memorandum however imperative may be the necessity for the departure. It **cannot enter** into a contract or engage in any trade or business, which is beyond the power confessed on it by the memorandum. If it does so, it would be **ultra vires** the company and **void**.

II. The memorandum of a company shall state—

(a) **In relation to the name clause**- the **name of the company** with the last word "**Limited**" in the case of a public limited company, or the last words "**Private Limited**" in the case of a private limited company.[9]

Exception: This clause is not applicable on the companies formed under **section 8** of the Act.

(b) **In relation to the Registered Office Clause-** the **State** in which the registered office of the company is to be situated;

(c) **In relation to the Object Clause**- the **objects** for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;[10]

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[9] In case of Specified IFSC Public Company and IFSC Private Company, name shall have the suffix, "International Financial Service company" or "IFSC" as a part of its name.

[10] Specified IFSC Public Company & IFSC Private company shall state its objects to do financial services activities as permitted under the Special Economic Zones Act, 2005 read with SEZ Rules, 2006 and any matter considered necessary in furtherance thereof in accordance with license to operate, from International Financial Services Centre located in an approved multi services Special Economic Zone, granted by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India.

III. Liability / Capital Clause:

(a) This clause covers details on the **liability of members** of the company, whether limited or unlimited, and also state—

- in the case of a company **limited by shares,** that the liability of its members is limited to the **amount unpaid**, if any, on the shares held by them; and
- in the case of a company **limited by guarantee,** the amount up to which each member undertakes to **contribute**—
  - **to the assets** of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the **debts and liabilities** of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
  - to the costs, charges and **expenses of winding-up** and
  - for adjustment of the rights of the **contributories** among themselves;

(b) in the case of a company having a **share capital**—

- the **amount** of share capital with which the company is to be registered and the **division** thereof into shares of a fixed amount and the number of shares which the **subscribers** to the memorandum agree to subscribe which shall not be less than **one share**; and
- the **number of shares** each subscriber to the memorandum intends to take, indicated **opposite his name**;

The clause, in the case of One Person Company, covers the name of the person (**nominee**) who, in the event of death of the subscriber, shall become the member of the company.

IV. Name Clause

Applying for the name of the company: The name stated in the memorandum shall not—

(a) be **identical** with or **resemble** too nearly to the name of an existing company registered under this Act or any previous company law; or

(b) be such that its use by the company—

- will constitute an offence under **any law** for the time being in force; or
- is **undesirable** in the opinion of the **Central Government**[11].

(c) **Undesirable Names:** A company shall **not** be registered with a name which contains—

(i) any word or expression which is likely to give the impression that the company is in any way **connected with**, or having the patronage of, the Central **Government**, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or

(ii) such word or expression, as may be **prescribed**, unless the previous **approval** of the Central Government has been obtained for the use of any such word or expression.

As per rule 8 of Companies (Incorporation) Rules, 2014 : The following words and combinations thereof shall not be used in the name of a company unless the **previous approval** of the Central Government has been obtained for the use of any such word or expression-Board; Commission; Authority; Undertaking; **National**; **Union**; **Central**; Federal; Republic; President etc.

If the proposed name include words such as '**Insurance'**, **'Bank'**, 'Stock Exchange', 'Venture Capital', 'Asset Management', 'Nidhi', 'Mutual fund' **etc.**, unless a declaration is submitted by the applicant that the requirements **mandated by** the **respective regulator**, such as IRDA, RBI, SEBI, MCA etc. have been complied with by the applicant;

(d) **[12]Reservation of name:**

Applying for name: A person may make an application, in such form and manner and accompanied by such fee, as may be prescribed, to the Registrar for the **reservation** of a name set out in the application as—

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[11] Power of Central Government has been delegated to ROC [S.O. 1353(E), dated 21st May, 2014].

[12] Rule 9: **Reservation of name**

An application for reservation of name shall be made through the web service available at www.mca.gov.in by using [form RUN](Reserve Unique Name) along with fee as provided in the Companies (Registration offices and fees) Rules, 2014, which may either be approved or rejected, as the case may be, by the Registrar, Central Registration Centre after allowing re--submission of such application within fifteen days for rectification of the defects, if any. [Notification G.S.R. 284(E) dated 23rd March, 2018]

(i) the **name** of the proposed company; or

(ii) the name to which the company proposes to **change** its name.

Reserving the name: Upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of **twenty days** from the date of approval or such other period as may be prescribed:

Provided that in case of an application for reservation of name or for change of its name by an existing company, the Registrar may reserve the name for a period of **sixty days** from the date of approval.

Cancelling name: Where after reservation of name, it is found that name was applied by furnishing wrong or incorrect information, then—

(i) if the company has **not** been **incorporated**, the reserved name shall be **cancelled** and the person who has made the application shall be liable to a **penalty** which may extend to one lakh rupees;

(ii) if the company has been **incorporated**, the Registrar may, after giving the company an opportunity of being heard—

(1) either direct the company to **change** its name within a period of **3 months**, after passing an **ordinary** resolution;

(2) take action for **striking off** the name of the company from the register of companies; or

(3) make a petition for **winding up** of the company.

Circular: As per the *General Circular No.29/2014, dated 11th of July, 2014,* Government directed that while allotting names to Companies/Limited Liability Partnerships, the Registrar of Companies concerned should exercise due care to ensure that the names are **not in contravention** of the provisions of the ***Emblems and Names (Prevention of Improper Use) Act****, 1950*. It is necessary that Registrars are fully familiar with the provisions of the said Act.

Note: Rule 8–Undesirable Names of *the Companies (Incorporation) Rules, 2014*, determines whether a proposed name is identical with another or other rules which may be kept in mind while dealing with the Name clause of the MOA.

V. Domicile Clause

The name of federal **state** is mentioned where the registered office is to be situated. Registered office is the permanent address of the company. It is residence of company.

VI. Objects Clause

Covers the **objects** for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

Doctrine of Ultra Vires

In the case of a company, whatever is **not stated in the memorandum** as the objects or powers **is prohibited** by the doctrine of ultra vires. As a result, an act which is ultra vires is **void**, and does not bind the company. Neither the company nor the contracting party can sue on it. The company cannot make it valid, even if every member assents to it.

The general rule is that an act which is **ultra vires** the company is **incapable of ratification**. An act which is intra vires the company but **outside the authority of the directors may be ratified** by the company in proper form [*Rajendra Nath Dutta v. Shilendra Nath Mukherjee, (1982) 52 Com Cases 293 (Cal.)*]**.**

If the act is ultra vires (beyond the powers of) the directors only, the shareholders can ratify it. If it is ultra vires the articles of association, the company can alter its articles in the proper way.

The rule is meant to **protect** shareholders and the creditors of the company. The doctrine of ultra vires was first enunciated by the House of Lords in a classic case, ***Ashbury Railway Carriage and Iron Co. Ltd. v. Riche****, (1878) L.R. 7 H.L. 653***.**The memorandum of the company in the said case defined its objects thus: "The objects for which the company is established are to make and sell, or lend or hire, railway plants to carry on the business of mechanical engineers and general contractors.....".

The company entered into a contract with M/s. Riche, a firm of railway contractors to finance the construction of a railway line in Belgium. On subsequent repudiation of this contract by the company on the ground of its being ultra vires, Riche brought a case for damages on the ground of breach of contract, as according to him the words "general contractors" in the objects clause gave

power to the company to enter into such a contract and, therefore, it was within the powers of the company. More so because the contract was ratified by a majority of shareholders.

The House of Lords held that the contract was ultra vires the company and, therefore, null and void. The term "general contractor" was interpreted to indicate as the making generally of such contracts as are connected with the business of mechanical engineers. The Court held that if every shareholder of the company had been in the room and had said, "That is a contract which we desire to make, which we authorise the directors to make", still it would be ultra vires. The shareholders **cannot ratify** such a contract, as the contract was ultra vires the objects clause, which by Act of Parliament, they were prohibited from doing.

The purpose of doctrine of ultra vires has been **defeated** as now the object clause can be easily altered, by passing just a special resolution by the shareholders.

VII. Subscription Clause:

According to section 7(1)(a) there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the memorandum and articles of the company **duly signed by all the subscribers** to the memorandum in such manner as may be prescribed in Rule 13 of *the Companies (Incorporation) Rules, 2014*.

VIII. Forms and schedule related to Memorandum:

The memorandum of a company shall be in respective forms specified in **Tables A, B, C, D and E** in Schedule I as may be applicable to such company.

The MOA and AOA shall be in respective forms as provided in **Schedule I** to the Companies Act, 2013:

TABLE –A

- MEMORANDUM OF ASSOCIATION OF A COMPANY LIMITED BY SHARES

TABLE –B

- MEMORANDUM OF ASSOCIATION OF A COMPANY LIMITED BY GUARANTEE AND NOT HAVING A SHARE CAPITAL

TABLE -C

- MEMORANDUM OF ASSOCIATION OF A COMPANY LIMITED BY GUARANTEE AND HAVING A SHARE CAPITAL

TABLE -D

- MEMORANDUM OF ASSOCIATION OF AN UNLIMITED COMPANY AND NOT HAVING SHARE CAPITAL

TABLE -E

- MEMORANDUM OF ASSOCIATION OF AN UNLIMITED COMPANY AND HAVING SHARE CAPITAL

TABLE -F

- ARTICLES OF ASSOCIATION OF A COMPANY LIMITED BY SHARES

TABLE – G

- ARTICLES OF ASSOCIATION OF A COMPANY LIMITED BY GUARANTEE AND HAVING A SHARE CAPITAL

TABLE - H

- ARTICLES OF ASSOCIATION OF A COMPANY LIMITED BY GUARANTEE AND NOT HAVING SHARE CAPITAL

TABLE – I

- ARTICLES OF ASSOCIATION OF AN UNLIMITED COMPANY AND HAVING A SHARE CAPITAL

TABLE - J

- ARTICLES OF ASSOCIATION OF AN UNLIMITED COMPANY AND NOT HAVING SHARE CAPITAL

IX. Any provision in the memorandum or articles, in the case of a company **limited by guarantee and not having a share capital**, shall not give any person a right to participate in the divisible profits of the company otherwise than as a member. If the contrary is done, it shall be **void**.

8. ARTICLES OF ASSOCIATION –AOA [SECTION 5]

As per **Section 2(5)**—articles means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act.

Actually, article of association of a company contains internal rules and regulation of the company.

Section 5 of the Companies Act, 2013 seeks to provide the contents and model of

articles of association. The section lays the following law—

(1) **Contains regulations:** The articles of a company shall contain the regulations for **management** of the company.

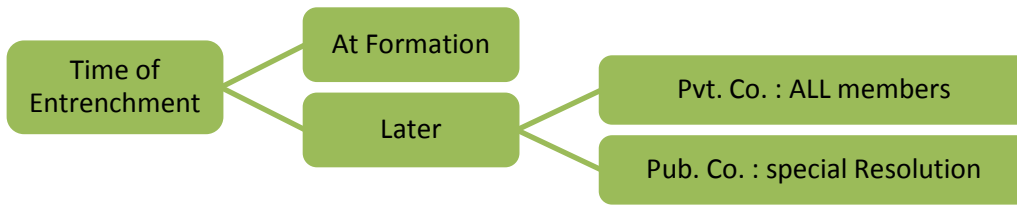
(2) **Inclusion of matters:** The articles shall also contain such matters, as are prescribed under the rules. However, a company may also include such **additional matters** in its articles as may be considered necessary for its management.

(3) **Entrenchment:** Usually an article of association may be altered by passing special resolution but entrenchment makes it more difficult to change it. So entrenchment means making something more protective.

Contain provisions for entrenchment: The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are **more restrictive than** those applicable in the case of a **special resolution**, are met or complied with.

Manner of inclusion of the entrenchment provision: The provisions for entrenchment shall only be made either on **formation** of a company, **or** by an **amendment** in the articles agreed to by **all** the members of the company in the case of a **private company** and by a **special resolution** in the case of **a public company**.

Notice to the registrar of the entrenchment provision: Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.



Example: Mr. Tarun promoted an education start up and got it registered as a private limited company. Initially he and his family are holding all shares in the company. In the article of association of company it is written that Mr. Tarun will remain director of the company for lifetime. But he has a fear that tomorrow if 75% or more shares in the company are held by non family

members then by passing a special resolution article may be changed and he may be removed from the post of director.

Therefore, it was also written in the article that he can be removed from the post of director only if 95% votes are cast in favour of the resolution. This is entrenchment.

Example: If PQR Company subscribes 20% shares of XYZ, a Private Ltd. company. Remaining 80% shares are held by promoters and family. Tomorrow if XYZ private limited approaches any Bank for a loan, the bank officials would read the Articles & would ask to get the consent of PQR Company. Now, if there is no entrenchment provision, then 'XYZ' may, after passing a special resolution remove the minority right and can borrow beyond the limit.

In order to control it, the entrenchment provisions are usually compelled by the minority to make the majority responsible and the minority in these provisions can get incorporated a clause saying that borrowing beyond a particular limit or issuances of shares is to be done only after the requisite consent of minority has been obtained.

(4) **Forms of articles:** The articles of a company shall be in respective **forms** specified in **Tables, F, G, H, I and J** in Schedule I as may be applicable to such company.

(5) **Model articles:** A company may adopt all or any of the regulations contained in the **model articles** applicable to such company.

(6) **Company registered after the commencement of this Act:** In case of any company, which is registered after the commencement of this Act, in so far as the registered **articles** of such company do not exclude or modify the regulations contained in the **model articles** applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

(7) **Section not apply on company registered under any previous company law:** Nothing in this section shall apply to the articles of a company registered under any previous company law, unless amended under this Act.

Doctrine of Indoor Management

According to this doctrine, persons dealing with the company **cannot be assumed to have knowledge** of internal problems of the company. He can

simply assume that all the required things were get done properly in the company.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to **take it for granted** that the company had gone through all these proceedings in a regular manner.

The doctrine helps protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management evolved around 150 years ago in the context of the doctrine of constructive notice. **The role of doctrine of indoor management is opposed to of the role of doctrine of constructive notice**. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company. This doctrine also is a possible safeguard against the possibility of abusing the doctrine of constructive notice.

Basis for Doctrine of Indoor Management

1. What happens internal to a company is not a matter of public knowledge. An outsider can only **presume** the intentions of a company, but not know the information he/she is not privy to.

2. If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice)

Knowledge of irregularity: In case this 'outsider' has **actual knowledge** of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity**.**

Negligence: If, with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available where the circumstances company does not make proper inquiry.

Forgery: The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

9. ACT TO OVERRIDE MEMORANDUM, ARTICLES, ETC. [SECTION 6]

According to section 6 of the Act,

'Save as otherwise expressly provided in this Act—

(a) the **provisions of this Act shall have effect** notwithstanding anything to the contrary contained in the **memorandum** or **articles** of a company, or in any **agreement** executed by it, or in any **resolution** passed by the company in general meeting or by its **Board** of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and

(b) any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant (in conflict) to the provisions of this Act, **become or be void**, as the case may be.'

In simple words, the provisions of this Act shall have overriding effect**.** But keep in mind that this section starts with **"Save as otherwise ...."**. It means that if any other section of the Act says that article is superior then we will treat it accordingly.

For **example** section 47 of the Act deals with voting power of members. And a notification dated 5th June, 2015 says that section 47 is applicable to a private company subject to its Article of Association (AOA). Now if AOA of a private company says that section 47 is not applicable to it then in this case AOA will become superior and section 47 of the Act will not be applicable.

10. EFFECT OF MEMORANDUM AND ARTICLES [SECTION 10]

(1) Subject to the provisions of this Act, the memorandum and articles shall, when registered, **bind the company and the members** thereof to the same extent as if they respectively had been **signed** by the company and by each member, and contained covenants on its and his part to observe all the provisions of the memorandum and of the articles.

It means that, on the basis of MOA and AOA:

a) Company is liable to members

b) Members are liable to company

c) But normally members are not liable to each other

(2) All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company. [For example a company can recover call in arrear from a member as forcefully as it is recovering loan due.]

11. ALTERATION OF MEMORANDUM [SECTION 13]

As per **Section 2(3)**—alter or —alteration includes the making of additions, omissions and substitutions.

I. Procedure of alteration of memorandum: Section 13 of the Companies Act, 2013 provides the provisions that deals with the alteration of the memorandum. The provision says that—

(1) Alteration by special resolution: Company may alter the provisions of its memorandum with the approval of the members by a special resolution.

(2) Name change of the company: Any change in the name of a company shall be effected only with the approval of **the Central Government**[13] in writing:

However, **no** such **approval** shall be necessary where the change in the name of the company is only the **addition/deletion** of the word **"Private",** on the conversion of any one class of companies to another class in accordance with the provisions of the Act.

According to *the Companies (Incorporation) Rules, 2014*:

The change of name shall **not** be **allowed** to a company which has not filed **annual returns or financial statements** due for filing with the Registrar or which has failed to pay or repay matured **deposits** or **debentures** or **interest** thereon: Provided that the change of name shall be allowed upon filing necessary documents or payment or repayment of matured deposits or debentures or interest thereon as the case may be.

(3) Entry in register of companies: On any change in the name of a company, the **Registrar** shall enter the new name in the register of companies in place of the old name and issue a **fresh certificate** of incorporation with the new

[13] Notification S.O. 1353(E), dated 21st May, 2014. In exercise of powers conferred by Section 458 of the Companies Act, 2013 the Central Government. hereby **delegates to the ROC** the power & functions vested in it under this section [i.e. section 13(2)] of the said Act, subject to the condition that the Central Government may revoke such delegation of powers or may itself exercise the powers & functions under the said sections, if in its opinion, such course of action is necessary in the public interest.

name and the change in the name shall be complete and effective only on the issue of such a certificate.

(4) **Change in the registered office:** The alteration of the memorandum relating to the place of the registered office from one State to another shall not have any effect unless it is approved by the **Central Government**[14] on an application in such form and manner as may be prescribed.

(5) **Dispose of the application of change of place of the registered office:** The [15]Central Government shall dispose of the application of change of place of the registered office within a period of **60 days.**

Before passing of order, Central Government may satisfy itself that-

- the alteration has the **consent** of the **creditors**, **debenture-holders** and other persons **concerned** with the company, or
- the sufficient provision has been made by the company either for the due **discharge** of all its debts and obligations, or
- adequate **security** has been provided for such discharge.

(6) **Filing with Registrar:** A company shall, in relation to any alteration of its memorandum, file with the Registrar—

- the **special resolution** passed by the company under sub-section (1);
- the approval of the **Central Government** under sub-section (2), if the alteration involves any change in the name of the company.

(7) **Filing of the certified copy of the order with the registrar of the states:** Where an alteration of the memorandum results in the transfer of the registered office of a company from **one State to another**, a certified copy of the order of the Central Government approving the alteration shall be **filed** by the company with the **Registrar of each of the States** within such time and in such manner as may be prescribed, who shall register the same.

(8) **Issue of fresh certificate of incorporation:** The Registrar of the State where the registered office is being shifted to, shall issue a **fresh certificate** of incorporation indicating the alteration.

(9) **Change in the object of the company:** A company, which has raised money from public through prospectus and still has any **unutilized amount** out of the money so raised, shall not change its objects for which it raised the money

[14] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]
[15] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]

through prospectus unless a **special resolution** through **postal ballot** is passed by the company and—

- the details, in respect of such resolution shall also be published in the **newspapers** (one in **English** and one in **vernacular** language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the **website** of the company, if any, indicating there in the justification for such change;
- the **dissenting shareholders** shall be given an opportunity to **exit** by the **promoters** and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

(10) Registrar to certify the registration on the alteration of the objects: The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of **30 days** from the date of filing of the special resolution.

(11) Alteration to be registered: No alteration made under this section shall have any **effect until** it has been **registered** in accordance with the provisions of this section.

(12) Only member have a right to participate in the divisible profits of the company: Any **alteration of the memorandum**, in the case of a company limited by guarantee and not having a share capital, intending to give any person a **right to participate** in the divisible profits of the company otherwise than as a member, shall be **void**.

II. Alteration noted in every copy: Every **alteration** made in the memorandum or articles of a company shall be **noted in every copy** of the memorandum or articles, as the case may be. If a company makes any default in complying with the stated provisions, the company and every officer who is in default shall be liable to a **penalty** of one thousand rupees for every copy of the memorandum or articles issued without such alteration**. [Section 15]**

MOA clause	Members' Resolution	External approvals	Outcome	Applicability
Name Clause	Special Resolution	Approval of Central Government and subject to Section 16	New incorporation certificate issued by **ROC**	**Not applicable** where only word "Private" is added or deleted on company class conversion
Domicile Clause	Special resolution	Approval of Central Government required only when **registered office is changed** from one state to another	The **Central Government** shall dispose of the application within a period of **sixty days** and before passing its order may satisfy itself that the the consent of the creditors, debenture-holders and other persons concerned or that the sufficient provision has been made for the due discharge or that adequate security has been provided for discharge of obligations.	
Objects Clause	Special resolution	-	A company, which has raised money from public through prospectus and still has any	

			unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a **special resolution** is passed by the company and— (i) the details, as may be prescribed, in respect of such resolution shall also be **published** in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change; (ii) the **dissenting shareholders**	

			shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.	
Liability /Capital Clause	Special resolution	–	Any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a **right to participate** in the divisible profits of the company otherwise than as a member, shall be **void**.	

12. ALTERATION OF ARTICLES [SECTION 14]

I. Section 14 of the Companies Act, 2013, vests companies with power to alter or add to its articles. A company cannot divest itself of these powers [*Andrews vs. Gas Meter Co. [1897] 1 Ch. 161*]. Matters as to which the memorandum is silent can be dealt with by the alteration of article. Section 14 of the Companies Act, 2013 vests companies with power to alter or add to its articles. The law with respect to alteration of articles is as follows:

(1) Alteration by special resolution: Subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution alter its articles.

(2) Alteration to include conversion of companies: Alteration of articles include alterations having the effect of conversion of—

(a) a **private** company into a public company; or

(b) a **public** company into a private company:

Even where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, then such company shall, as from the date of such alteration, **cease to be a private company:**

Provided further that any alteration having the effect of **conversion** of a public company into a private company shall not be valid unless it is approved by an order of the **Central Government** on an application made in such form and manner as may be prescribed:

Provided also that any application **pending** before the **Tribunal**, as on the date of commencement of the Companies (Amendment) Ordinance, 2019, shall be **disposed** of by the Tribunal in accordance with the provisions applicable to it before such commencement.

(3) Filing of alteration with the registrar: Every alteration of the articles and a copy of the **order** of the Central Government approving the alteration, shall be filed with the Registrar, together with a printed copy of the **altered articles**, within a period of **fifteen days** in such manner as may be prescribed, who shall register the same.

(4) Any alteration made shall be valid: Any alteration of the articles registered as above shall, subject to the provisions of this Act, be **valid as if it were originally** contained in the articles.

II. Alteration noted in every copy: Every **alteration** made in articles of a company shall be **noted in every copy** of the articles, as the case may be. If a company makes any default in complying with the stated provisions, the company and every officer who is in default shall be liable to a **penalty** of one thousand rupees for every copy of the articles issued without such alteration. **[Section 15]**

13. COPIES OF MEMORANDUM, ARTICLES, ETC., TO BE GIVEN TO MEMBERS [SECTION 17]

According to section 17 every company on being so requested by a **member**, shall send copies of the following documents within **seven days** of the request on

the payment of **fees**—

(a) the **memorandum**;

(b) the **articles**; and

(c) every **agreement** and every resolution referred in section 117 (Resolutions and agreements to be filed), if and in so far as they have not been embodied in the memorandum and articles.

In case of **default**, the company and every officer who is in default shall be liable for each default, to a **penalty** of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

14. REGISTERED OFFICE OF COMPANY [SECTION 12]

A company is considered to be a separate legal entity from the members. Once a company gets incorporated, it is required to maintain a registered office. This is a **physical office** where the corporation will **receive service of legal documents** from ROC or in case of a lawsuit, etc. This address cannot be a P.O. box but must be a physical location where someone is present, to receive service of legal documents during normal business hours. **It could be different from a Head Office or Corporate office.**

Section 12 of the Companies Act, 2013 seeks to provide for the registered office of the companies for the communication and serving of necessary documents, notices letters etc. The **domicile** and the nationality of a company **is determined by the place of its registered officer**. This is also important for determining the jurisdiction of the court.

(1) **Registered office:** A company shall, within **thirty** days of its **incorporation** and at all times thereafter, have a **registered office** capable of receiving and acknowledging all communications and notices as may be addressed to it.[16]

[16] With the respected specified IFSC public & IFSC private companies, they shall have its registered office at the IFSC located in the approved multiservice SEZ set up under the SEZ Act, 2005 read with SEZ Rules, 2006.

(2) **Verification of registered office:** The company shall furnish to the Registrar verification of its registered office within a period of **thirty days** of its incorporation.[17]

(3) **Labeling of company:** Every company shall—

- **paint** or affix its **name**, and the **address** of its registered office, and keep the same painted or affixed, on the **outside of every office** or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed are not those of the **language/s in general use in that locality**, then **also** in the characters of that language/s.
- have its **name** engraved in legible characters on its **seal,** if any;
- get its **name, address** of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in **all** its business letters, billheads, letter papers and in all its notices and other official publications; and
- have its **name** printed on hundies, promissory notes, bills of exchange and such other **documents** as may be prescribed:

(4) **Name change by the company:** Where a company has changed its name/s during the **last two years**, it shall **paint** or **affix** or **print**, along with its name, the **former name** or **names so changed** during the last two years.

(5) **In case of OPC:** The words **''One Person Company''** shall be mentioned **in brackets** below the name of such company, wherever its name is printed, affixed or engraved.

(6) **Notice of change to registrar:** Notice of every change of the situation of the registered office, verified in the manner prescribed, after the date of incorporation of the company, shall be given to the Registrar **within 30 days of the change,** who shall record the same.[18]

(7) **Change by passing of special resolution:** The registered office of the company shall be changed only by passing of **special resolution** by a company, **outside the local limits** of any city, town or village where such

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[17] In case of specified IFSC public & IFSC private company word "thirty days" will be read as "sixty days".

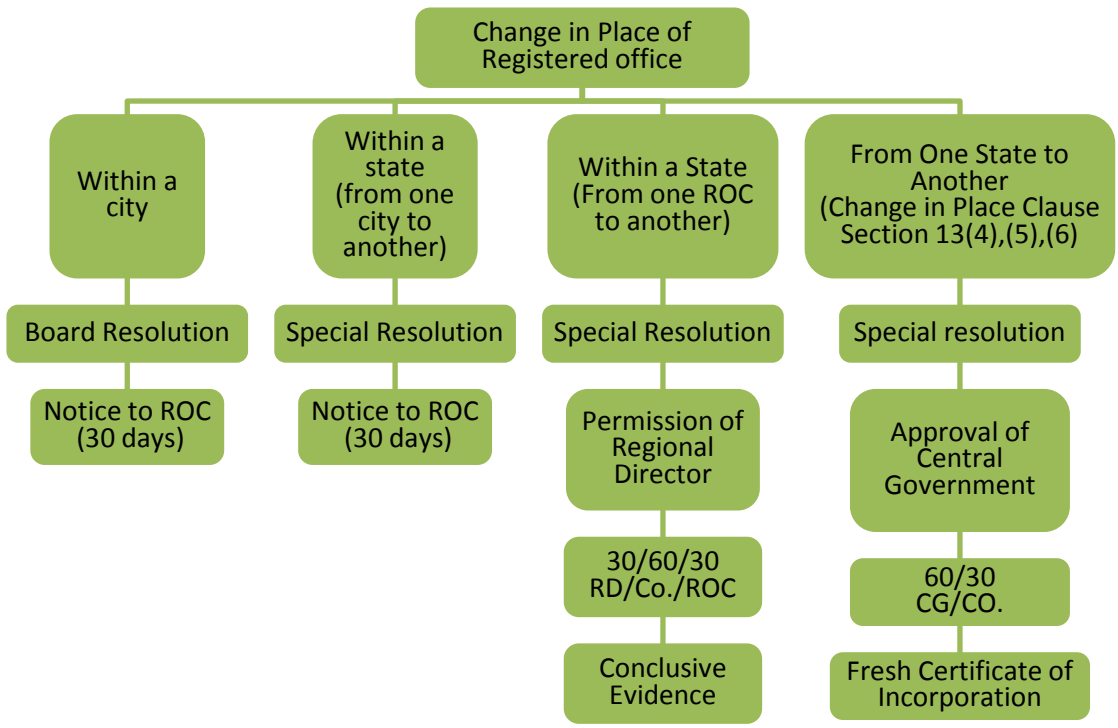
[18] In the case of specified IFSC public & IFSC private companies for the word "30 days" read as "60 days".

office is situated or where it may be situated later by virtue of a special resolution passed by the company.

(8) **Change of registered office outside the jurisdiction of registrar:** Where a company changes the place of its registered office from the jurisdiction of **one Registrar** to the jurisdiction of **another Registrar** within the same State, there such change is to confirmed by the **Regional Director** on an application made by the company.

(9) **Communication and filing of confirmation:** The confirmation of change of registered office from jurisdiction of one registrar to another registrar within the same state, shall be–

- **communicated** within **30 days** from the date of receipt of application by the Regional Director to the company, and
- the company shall **file** the confirmation with the Registrar within a period of **60 days** of the date of confirmation who shall register the same, and
- **certify** the registration within a period of **thirty days** from the date of filing of such confirmation.



(10) Certificate, a conclusive evidence of compliance of requirements of this Act: The certificate shall be **conclusive evidence** that all the requirements of this Act with respect to change of registered office have been complied with and the change shall take effect from the date of the certificate.

(11) In case of default: If any default is made in complying with the requirements of this section, the company and every officer who is in default shall be liable to a **penalty** of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees. [Sub- section (8)]

(12) If the Registrar has reasonable cause to believe that the company is **not carrying on any business** or operations, he may cause a **physical verification** of the registered office of the company in such manner as may be prescribed and if any default is found to be made in complying with the requirements of sub-section (1), he may without prejudice to the provisions of sub-section (8), initiate action for the **removal of the name** of the company from the register of companies under Chapter XVIII.

15. COMMENCEMENT OF BUSINESS ETC. [SECTION 10A]

(1) A company incorporated after the commencement of the Companies (Amendment) Ordinance, 2019 and having a share capital shall not **commence** any **business** or exercise any **borrowing** powers unless—

(a) a **declaration** is filed by a director within a period of **180 days** of the date of incorporation of the company in such form and verified in such manner as may be prescribed, with the **Registrar** that every subscriber to the memorandum has **paid** the value of the shares agreed to be taken by him on the date of making of such declaration; and

(b) The company has filed with the Registrar a **verification of its registered office** as provided in sub-section (2) of section 12.

(2) If any default is made in complying with the requirements of this section, the company shall be **liable to a penalty** of fifty thousand rupees and every officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues but not exceeding an amount of one lakh rupees.

(3) Where no declaration has been filed with the Registrar under clause (a) of

sub-section (1) within a period of one hundred and eighty days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is **not carrying on any business** or operations, he may, without prejudice to the provisions of sub-section (2), initiate action for the **removal of the name** of the company from the register of companies under Chapter XVIII.

As per Rule 23A [Declaration at the time of commencement of business.] of the *Companies (Incorporation) Rules, 2014*, the declaration under section 10A by a director shall be in prescribed form with prescribed fees and the contents of the said form shall be verified by a Company Secretary or a Chartered Accountant or a Cost Accountant, in practice:

Provided that in the case of a company pursuing objects requiring registration or approval from any sectoral regulators such as the Reserve Bank of India, Securities and Exchange Board of India, etc., the registration or approval, as the case may be from such regulator shall also be obtained and attached with the declaration.

16. RECTIFICATION OF NAME OF COMPANY [SECTION 16]

According to **Section 16**

(1) If, through inadvertence or otherwise, a company on its first registration or on its registration by a new name, is **registered by a name** which, —

(a) in the opinion of the Central Government[19], is **identical** with or too nearly resembles the name by which a **company** in existence had been previously registered, whether under this Act or any previous company law, it may direct the company to **change its name** and the company shall change its name or new name, as the case may be, within a period of **three months** from the issue of such direction, after adopting an ordinary resolution for the purpose;

(b) on an application by a registered proprietor of a **trade mark** that the name is identical with or too nearly resembles to a registered trade mark of such proprietor under the Trade Marks Act, 1999, made to the [20]Central Government within **3 years** of incorporation or registration or change of name of the company, whether under this Act or any previous company law, in the opinion

[19] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]
[20] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]

of the [21]Central Government, is identical with or too nearly resembles to an existing trade mark, it may direct the company to change its name and the company shall change its name or new name, as the case may be, within a period of **6 months** from the issue of such direction, after adopting an ordinary resolution for the purpose.

(2) Where a company changes its name or obtains a new name under sub-section (1), it shall within a period of **15 days** from the date of such change, **give notice** of the change to the Registrar along with the order of the [22]Central Government, who shall carry out necessary changes in the **certificate of incorporation** and the memorandum.

(3) If a company makes default in complying with any direction—

Liable person	Penalty/punishment
Company	Fine of 1,000 rupees for every day during which the default continues
Every Officer who is in default	Fine varying from 5,000 rupees to 1 lakh rupees.

17. CONVERSION OF COMPANIES ALREADY REGISTERED [SECTION 18]

According to Section 18 of the Companies Act, 2013, a company may **convert** itself in some other class of company by altering its memorandum and articles of association. Following is the law with respect to the conversion of the companies already registered.

1. By alteration of memorandum and articles: A company of **any class** registered under this Act may **convert** itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of this Chapter.

2. File an application to the Registrar: Wherever such conversion of companies is required to be done, the company shall file an application to the Registrar, who shall after satisfying himself that the provisions applicable for registration of companies have been complied with, **close the former registration of the company.**

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[21] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]

[22] Power deleted to Regional Director [S.O. 4090(E), dated 19th December, 2016]

3. Issue a certificate of incorporation: After registering the required documents, issue a certificate of incorporation in the same manner as its first registration.

4. No effect on the debts, liabilities etc. incurred before conversion: The registration of a company under this section **shall not affect any debts, liabilities**, obligations or contracts incurred or entered into, by or on behalf of the company before conversion and such debts, liabilities, obligations and contracts may be enforced in the manner as if such registration had not been done.

18. SUBSIDIARY COMPANY NOT TO HOLD SHARES IN ITS HOLDING COMPANY [SECTION 19]

As per Section 19 of the Companies Act, 2013,

(1) No company shall, either by itself or through its nominees, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be **void**:

Provided that nothing in this sub-section shall apply to a case—

(a) where the subsidiary company holds such shares as the **legal representative** of a deceased member of the holding company; or

(b) where the subsidiary company holds such shares as a **trustee**; or

(c) where the subsidiary company is a shareholder even **before it became a subsidiary** company of the holding company:

However, the subsidiary company referred to in the preceding proviso shall have a **right to vote** at a meeting of the holding company only in respect of the shares held by it as a **legal representative** or as **a trustee**, as referred to in clause (a) or clause (b) of the said proviso.

(2) The reference in this section to the shares of a holding company which is a company limited by **guarantee or an unlimited company**, not having a share capital, shall be construed as a reference to the interest of its members, whatever be the form of interest.

Example: RPIP Ltd. has invested 51% in the shares of SSP Pvt. Ltd. on 31 March 2017. SSP Pvt. Ltd. have been holding 2% equity of RPIP Ltd since 2011. SSP Pvt. Ltd. cannot increase its equity beyond that 2% on or after 31 March 2017. However, it could continue to hold or reduce its initial 2% stake.

19. SERVICE OF DOCUMENTS [SECTION 20]

Section 20 of the Companies Act, 2013, provides the mode in which documents may be served on the company, on the members and also on the registrars.

Law with respect to the service of documents is as follows—

(1) **Serving of document to company:** A document may be served on a company or an officer thereof by sending it to the company or the officer at the **registered office** of the company by-

- **registered post**, or
- **speed post**, or
- **courier service**, or
- **leaving** it at its registered office, or
- means of such **electronic or other mode** as may be prescribed:

However, where securities are held with a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic or other mode.

(2) **Serving of document to registrar or member:** Save as provided in this Act or the rules made there under for filing of documents with the Registrar in electronic mode, a document may be served on Registrar or any member by sending it to him by—

- **Post**, or
- **registered post**, or
- **speed post**, or
- **courier**, or
- by **delivering** at his office or address, or
- by such **electronic** or other mode as may be prescribed:

However, a member may request for delivery of any document through a **particular mode**, for which he shall pay such **fees** as may be determined by the company in its annual general meeting.

Explanation—For the purposes of this section, the term "courier" means a person or agency which delivers the document and provides **proof of its delivery**.

Exemption-Section 20 (2) shall apply to a **Nidhi Company,** subject to the modification that in the case of a Nidhi, the document may be served only on members who hold shares of more than ₹ **1,000** in face value or more than 1%, of the total paid-up share capital of the Nidhis whichever is less.

For other shareholders, document may be served by a public notice in newspaper circulated in the district where the Registered Office of the Nidhi is situated; and publication of the same on the notice board of the Nidhi. [*Notification dated 5th June, 2015*.]

As per the *Companies (Incorporation) Rules,* 2014,

1. The term, "**electronic transmission**" means a communication that creates a record that is capable of retention, retrieval (recovery) and review, and which may thereafter be rendered into clearly legible tangible form. It may be made by—
   - facsimile telecommunication (**fax**) or electronic mail (**email**), which the company or the officer has provided from time to time for sending communications,
   - posting of an electronic message board or **network** that the Registrar or the member has designated for those communications, and which transmission shall be validly delivered upon the posting , or
   - **other means** of electronic communication, in respect of which the company or the officer has put in place **reasonable systems** to verify that the sender is the person purporting to send the transmission.
2. In case of delivery by post, such service shall be deemed to have been effected—
   (i) in the case of a **notice of a meeting**, at the expiration of **48 hours** after the letter containing the same is posted; and
   (ii) in **any other case**, at the time at which the letter would be delivered in the **ordinary course** of post.

20. AUTHENTICATION OF DOCUMENTS, PROCEEDINGS AND CONTRACTS [SECTION 21]

As per section 21 of the Companies Act, 2013, a document or proceeding requiring authentication by a company or contracts made by or on behalf of a company may be **signed by**–

(i) any key managerial personnel, or

(ii) an officer or employee of the company duly **authorized** by the Board in this behalf.[23]

Authentication of documents, proceedings and contracts

As per Sec.21 these may be signed by any "key managerial personnel" or an officer or employee of the company duly authorised by the Board in this behalf.

As per **Sec.2(51) —Key managerial personnel**, in relation to a company, means—

(i) the CEO or the MD or the manager;

(ii) the company secretary;

(iii) the whole-time director;

(iv) the CFO;

(v) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and

(vi) such other officer as may be prescribed;

21. EXECUTION OF BILLS OF EXCHANGE, ETC. [SECTION 22]

(1) A **bill of exchange**, hundi or promissory note shall be deemed to have been made, accepted, drawn or endorsed on behalf of a company if made,

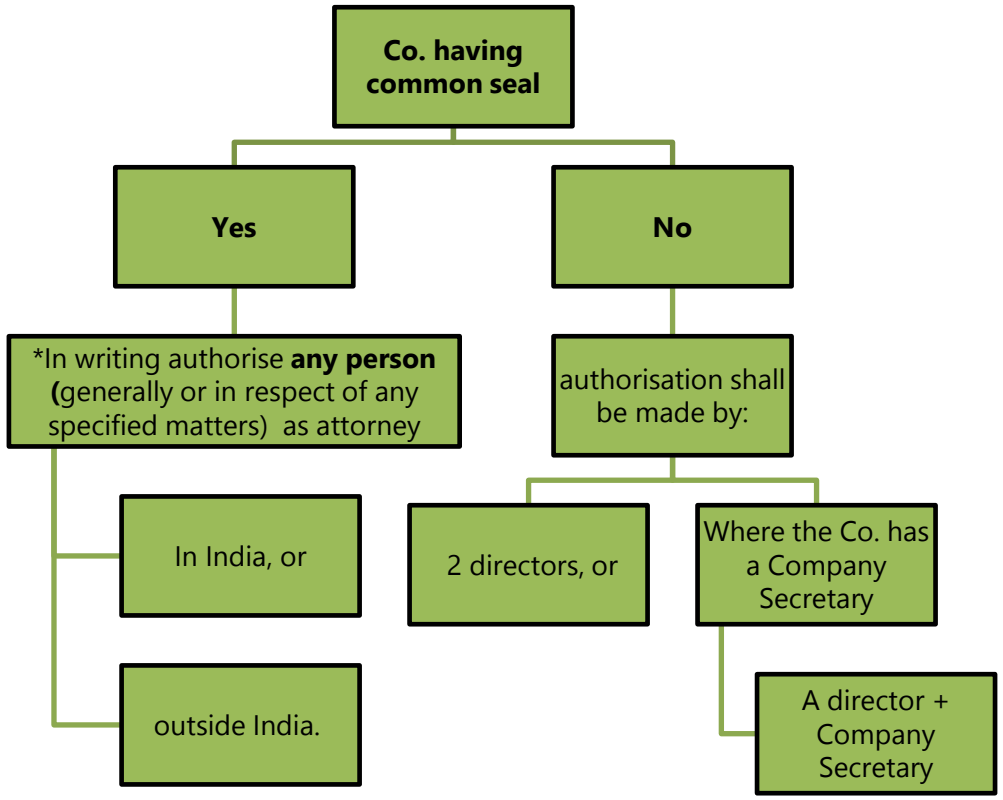
[23] In the case of specified IFSC public company and IFSC private company, for the word "An officer" read as "An officer or any other person".

accepted, drawn, or endorsed in the name of, or on behalf of or on account of, the company by any person **acting under its authority**, express or implied.

(2) A company may, by writing under its **common seal**, if any, authorise any person, either generally or in respect of any specified matters, as its attorney to execute other **deeds** on its behalf in any place either in or outside India.

However, in case a company does not have a common seal, the above authorisation shall be made by **2 directors** or **by a director and the Company Secretary**, wherever the company has appointed a Company Secretary.

(3) A deed signed by such an attorney on behalf of the company and under his seal shall **bind the company**.



*It can be observed from above that a company may or **may not have a common seal**. If company decides to have a common seal then it has to affix the same for specified matters, execution of deeds on behalf of the company.

SUMMARY

- A company can be defined as an "**artificial person**", invisible, intangible, created by or under law, with a **distinct** legal personality and **perpetual** succession. It is not affected by the death, insanity, or insolvency of an individual member.
- The **memorandum** of association is the document that sets up the company and the **articles** of association set out how the company is run, governed and owned.
- Once an association becomes incorporated it acquires a new legal status – it becomes a legal entity in its **own right**, separate from the individual members.
- A company of any class may **convert** itself as a company of other class by alteration of its MOA and AOA

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. The minimum number of members in a private company and public company are

   (a) Three and Seven respectively

   (b) Two and seven respectively

   (c) Two and nine respectively

   (d) None of the above

2. Which one of the following is not the content of the Memorandum of Association?

   (a) Name clause

   (b) Registered office clause

   (c) Objects clause

   (d) Board of Directors clause

3. The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of _____ from the date of filing of the special resolution.

(a) 30 days

(b) 60 days

(c) 90 days

(d) 6 months

4. Only a natural person who is an Indian citizen and who has stayed in India for a period of at least _____ days during the immediately preceding one calendar year shall be eligible to incorporate a OPC.

(a) 180 days

(b) 181 days

(c) 182 days

(d) 183 days

5. A section 8 company can call its general meeting by giving a clear at least _____ notice.

(a) 7 days

(b) 14 days

(c) 21 days

(d) 27 days

6. XYZ Co; is having 15% share capital held by X Company and 50% held by central Government and 10% held by State Government and 25% held by other people then that company will be _____ .

(a) Government Company

(b) Private Company

(c) Public Company

(d) None of these

7. Which one of the following statements is least likely to be true. A company is a subsidiary if another company:

(a) exercises more than 50% of the total voting power

(b) controls the composition of its board of directors

(c) is subsidiary of a company which is subsidiary of the first mentioned company

(d) is holding of a company which is the holding for the first mentioned company

8. Forms of (1) Articles of guarantee company having a share capital (2) Articles of a guarantee company not having a share capital (3) Memorandum of an unlimited company with share capital (4) Memorandum of a company limited by shares; are respectively given in:

(a) Table G; H; E & B

(b) Table G; H; E & A

(c) Table G; H; D & A

(d) Table G; H; B & A

9. Tweeter Ltd. has invested 51% in the shares of Snapchat Pvt. Ltd. on 31 March 2018. Snapchat Pvt. Ltd. have been holding 2% equity of Tweeter Ltd since 2011. Snapchat Pvt. Ltd. wants to increase its holdings in equity upto 4% in Tweeter Ltd. after 31 march 2017.Can Snapchat Pvt. Ltd. increase its holdings in equity upto 4% in Tweeter Ltd. after 31 march 2018?

(a) Yes; it can increase its holdings

(b) No; it cannot increase its holdings

(c) Can't say

(d) None of the above

10 A director member deposited with company ₹ 5000 and demanded that AGM notice should be sent by Blue Dart courier only. Is that company bound to serve it that way only?

(a) Yes because he is a director

(b) No because company is allowed to serve documents by ordinary post

(c) Yes because member has deposited money

(d) No because directors can't get special privileges

11. To entrench its article after incorporation a public company:

(a) will have to pass a special resolution

(b) will have to take consent of all members

(c) is not allowed to do so

(d) will have to pass special resolution and take approval of Tribunal

12. AOA of a private company says that Preference shareholders will have right to vote only if last 3 years dividend is not paid. This is:

(a) Void as it is against the companies act

(b) Valid because section 47 is applicable to a private company subject to AOA.

(c) Void because as per section 6 act is superior

(d) Valid because companies act allows voting power to preference shareholders if there dividend is not paid for last 3 years.

13. If a company is registered by incorrect information then its winding up may be ordered by:

(a) Central Government

(b) Registrar of Companies

(c) National Company Law Tribunal

(d) Court

14. "A not for profit company shall not alter the provisions of its memorandum or articles".

(a) False; it can freely change it

(b) False; It can do so with permission of Central Government

(c) True; because it will be violation of terms of licence

(d) True; because MOA/AOA of a section 8 company is unalterable

15. If a company changes its name; which of the following is most accurate:

(a) It is not allowed to use old name in any way

(b) New name should not be identical with old name

(c) Old name should be painted/printed for next 1 years along with new name

(d) Old name should be painted/printed for next 2 years along with new name

16. A company registered with the name of a trade mark already in existence:

(a) Central Government can give it an order anytime to change its name

(b) Company will have to change its name within 3 months from the order of Central Government

(c) Trademark owner will make complaint within three years

(d) All of the above

Answer to MCQs

1.	(b)	**2.**	(d)	**3.**	(a)	**4.**	(c)	**5.**	(b)	**6.**	(a)
7.	(c)	**8.**	(b)	**9.**	(b)	**10.**	(c)	**11.**	(a)	**12.**	(b)
13.	(c)	**14.**	(b)	**15.**	(d)	**16.**	(c)				

Question and Answer

Question 1

XY Ltd. has its registered office at Mumbai in the State of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune (within the State of Maharashtra, but from Mumbai ROC to Pune ROC). What formalities the company has to comply with under the provisions of the Companies Act, 2013 for shifting its registered office as stated above? Explain.

Answer

The Companies Act, 2013 under section 13 provides for the process of altering the Memorandum of a company. Since the location or Registered Office clause in the Memorandum only names the state in which its registered office is situated, a change in address from Mumbai to Pune, **does not result in the alteration of the Memorandum** and hence the provisions of section 13 (and its sub sections) do not apply in this case.

However, under section 12 (5) of the Act which deals with the registered office of company, the change in registered office from one town or city to another in the same state, must be approved by a **special resolution** of the company. Further, registered office is shifted from one ROC to another, therefore company will have to seek approval of Regional director.

Question 2

The persons (not being members) dealing with the company are always protected by the doctrine of indoor management. Explain. Also, explain when doctrine of Constructive Notice will apply.

Answer

Doctrine of Indoor Management

According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders **need not enquire** whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to **take it for granted** that the company had gone through all these proceedings in a regular manner.

The doctrine helps to **protect external** members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management is **opposite to the doctrine of constructive** notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company. This doctrine also is a safeguard against the possibility of abusing the doctrine of constructive notice.

Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice)

(i) **Knowledge of irregularity:** In case an 'outsider' **has actual knowledge** of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.

(ii) **Negligence:** If, with a **minimum of effort**, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available where the circumstances surrounding the contract are so **suspicious as to invite inquiry**, and the outsider dealing with the company does not make proper inquiry.

(iii) **Forgery:** The rule does not apply where a person relies upon a document that turns out to be forged since **nothing can validate forgery**. A company can never be held bound for forgeries committed by its officers.

Question 3

Alfa school started imparting education on 1.4.2010, with the sole objective of providing education to children of weaker society either free of cost or at a very nominal fee depending upon the financial condition of their parents. However, on 30th March 2018, it came to the knowledge of the Central Government that the said school was operating by violating the objects of its objective clause due to which it was granted the status of a section 8 company under the Companies Act, 2013. Describe what powers can be exercised by the Central Government against the Alfa School, in such a case?

Answer

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, education, sports etc. Such company intends to apply its profit in promoting its objects. Section 8 companies are registered by the Registrar only when a license is issued by the Central Government to them. Since, Alfa School was a Section 8 company and it had started violating the objects of its objective clause, hence in such a situation the following powers can be exercised by the Central Government:

(i) The Central Government may by order **revoke the licence** of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and **opportunity** to be **heard** in the matter.

(ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be **wound up** under this Act or **amalgamated** with another company registered under this section.

However, no such order shall be made unless the company is given a reasonable **opportunity** of being heard.

(iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be **amalgamated** with another company registered

under this section and having **similar objects**, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

Question 4

The object clause of the Memorandum of Vivek Industries Ltd., empowers it to carry on real-estate business and any other business that is allied to it. Due to a downward trend in real-estate business the management of the company has decided to take up the business of Food processing activity. The company wants to alter its Memorandum, so as to include the Food Processing Business in its objects clause. Examine whether the company can make such change as per the provisions of the Companies Act, 2013?

Answer

Alteration of Objects Clause of Memorandum

The Companies Act, 2013 has made alteration of the memorandum simpler and more flexible. Under section 13(1) of the Act, a company may, by a **special resolution** after complying with the procedure specified in this section, alter the provisions of its Memorandum.

In the case of alteration to the objects clause, Section 13(6) requires the filing of the Special Resolution by the company with the Registrar. Section 13 (9) states that the Registrar shall register any alteration to the Memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution by the company. Section 13 (10) further stipulates that no alteration in the Memorandum shall take effect unless it has been **registered with the Registrar** as above.

Hence, the Companies Act, 2013 permits any alteration to the objects clause with ease. Vivek Industries Ltd. can make the required changes in the object clause of its Memorandum of Association.

Question 5

Explain in the light of the provisions of the Companies Act, 2013, the circumstances under which a subsidiary company can become a member of its holding company.

Answer

In accordance with the provisions of Section 19 of the Companies Act, 2013, a subsidiary company cannot either by itself or through its nominees hold any shares in its holding company and no holding company shall allot or transfer its shares to any subsidiary companies. Any such allotment or transfer of shares in a company to its subsidiary is void. The section however does not apply where:

(1) the subsidiary company holds shares in its holding company as the **legal representative** of a deceased member of the holding company,

(2) the subsidiary company holds such shares as a **trustee**, or

(3) the subsidiary company was a shareholder in the holding company even **before it became its subsidiary.**

Question 6

Explain the provisions of the Companies Act, 2013 relating to the 'Service of Documents' on a company and the members of the company.

Answer

Under section 20 of the Companies Act, 2013 a document may be served on a company or an officer thereof by sending it to the company or the officer at the **registered office** of the company by **registered post** or by **speed post** or by **courier** service or by **leaving** it at its registered office or by means of such **electronic** or other mode as may be **prescribed**. However, in case where securities are held with a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic or other mode.

Under section 20 (2), save as provided in the Act or the rule thereunder for filing of documents with the **registrar** in **electronic** mode, a document may be served on Registrar or any **member** by sending it to him by **post** or by **registered** post or by **speed** post or by **courier** or by **delivering** at his office or address, or by such **electronic** or other mode as may be prescribed. However, a member may request for delivery of any document through a **particular mode**, for which he shall pay such **fees** as may be determined by the company in its annual general meeting.

Question 7

Yadav dairy products Private limited has registered its articles along with memorandum at the time of registration of company in December, 2014. Now

directors of the company are of the view that provisions of articles regarding forfeiture of shares should not be changed except by a resolution of 90% majority. While as per section 14 of the Companies Act, 2013 articles may be changed by passing a special resolution only. One of the directors said that they cannot make a provision against the Companies Act. You are required to advise the company on this matter.

Answer

As per section 5 of the Companies Act, 2013 the article may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if more restrictive conditions than a special resolution, are met.

The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in prescribed manner.

In the present case, Yadav dairy products Private Limited is a private company and wants to protect provisions of articles regarding forfeiture of shares. It means it wants to make entrenchment of articles, which is allowed. But the company will have to pass a resolution taking permission of all the members and it should also give notice to ROC regarding entrenchment of articles.

Question 8

Anushka security equipments limited is a manufacturer of CCTV cameras. It has raised ₹ 100 crores through public issue of its equity shares for starting one more unit of CCTV camera manufacturing. It has utilized 10 crores rupees and then it realized that its existing business has no potential for expansion because government has reduced customs duty on import of CCTV camera hence imported cameras from china are cheaper than its own manufacturing. Now it wants to utilize remaining amount in mobile app development business by adding a new object in its memorandum of association.

Does the Companies Act allow such change of object. If not then what advise will you give to company. If yes, then give steps to be followed.

Answer

According to section 13 of the Companies Act, 2013 a company, which has raised

money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and—

(i) the details in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change;

(ii) the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with SEBI regulations.

Company will have to file copy of special resolution with ROC and he will certify the registration within a period of thirty days. Alteration will be effective only after this certificate by ROC.

Looking at the above provision we can say that company can add the object of mobile app development in its memorandum and divert public money into that business. But for that it will have to comply with above requirements.

Question 9

Manglu and friends got registered a company in the name of Taxmann advisory private limited. Taxmann is a registered trade mark. After 5 years When the owner of trade mark came to know about the same, it filed an application with relevant authority. Can the company be compelled to change its name by the owner of trade mark? Can the owner of registered trade mark request the company and then company changes its name at its discretion?

Answer

According to section 16 of the Companies Act, 2013 if a company is registered by a name which,—

- in the opinion of the Central Government, is identical with the name by which a company had been previously registered, it may direct the company to change its name. Then the company shall by passing an ordinary resolution change its name within 3 months.
- is identical with a registered trade mark and owner of that trade mark apply to the Central Government within three years of incorporation of registration of the company, it may direct the company to change its name.

Then the company shall change its name by passing an ordinary resolution within 6 months.

Company shall give notice to ROC along with the order of Central Government within 15 days of change. In case of default company and defaulting officer are punishable.

In the given case, owner of registered trade mark is filing objection after 5 years of registration of company with a wrong name. While it should have filed the same within 3 years. Therefore, the company cannot be compelled to change its name.

As per section 13, company can anytime change it name by passing a special resolution and taking approval of Central Government. Therefore, if owner of registered trade mark request the company for change of its name and the company accepts the same then it can change it name voluntarily by following the provisions of section 13.

Question 10

Shri Laxmi Electricals Ltd. (S) is a company in which Hanumaan power suppliers Limited (H) is holding 60% of its paid up share capital. One of the shareholder of H made a charitable trust and donated his 10% shares in H and ₹ 50 crores to the trust. He appoint S as the trustee. All the assets of the trust are held in the name of S. Can a subsidiary hold shares in its holding company in this way?

Answer

According to section 19 of the Companies Act, 2013 a company shall not hold any shares in its holding company either by itself or through its nominees. Also, holding company shall not allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

Following are the exceptions to the above rule—

(a) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or

(b) where the subsidiary company holds such shares as a trustee; or

where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company but in this case it will not have a right to vote in the meeting of holding company.

In the given case one of the shareholders of holding company has transferred his

shares in the holding company to a trust where the shares will be held by subsidiary company. It means now subsidiary will hold shares in the holding company. But it will hold shares in the capacity of a trustee. Therefore, we can conclude that in the given situation S can hold shares in H.

Question 11

Parag Constructions Limited is a leading infrastructure company. One of the directors of the company Mr. Parag has been singing all construction contracts on behalf of company for many years. All the parties who ever deal with the company know Mr. Parag very well. Company has got a very important construction contract from a renowned software company. Parag constructions will do construction for this site in partnership with a local contractor Firoz bhai. Mr. Parag signed partnership deed with Firoz bhai on behalf of company because he has an implied authority. Later in a dispute company denied to accept liability as a partner. Can the company deny its liability as a partner?

Answer

As per section 22 of the Companies Act, 2013 a company may authorise any person as its attorney to execute deeds on its behalf in any place either in or outside India. But common seal should be affixed on his authority letter or the authority letter should be signed by two directors of the company or it should be signed by one director and secretary. This authority may be either general for any deeds or it may be for any specific deed.

A deed signed by such an attorney on behalf of the company and under his seal shall bind the company as if it were made under its common seal.

In the present case company has not neither given any written authority not affixed common seal of the authority letter. It means that Mr. Parag is not legally entitled to execute deeds on behalf of the company. Therefore, deeds executed by him are not binding on the company. Therefore, company can deny its liability as a partner.

CHAPTER 3

PROSPECTUS AND ALLOTMENT OF SECURITIES

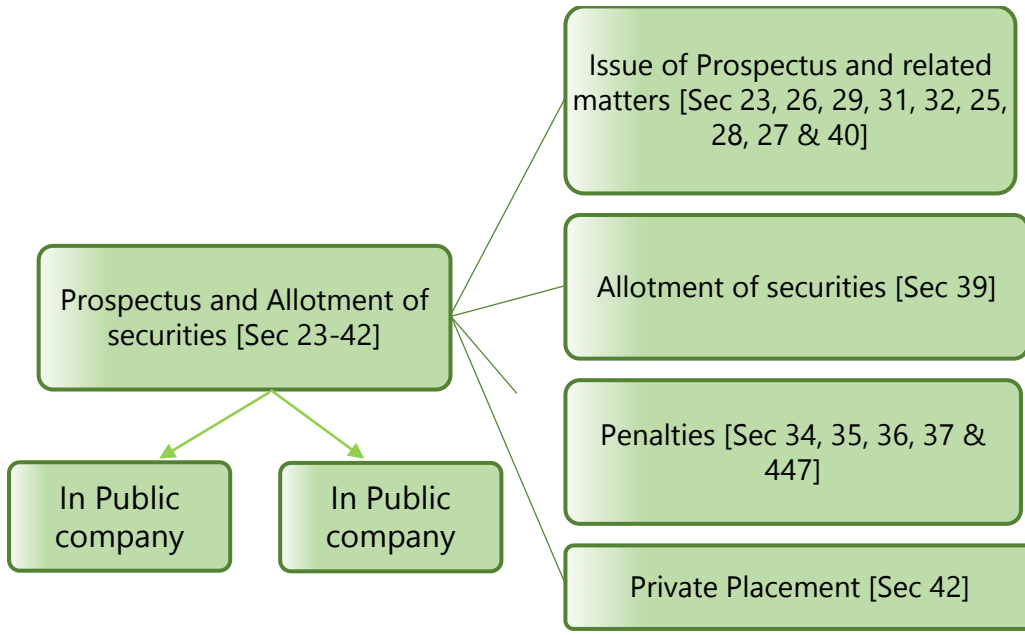
LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Define prospectus & its types and explain the procedure for issue of prospectus and other related concepts
- Know the criminal and civil liability for mis-statements in prospectus and punishment for fraudulently inducing persons to invest money
- Know about the allotment of securities by company
- Explain the procedure for issue of GDR
- Know the procedure of private placement

CHAPTER OVERVIEW

This Chapter constitutes chapter III of the Act consisting of sections 23 to 42 dealing with the prospectus and allotment of securities. The Act provides the manner in which securities can be issued by both public and private company This chapter relating to issue of securities is covered under two headings Part I relates to issue of public offer and Part II relates to issue of securities through private placement.



1. INTRODUCTION

One of the advantages of floating a company is **raising of capital**. Capital could be raised from **public** at large or from a defined group or **inner circle** (pre-known select group of persons). The former is called the 'Public offer' and the latter is called 'Private Placement'. Capital acquisition is inflow of funds for the issuer and needs **advertisement** which should be in accordance with the relevant legal provisions so that any investor is **not defrauded** or be-fooled. On successful closure of the application process, securities are allotted to investors which could be then listed on an appropriate segment of a recognised stock exchange.

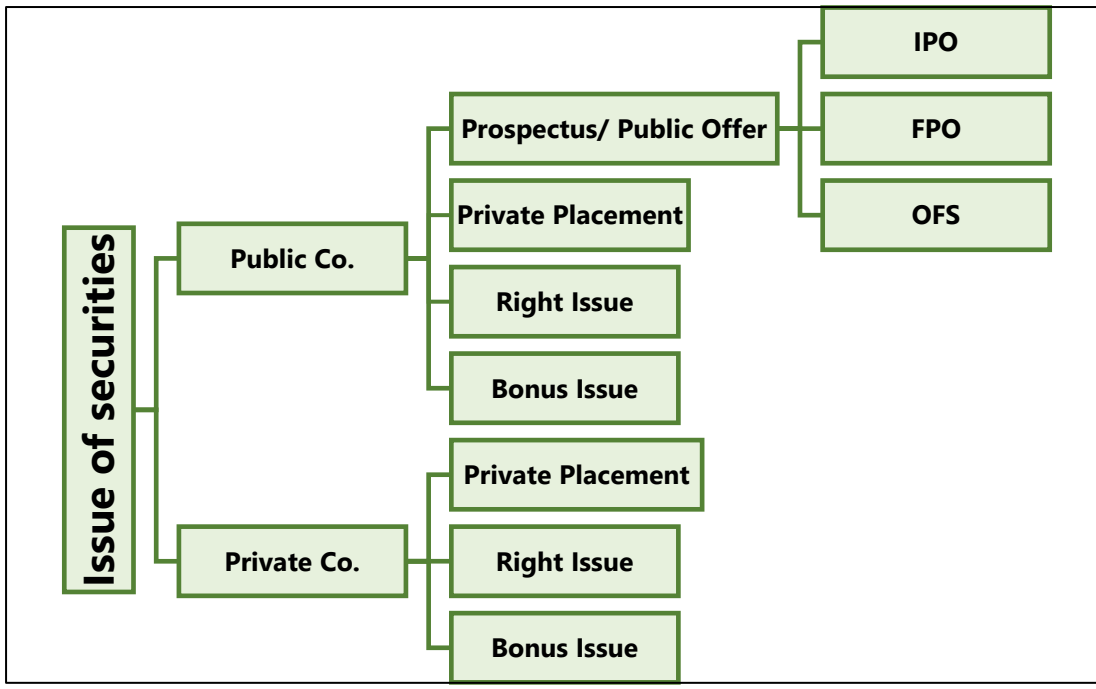
The provisions related to raising of capital such as issue of prospectus, allotment

of shares etc. and other matters incidental thereto are contained in Chapter III of the Companies Act, 2013, which is divided into two parts:

Part I – Public Offer of the chapter comprise sections 23 to 41, and

Part II – Private Placement comprises section 42.

2. PUBLIC OFFER AND PRIVATE PLACEMENT



As per Section 23 (1) A **public company** may issue securities—

(a) to public through prospectus (herein referred to as **"public offer"**) by complying with the provisions of this Part; or

(b) through **private placement** by complying with the provisions of Part II of this Chapter; or

(c) through a **rights** issue or a **bonus issue** in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

As per **Section 23(2),** a **private company** may issue securities—

(a) by way of **rights** issue or **bonus** issue in accordance with the provisions of this Act; or

(b) through **private placement** by complying with the provisions of Part II of this Chapter.

Explanation —For the purposes of this Chapter, "public offer" includes initial public offer (IPO) or further public offer (FPO) of securities to the public by a company, or an offer for sale of securities (OFS) to the public by an existing shareholder, through issue of a prospectus.

As per **Section 2 (81)**—securities means the securities as defined in clause (h) of section 2 of **the Securities Contracts (Regulation) Act, 1956**

"Securities" include—

(i) Shares, scrips, stocks, bonds, debentures, debenture stock or other **marketable** securities of a like nature in or of any incorporated company or other body corporate;

(ia) **derivative**;

(ib) **units** or any other instruments issued by any collective investment scheme to the investors in such schemes;

(ic) security **receipt** as defined in clause (zg) under section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

(id) **units** or any other such instrument issued to the investors under any **mutual fund** scheme.

Securities however, shall not include any **unit linked insurance** policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938.

(ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a **special purpose** distinct **entity** which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;

(ii) **Government** securities;

(iia) such other instruments as may be **declared by the Central Government** to be securities; and

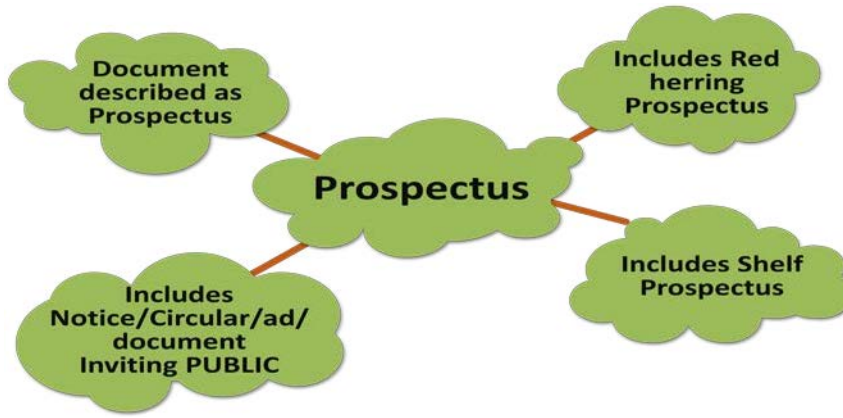
(iii) rights or **interests in** securities;

The provisions of Section 23 are tabulated below:

	Public Company	Private Company
Public Offer (including IPO, FPO or OFS)	Yes	No
Private Placement	Yes	Yes
Rights issue / Bonus Issue	Yes	Yes
Compliance with SEBI rules and regulations	Yes, for listed company or company proposed to be listed	No

3. PROSPECTUS

As per the definition given in Section 2(70) of the Companies Act, 2013, prospectus means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of body corporate.



(I) Matters to be stated in prospectus

(1) According to **Section 26 (1),** every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be **dated and signed** and shall state such **information** and set out such **reports** on financial information as may be **specified by the Securities and Exchange Board in consultation with the Central Government**:

Provided that until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, in respect of such financial information or reports on financial information shall apply.

[1](c) prospectus shall make a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder; and

(2) Exceptions: Nothing in sub-section (1) shall apply—

(a) to the issue to **existing** members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares or not under sub-clause (ii) of clause (a) of sub-section (1) of section 62 in favour of any other person; or

(b) to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects **uniform** with shares or debentures previously issued and for the time being dealt in or **quoted** on a recognised stock exchange. [Sub- section (2)]

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[1]clauses (a), (b) and (d) have been omitted [Companies (Amendment) Act, 2017, Enforcement Date: 7th May, 2018]

(3) **Application of sub-section (1) to prospectus or to an application related to formation of a company:** Subject to sub-section (2), the provisions of sub-section (1) shall apply to a prospectus or a form of application, whether issued on or with reference to the formation of a company or subsequently. The date indicated in the prospectus shall be deemed to be the date of its publication.

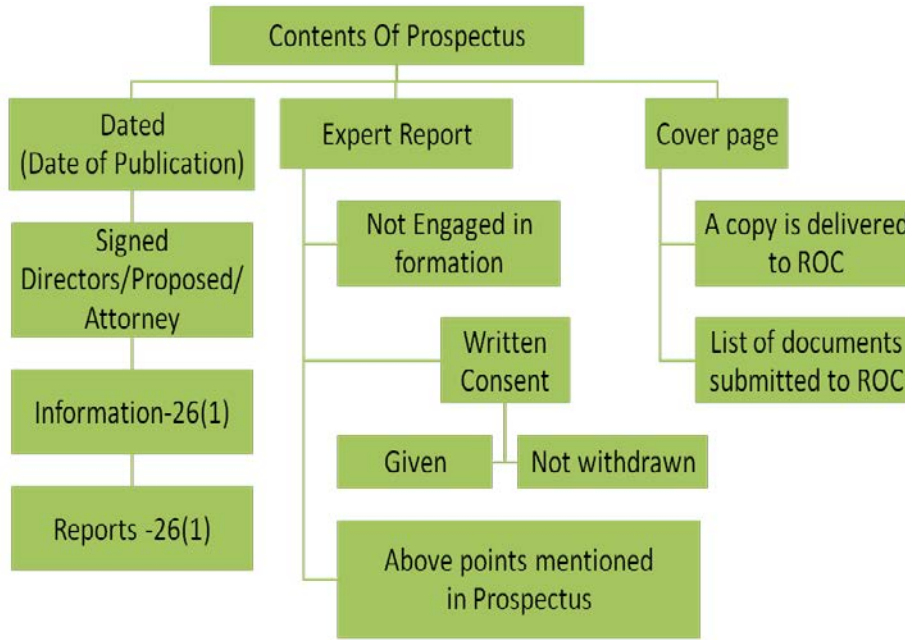
(4) **Prospectus to be issued after registration and compliance with other formalities:** No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless **on or before the date of its publication**, there has been delivered to the **Registrar** for registration, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney. [Sub- section (4)]

(5) **Experts'excluded from making a statement:** A prospectus issued under sub-section (1) shall not include a statement purporting to be made by an expert unless the expert is a person who is **not**, and has not been, **engaged** or interested in the formation or promotion or management, of the company and has given his written **consent** to the issue of the prospectus and has **not withdrawn** such consent before the delivery of a copy of the prospectus to the Registrar for registration and a **statement** to that effect shall be included in the prospectus.

(6) **Mention compliances of the formalities:** Every prospectus issued under sub-section (1) shall, on the face of it—

(a) state that a copy has been **delivered** for registration to the Registrar as required under sub-section (4); and

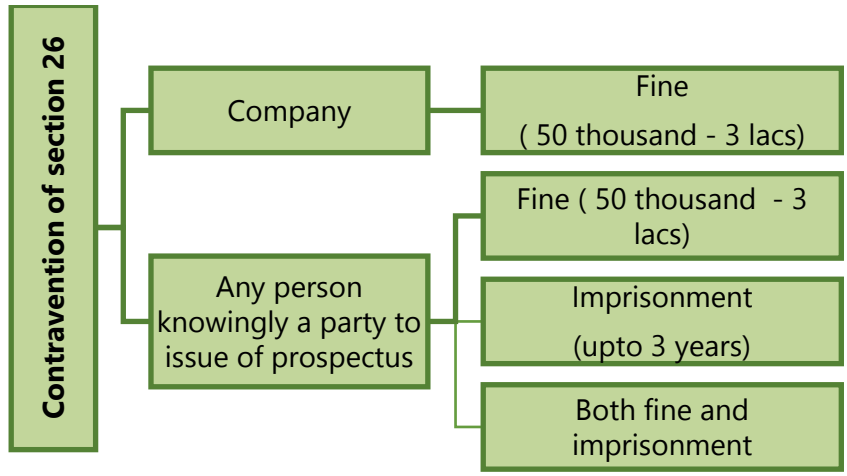
(b) specify any **documents** required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.



(7) Compliance of requirements of this sections before registration: The Registrar shall **not register** a prospectus unless the requirements of this section with respect to its registration are **complied** with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

(8) Period for the issue of prospectus: No prospectus shall be **valid** if it is issued more than **ninety days** after the date on which a copy thereof is delivered to the Registrar under sub-section (4).

(9) Punishment in case of contravention: If a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.



The major minimum contents of a prospectus or deemed prospectus are underlined in the sub-section (1) of Section 26 above. In addition to these there are substantial disclosure requirements which are prescribed under *Companies (Prospectus and Allotment of Securities) Rules, 2014*.

As per Section 2(38) —**expert includes** an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force;

(II) Public offer of securities to be in dematerialised form

(1) Section 29(1) states that every company making **public offer**; and Such other class or classes of public companies as may be **prescribed** under the Rule 9 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*, shall issue the securities only in **dematerialised** form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

(2) Any company, **other** than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in **physical** form in accordance with the provisions of this Act **or** in **dematerialised** form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Securities could be held in physical or dematerialised form. However public offer of securities has to be mandatorily in demat form in accordance with the **Depositories Act, 1996.** Demat ensures fool proof control over issue, sale, purchase, pledge, extinguishment of securities lending transparency and credibility to the entire process and securities markets.

According to Rule 9 of *Companies (Prospectus and Allotment of Securities) Rules, 2014 (Dematerialisation of securities*)

The **promoters** of every public company making a public offer of any convertible securities may hold such securities **only** in **dematerialised** form:

Provided that the entire holding of **convertible securities** of the company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialized form only.

(III) Shelf Prospectus, Red Herring Prospectus and Abridged Prospectus

Section 31 and Section 32 deals with important provision related to Shelf Prospectus and Red-herring Prospectus respectively. These twin provisions play a significant role in facilitating commercial and logistical consideration involved in the funds raising cycle.

Imagine a situation where the issuer company **issues debentures frequently** and has to file a prospectus every time it issues a new series of debenture. In this case, concept of shelf prospectus comes into play. Literally, it means prospectus with a given shelf life. Any number of issues could be made during the tenure of the shelf prospectus. The only caveat is to supplement the shelf prospectus by an "information memorandum" containing key updates or changes

Likewise, developments in financial markets allow innovative methods of raising funds making the most of favourable market conditions. Timing the issue and **Book building** of issue are facilitated by the concept of red herring prospectus whereby the price per security and number of securities are left open to be decided post closure of the issue.

SHELF PROSPECTUS –The expression "shelf prospectus" means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus

(1) Filing of shelf prospectus with the registrar: According to section 31, any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage-

(i) of the first offer of securities included therein which shall indicate a period not exceeding **one year** as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus, and

(ii) in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus,

no further prospectus is required.

(2) Filing of information memorandum with the shelf prospectus: A company filing a shelf prospectus shall be required to file an **information memorandum** containing all **material facts** relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus:

Provided that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

(3) Memorandum together with the shelf prospectus shall be deemed to be a prospectus: Where an information memorandum is filed, every time an offer of securities is made under sub-section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

RED HERRING PROSPECTUS— The expression "red herring prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Section 32 deals with the issue of red herring prospectus by a company. Accordingly law states that-

(i) Issue a red herring prospectus prior to the issue of a prospectus: A company proposing to make an offer of securities

may issue a red herring prospectus **prior** to the issue of a prospectus.

(ii) Filing with the registrar: A company proposing to issue a red herring prospectus shall **file** it with the Registrar at least **three days** prior to the opening of the subscription list and the offer.

(iii) Same obligation: A red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be **highlighted as variations** in the prospectus.

(iv) Filing of red herring prospectus with registrar and SEBI upon closing of offer: Upon the closing of the offer of securities under this section, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

ABRIDGED PROSPECTUS means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf. **[Refer the topic 'Issue of application forms for Securities']**

(IV) Document containing offer of securities for sale to be deemed prospectus

Section 25 of the Act states the law related to the document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company.

(1) Documents which deemed to be a prospectus: As per Section 25(1), where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company; and all enactments and rules of law as to the contents of prospectus and as to liability in respect of mis-statements, in and omissions from, prospectus, or otherwise relating to prospectus, shall apply with the modifications specified in subsections (3) and (4) and shall have effect accordingly, as if the securities had been offered to the public for subscription and as if persons accepting

the offer in respect of any securities were subscribers for those securities, but without prejudice to the liability, if any, of the persons by whom the offer is made in respect of mis-statements contained in the document or otherwise in respect thereof.

(2) **Securities offered for sale to the public:** For the purposes of this Act, it shall, unless the contrary is proved, be evidence that an allotment of, or an agreement to allot, securities was made with a view to the securities being offered for sale to the public if it is shown—

(a) that an offer of the securities or of any of them for sale to the public was made within **six months** after the allotment or agreement to allot; or

(b) that at the date when the offer was made, the whole **consideration** to be received by the company in respect of the securities had not been received by it.

(3) **Effect of section 26:** Section 26 as applied by section 25 shall have effect as if —

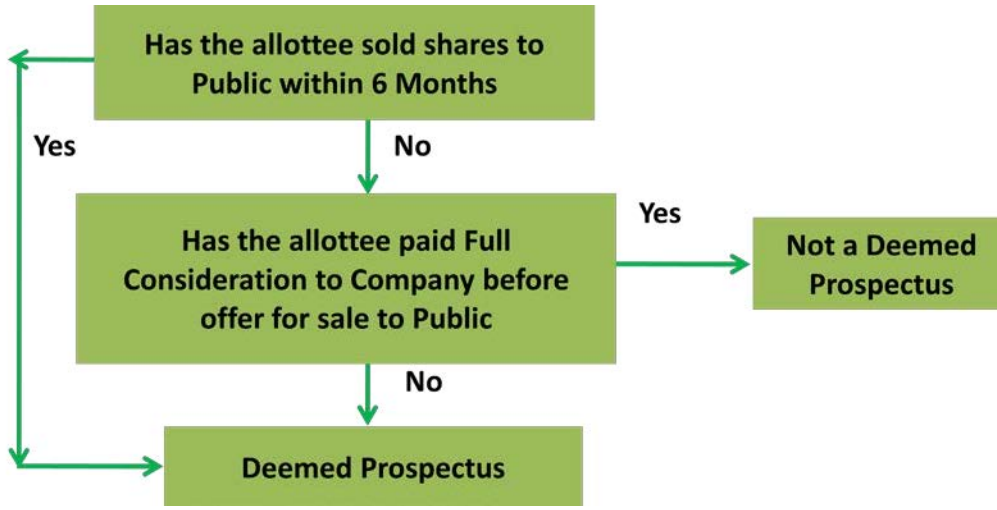
(i) it required a prospectus to state in addition to the matters required by that section to be stated in a prospectus—

(a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and

(b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;

(ii) the persons making the offer were persons named in a prospectus as directors of a company.

(4) **Person making an offer is a company or a firm:** Where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the document referred to in sub-section (1) is signed on behalf of the company or firm by two directors of the company or by not less than one-half of the partners in the firm, as the case may be.



Accordingly, all applicable provisions relating to prospectus viz., mis-statement, contents, civil, criminal liability etc. are applicable to the said deemed prospectus. There is no dilution of liability for the persons making the offer which is in addition to liability of the company whose securities are offered for sale. Additionally, below to be disclosed as well in the deemed prospectus:

- the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and
- the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;

The purpose is to protect gullible investors in all possible manners.

(V) Offer of sale of shares by certain members of company

Sections 28 of the Act deals with the Offer for sale of securities **by** certain **members** of company.

(1) Where certain members of a company propose, in consultation with the **Board** of directors to offer, in accordance with the provisions of any law for the time being in force, whole or part of their holding of shares to the public, they may do so in accordance with such procedure as may be prescribed.

(2) Any **document** by which the offer of sale to the public is made shall, for all purposes, be **deemed** to be a **prospectus** issued by the company and all laws and rules made thereunder as to the contents of

the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

(3) The members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively **authorise the company**, whose shares are offered for sale to the public, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter.

(VI) Variation in terms of contract or objects in prospectus [Section 27]

Section 27 deals with Variation in terms of contract or objects in prospectus. Once funds are raised through a given prospectus, the principles of "doctrine of ultra vires" (*mutatis mutandis*) comes into play i.e., the company has to use the funds strictly in accordance with the prospectus. Deviations are required to be pre-approved by the investors and recall option to be given to dissenting investors. Deviation regarding use of issue proceeds for buying, trading or otherwise dealing in equity shares of any other listed company is not permitted.

Accordingly, the section states that-

(1) Variation on approval in general meeting by passing of SR: A company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority given by the company in general meeting by way of **special resolution:**

Provided that the details, as may be prescribed, of the notice in respect of such resolution to shareholders, shall also be published in the **newspapers** (one in English and one in vernacular language) in the city where the registered office of the company is situated indicating clearly the justification for such variation:

Provided further that such company shall **not use** any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any **other listed company.**

(2) Exit offer to dissenting shareholders: The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall

be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

4. SECURITIES TO BE DEALT WITH IN STOCK EXCHANGES

(1) **Filing of an application with recognised stock exchange:** In accordance to Section 40(1) every company making public offer shall, before making such offer, make an application to **one or more recognised stock exchange or exchanges** and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

(2) **Prospectus to state name of stock exchange:** Where a prospectus states that an application has been made, such prospectus shall also **state the name** or names of the stock exchange in which the securities shall be dealt with.

(3) **To maintain separate bank account:** All monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a **scheduled bank** and shall not be utilised for any purpose other than—

(a) for adjustment **against allotment** of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or

(b) for the **repayment** of monies within the time specified by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.

(4) **Condition purporting to waive compliance shall be void:** Any condition purporting to require or bind any applicant for securities to waive compliance with any of the requirements of this section shall be **void**.

(5) **In case of default:** If a default is made in complying with the provisions of this section, both the company and the officer of the company shall be **liable**.

Company

- fine varying from five lakh rupees to fifty lakh rupees

Officer

- punishable with imprisonment upto one year, or
- with fine varying from fifty thousand rupees to three lakh rupees, or
- with both.

(6) Payment of commission: A company may pay **commission** to any person in connection with the subscription to its securities, whether absolute or conditional, subject to such conditions as given in Rule 13 of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*.

Conditions for the payment of commission:

(a) the payment of such commission shall be **authorized in the company's articles of association;**

(b) the commission may be **paid out of proceeds of the issue or the profit** of the company or both;

(c) **Rate of commission:** Following is the rate of commission to be paid to the person:

in case of shares	**in case of debentures**
☐ shall not exceed 5% of the price at which the shares are issued, or	☐ shall not exceed 2.5% of the price at which the debentures are issued, or
☐ a rate authorised by the articles,	☐ as specified in the company's articles,
☐ whichever is less	☐ whichever is less

(d) **Disclosure of the particulars:** the prospectus of the company shall disclose the following particulars -

(i) the name of the underwriters;

(ii) the rate and amount of the commission payable to the underwriter; and

(iii) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

(e) **No commission to be paid:** there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;

(f) **Copy of payment of commission to be delivered to registrar:** a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Example: A public limited company which went in for Public issue of shares had applied for listing of shares in three recognised Stock Exchanges and out of it only two had given permission for listing. Can the company proceed for allotment of shares?

Answer: Every company making a public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges. [Section 40 (1)]

Where a prospectus states that an application has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with. [Section 40 (2)]

From the above it is clear that not only the company has to apply for listing of the securities at a recognized stock exchange but also obtain permission thereof before making the public offer.

Hence, under the Companies Act, 2013 by making the offer of shares before getting the approval from the stock exchanges, it has violated the provisions of section 40.

Example: The Board of Directors of a company decide to pay 5% of issue price of shares as underwriting commission to the underwriters. On the other hand the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share

capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 2013?

Answer: Under the *Companies (Prospectus and Allotment of Securities) Rules, 2014* the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less.

The same rules allow the commission to be paid out of proceeds of the issue or the profit of the company or both.Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid while the decision to pay out of the proceeds of the share issue is valid.

5. ALLOTMENT OF SECURITIES BY COMPANY

"Allotment" means the appropriation out of previously un-appropriated capital of a company, of a certain number of shares to a person. Till such allotment, the shares do not exist as such. It is on allotment that the shares come into existence.

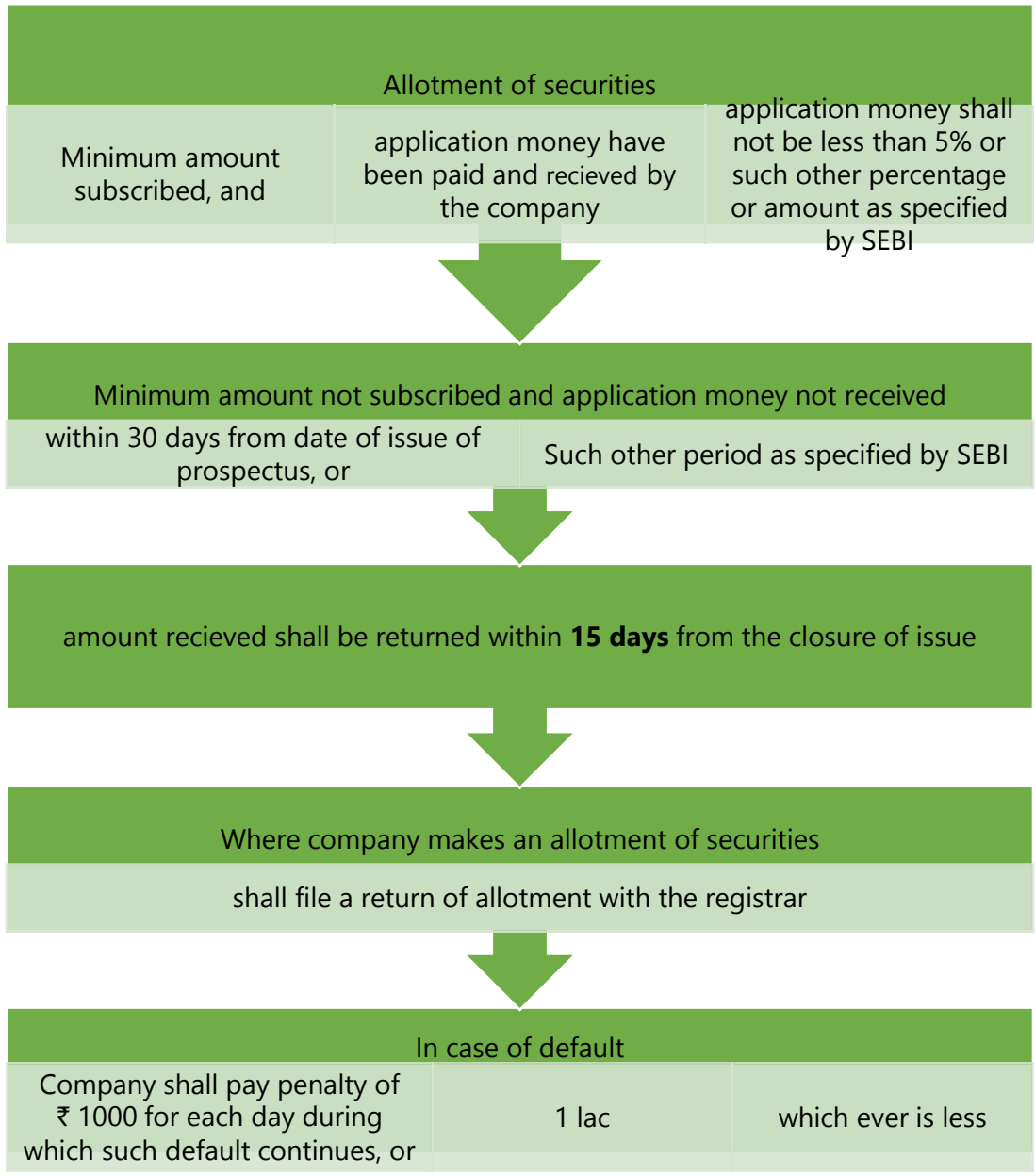
According to **Section 39(1)** no allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the **minimum** amount has been subscribed and the sums payable on **application** for the amount so stated have been paid to and received by the company by cheque or other instrument.

(2) The amount payable on application on every security shall not be less than **five per cent**. of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

(3) If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received under sub-section (1) shall be **returned** within such time and manner as may be prescribed.

(4) Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a **return of allotment** in such manner as may be prescribed.

(5) In case of any default under sub-section (3) or sub-section (4), the company and its officer who is in default shall be liable to a **penalty**, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.



Once securities are issued and subscribed for, these needs to be allotted in tune with the conditions as given below:

- Minimum subscription to be received within 30 days of issue of prospectus. In case minimum subscription is not received, the issue is regarded as failed. To take care of such eventuality, the merchant bankers in case of public offer resort to underwriting, suitable pricing, bringing in anchor investors etc. among other things. In case failed issue, the entire issue proceeds need to be refunded along with applicable interest.
- Application money > 5% of the nominal amount.
- Return of allotment needs to be filed with the ROC

As per *Rule 11 (Refund of Application Money*)

(1) If the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

(2) The application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

Example: After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares in favour of 'X'. The company deposited the said amount in the bank but withdrew 50% of the amount, before finalisation of the allotment, for the purchase of certain assets. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 2013.

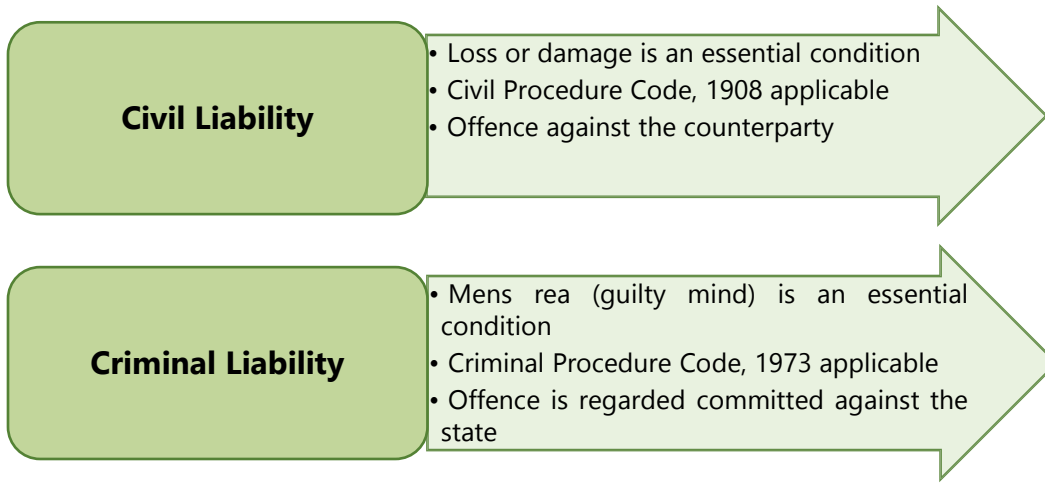
Answer: The company has received 80% of the minimum subscription as stated in the prospectus. Hence, the allotment is in contravention of section 39(1) of the Companies Act, 2013 which prohibits a company from making any allotment of securities until it has received the amount of minimum subscription stated in the prospectus. Under section 39 (3), it is required to refund the money received (i.e. 80% of the minimum subscription) to the applicants. It has no other option available.

Therefore, in the present case, X is within his rights to refuse to accept the allotment of shares which has been illegally made by the company.

6. MIS-STATEMENTS IN PROSPECTUS

In common parlance, mis-statement is the act of stating something that is false or not accurate. It could either be by commission or by omission or by both.

Mis- statement of prospectus is a serious offence which attracts section 34 and / or section 35**.** Liabilities can be classified under two headings:



CRIMINAL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS [SECTION 34]

Where a prospectus, issued, circulated or distributed under this Chapter, includes any statement which is **untrue** or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to **mislead**, every person who authorises the issue of such prospectus shall be liable under section **447**:

Provided that nothing in this section shall apply to a person if he proves that such statement or omission was **immaterial** or that he had reasonable **grounds** to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

CIVIL LIABILITY FOR MIS-STATEMENTS IN PROSPECTUS [SECTION 35]

(1) Liabilities of persons: According to **Section 35(1),** where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

(a) is a **director** of the company at the time of the issue of the prospectus;

(b) has **authorised himself** to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;

(c) is a **promoter** of the company;

(d) has **authorised** the **issue of the prospectus**; and

(e) is an **expert** referred to in sub-section (5) of section 26,

-shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay **compensation** to every person who has sustained such loss or damage.

(2) Exceptions: No person shall be liable if he proves—

(a) 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

(b) 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.

(c) that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder.

(3) Liability on defraud: Where it is proved that a prospectus has been issued with **intent to defraud** the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be **personally** responsible, without any **limitation** of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

Example: A company issued a prospectus. All the statements contained therein were literally true. It also stated that the company had paid dividends for a number of years, but did not disclose the fact that the dividends were not paid out of trading profits, but out of capital profits. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars.

Answer: The non disclosure of the fact that dividends were paid out of capital profits is a concealment of material fact as a company is normally required to distribute dividend only from trading or revenue profits and under exceptional circumstances can do so out of capital profits. Hence, a **material misrepresentation** has been made. Hence, in the given case the allottee can **avoid** the contract of allotment of shares.

Example: An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them and so director is not liable.

Answer: The Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, and section 35 more particularly includes a director of the company in the imposition of liability for such mis statements. Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus.

7. PUNISHMENT FOR FRAUDULENTLY INDUCING PERSONS TO INVEST MONEY [SECTION 36]

Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into—

(a) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or

(b) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

(c) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution,

-shall be liable for action under section **447**.

8. ACTION BY AFFECTED PERSONS [SECTION 37]

A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, **group of persons** or any association of persons **affected by any misleading statement** or the inclusion or omission of any matter in the prospectus.

Class Actions – Gift of Companies Act, 2013

Class action suit is for a group of people filing a suit against a defendant who has caused **common harm** to the entire group or class. This is not like a common litigation method where one defendant files a case against another defendant while both the parties are available in court. In the case of class action suit, the class or the **group** of people filing the case **need not be present** in the court and **can be represented by one petitioner**. The benefit of these type of suits is that if several people have been injured by one defendant, each one of the injured people need not file a case separately but all of the people can file one single case together against the defendant.

The need for these types of suits was first felt in the context of securities market during the time of **Satyam Scam**, where a large group of people were cheated

regarding their hard earned money invested in Stock Market. During that time, it was felt that it was **not** at all viable regarding **cost effectiveness** for a small stakeholder to file a case independently against the defendant. Millions of cheated investors during that time formed a large group and filed the case against the company, but since there was no available legal remedy or law which can actually support this type of litigation of a group filing charges, it became tough for those investors to take a recourse or gain advantage in the Indian Judicial System by this method. **Class action suits in India were so far filed under the guise of public interest litigations**. Courts were free to dismiss these. These shareholders ran pillar to post right from the National Consumer Disputes Redressal Commission up to the extent of Supreme Court and had their claims rejected.

Example: M applies for share on the basis of a prospectus which contains mis–statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement under section 37 of the Companies Act, 2013?

Answer: No, N cannot bring an action for rescission of the contract to buy shares from M on the ground of mis-statement as under section 37 of the Companies Act, 2013. A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

9. PUNISHMENT FOR FRAUD

Meaning of fraud: "Fraud" in relation to affairs of a company or any body corporate, includes-

- any act,
- omission,
- concealment of any fact, or
- abuse of position

committed by any person, or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person,

whether or not there is any wrongful gain or wrongful loss;

"Wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;

"Wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

According to section 447 of the Act, any person who is found to be guilty of fraud involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

	Fine		**Imprisonment**
Fraud of less than 10 lakh rupees or 1% of turnover whichever is less	Upto ₹ 50 Lakhs	or	Upto 5 years
Fraud of equal to or more than 10 lakh rupees or 1% of turnover whichever is less	Min: amount of fraud Max: (amount of fraud) x 3	and	Min: 6 months Max: 10 Years
Involving Public Interest	Min: amount of fraud Max: (amount of fraud) x 3	and	Min: 3 years Max: 10 Years

10. PRIVATE PLACEMENT OFFER OR INVITATION FOR SUBSCRIPTION OF SECURITIES ON PRIVATE PLACEMENT [SECTION 42]

Private Placement

- A private placement is a way of raising capital that involves the sale of securities to a relatively small number of select investors.
- A private placement is different from a public issue in which securities are made available for sale on the open market to any type of investor.

Offer or Invitation for Subscription of Securities on Private Placement: [Section 42]

(1) A company may, **subject** to the provisions of this section, make a private placement of securities.

(2) A private placement shall be made only to a select group of **persons** who have been **identified by the Board** (herein referred to as "identified persons"), whose number shall not exceed **fifty** or such higher number as may be prescribed [excluding the **qualified institutional buyers** and employees of the company being offered securities under a scheme of **employees** stock option in terms of provisions of clause (b) of sub-section (1) of section 62], in a financial year subject to such conditions as may be prescribed.

(3) A company making private placement shall issue private placement **offer and application** in such **form** and manner as may be prescribed to identified persons, whose names and addresses are recorded by the company in such manner as may be prescribed:

Provided that the private placement offer and application shall not carry any right of renunciation.

Explanation I.—"private placement" means any offer or invitation to subscribe or

issue of securities **to a select group of persons by a company (other than by way of public offer)** through private placement offer-cum-application, which satisfies the conditions specified in this section.

Explanation II.—"qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended from time to time, made under the Securities and Exchange Board of India Act, 1992.

Explanation III.—If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public and shall accordingly be governed by the provisions of Part I of this Chapter.

(*4*) Every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person alongwith subscription money paid either by **cheque or demand draft or other banking channel** and not by cash:

Provided that a company shall **not utilise** monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar in accordance with sub-section (*8*).

(5) **No fresh offer** or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company:

Provided that, subject to the maximum number of identified persons under sub-section (*2*), a company may, at any time, make more than one issue of securities to such class of identified persons as may be prescribed.

(6) A company making an offer or invitation under this section shall allot its securities within **sixty days** from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within **fifteen days** from the expiry of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent. per annum from the expiry of the sixtieth day:

Provided that monies received on application under this section shall be kept in a **separate bank account** in a **scheduled bank** and shall not be utilised for any purpose other than—

(*a*) for adjustment against **allotment** of securities; or

(*b*) for the **repayment** of monies where the company is unable to allotsecurities.

(7) **No** company issuing securities under this section shall release any public advertisements or utilise any media, **marketing** or distribution channels or agents to inform the public at large about such an issue.

(8) A company making any allotment of securities under this section, shall file with the Registrar a **return of allotment** within **fifteen days** from the date of the allotment in such manner as may be prescribed, including a complete list of all allottees, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

(9) If a company **defaults** in filing the return of allotment within the period prescribed under sub-section (*8*), the company, its promoters and directors shall be liable to a penalty for each default of **one thousand rupees** for each day during which such default continues but not exceeding **twenty-five lakh rupees**.

(10) Subject to sub-section (*11*), if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the **amount raised** through the private placement or **two crore rupees**, whichever is lower, and the company shall also **refund** all monies with interest as specified in sub-section (*6*) to subscribers within a period of **thirty** days of the order imposing the penalty.

(11) Notwithstanding anything contained in sub-section (*9*) and sub-section (*10*), any private placement issue not made in compliance of the provisions of sub-section (*2*) shall be deemed to be a **public offer** and all the provisions of this Act and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be applicable.

As per Rule 14 of *Companies (Prospectus and Allotment of Securities) Rules, 2014*,

(1) For the purposes of sub-section (2) and sub-section (3) of section 42, a company shall not make an offer or invitation to subscribe to securities through private placement unless the proposal has been previously approved by the shareholders of the company, by a **special resolution** for **each of the offers** or invitations:

Provided that in the explanatory statement annexed to the notice for shareholders' approval, the following disclosure shall be made:-

(a) particulars of the offer including date of passing of Board resolution;

(b) kinds of securities offered and the price at which security is being offered:

(c) basis or justification for the price (including premium, if any) at which the offer or invitation is being made;

(d) name and address of valuer who performed valuation;

(e) amount which the company intends to raise by way of such securities;

(f) material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities:

Provided further that this sub-rule shall not apply in case of offer or invitation for. non-convertible debentures, where the proposed amount to be raised through such offer or invitation does not exceed the limit as specified in clause (c) of sub section (1) of section 180 and in such cases relevant Board resolution under clause (c) of subsection (3) of section 179 would be adequate:

Provided also that in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation exceeds the limit as specified in clause (c) of sub-section (1) of section 180, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitations for such debentures during the year.

(2) For the purpose of sub-section (2) of section 42, an offer or invitation to subscribe securities under private placement shall not be made to persons more than **two hundred** in the aggregate in a financial year:

Provided that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 **shall not be considered** while calculating the limit of two hundred persons.

Explanation.- For the purposes of this sub-rule it is hereby clarified that the restrictions aforesaid would be **reckoned individually for each kind of security** that is equity share, preference share or debenture.

(3)[2] A return of allotment of securities under section 42 shall be filed with the Registrar within fifteen days of allotment.

(4)[3] The provisions of sub-rule (2) shall not be applicable to -

(a) non-banking financial companies which are registered with the Reserve Bank of India under the Reserve Bank of India Act,1934 and

(b) housing finance companies which are registered with the National Housing Bank under the National Housing Bank Act, 1987,

if they are complying with regulations made by the Reserve Bank of India or the National Housing Bank in respect of offer or invitation to be issued on private placement basis:

Provided that such companies shall comply with sub-rule (2) in case the Reserve Bank of India or the National Housing Bank have not specified similar regulations.

(5)[4] A company shall issue private placement offer cum application letter only after the relevant special resolution or Board resolution has been filed in the Registry:

Provided that private companies shall file with the Registry copy of the Board resolution or special resolution with respect to approval under clause (c) of subsection (3) of section 179.

SUMMARY

- Securities could be offered to public at large (public offer) or through private placement subject to the type of issuer company
- Prospectus, deemed prospectus, abridged prospectus, red-herring prospectus, shelf prospectus, information memorandum need to comply with the minimum information requirements as prescribed in the Act and the Rules
- Fraudulent Omission or commission in the issue documents attract civil as well as criminal liability.

[2] Rule 14 (6)
[3] Rule 14(7)
[4] Rule 14(8)

- SEBI has power to deal with matters related to listed or proposed to be listed securities. Central Government (MCA, Regional Director, ROC) has power to deal with matters related to unlisted securities
- Issue of securities (shares, debentures or hybrid securities) through public offer to be made only in demat form
- Existing holders of securities could offload their stake through required compliances for an OFS
- Provision related to timelines, pre-requisites for allotment and listing wherever applicable needs to strictly adhered to avoid any penal provision
- Private placements have somewhat diluted disclosure requirements as public exposure is not there

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Offer of securities or invitation to subscribe securities under private placement shall be made to ----------maximum number of person in the aggregate in a financial year.
   (a) 50
   (b) 100
   (c) 150
   (d) 200
2. A private company may issue securities through the way of , except-
   (a) Public offer
   (b) Rights issue
   (c) Bonus issue
   (d) Private placement
3. Registrar of companies shall refuse to register a prospectus:
   (a) If it is not dated
   (b) Contains statement of an expert who has not signed it
   (c) Contains information which is six month old

(d) In all the above cases

4. A prospectus issued in the form of advertisement must state:

(a) The objects for which the company has been formed

(b) The liability of members

(c) The amount of share capital of company

(d) All of the above

5. Shelf prospectus remains valid upto-

(a) 6 months

(b) 1 year

(c) 2 years

(d) 5 years

6. An issue house (share broker) has made an advertisement in newspaper for selling a big lot of share allotted to it by the company under a private placement. In which of the following conditions the advertisement will not be deemed as prospectus:

(a) advertisement was given within six months from the date of allotment but it has paid the entire consideration to the company

(b) advertisement was given after six months from the date of allotment & it has paid the entire consideration to the company

(c) It has not paid entire consideration to the company till the date of allotment

(d) None of the above

7. In which of the following situations a company will have to issue prospectus or abridged prospectus along with the application form:

(a) In relation to shares or debentures which are not offered to the public

(b) In relation to issue of shares or debentures to the existing members or debenture holders

(c) In relation of issue of shares which are uniform with shares previously issued and quoted on a recognized stock exchange

(d) in relation to shares or debentures which are to be offered to the public

8. Criminal liability under section 34 for misstatement in prospectus may be avoided if : 1) the consent to become director was withdrawn 2) prospectus was issued without his knowledge 3) misstatement was immaterial 4) had reasonable ground to believe in truthfulness 5) it was based on statement of expert

   (a) 3 & 4

   (b) 1; 2; 3; 4 & 5

   (c) 1; 2 & 5

   (d) 3; 4 & 5

9. If a person makes multiple applications in different names; then which of the following statements are not true:

   (a) he shall be liable for action under section 447

   (b) above provision shall be prominently reproduced in prospectus

   (c) Court may also order disgorgement of gain

   (d) Disgorged gain will be transferred to Insolvency and Bankruptcy fund

10. Which of the following is not true?

   (a) in case of shares; the rate of underwriting commission to be paid shall not exceed five percent of the issue price of the share.

   (b) underwriting commission should not be more than the rate specified by the Article of Association

   (c) in case of debentures; the rate of underwriting commission shall not exceed five percent of the issue price of the debentures.

   (d) amount of commission may be paid out of profits of the company

11. A holder of depository receipts shall have right to vote:

   (a) at par with other equity shareholders

   (b) through overseas depository and in the proportion as already specified by company

   (c) no right to vote

   (d) only on resolutions directly affecting them

12. A public company sent private placement offer letter to 200 persons of its choice in March 20XX and allotted shares to them in April 20XX. Can it send private placement offer letter to 200 new people in May 20XX?

(a) Yes

(b) No

(c) Yes with the permission of ROC

(d) Yes with the permission of NCLT

13. Which of the following statement is contrary with the provisions of the Companies Act; 2013?

(a) a private company can make a private placement of its securities

(b) company has to pass a special resolution for private placement

(c) Minimum offer per person should have Market Value of ₹ 20;000

(d) a public company can make a private placement of its securities

14. A company can change terms of contracts mentioned in prospectus by way of:

(a) Ordinary resolution though postal ballot

(b) Ordinary resolution in meeting

(c) Special resolution in meeting

(d) Special resolution through postal ballot

15. A shelf prospectus filed with the ROC shall remain valid for a period of:

(a) one year from the date of registration

(b) one year from the date of closing of first issue

(c) one year from the date of opening of first issue

(d) Ninety days from the date on which a copy was delivered to ROC

Answer to MCQs

1.	(d)	**2.**	(a)	**3.**	(d)	**4.**	(d)	**5.**	(b)	**6.**	(b)
7.	(d)	**8.**	(a)	**9.**	(d)	**10.**	(c)	**11.**	(b)	**12.**	(a)
13.	(c)	**14.**	(d)	**15.**	(c)						

Question and Answer

Question 1

Unique Builders Limited decides to pay 2.5 percent of the value of debentures as underwriting commission to the underwriters but the Articles of the company authorize only 2.0 percent underwriting commission on debentures. The company further decides to pay the underwriting commission in the form of flats. Examine the validity of the above arrangements under the provisions of the Companies Act,2013.

Answer

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to a number of conditions which are prescribed under *Companies (Prospectus and Allotment of Securities) Rules, 2014*. In relation to the case given, the conditions applicable under the above Rules are as under:

(a) The payment of such commission shall be authorized in the company's articles of association;

(b) The commission may be paid out of proceeds of the issue or the profit of the company or both;

(c) The rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent (2.5 %) of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;

Thus, the Underwriting commission is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates.

In view of the above, the decision of Unique Builders Ltd. to pay underwriting commission exceeding 2% as prescribed in the Articles is invalid.

The company may pay the underwriting commission in the form of flats as both the Companies Act and the Rules do not impose any restriction on the mode of payment though the source has been restricted to either the proceeds of the issue or profits of the company.

Question 2

PQR limited wants to raise funds for it upcoming project. It has issued private placement offer letters to 55 persons in their individual name to issue its equity shares. Out of these four are qualified institutional buyers. Before allotment under this offer letter company issued another private placement offer letter to another 155 persons in their individual name for issue of its debentures. Being a public company can it issue securities in a private placement? Is it in compliance with provisions related to private placement or should these offers be treated as public offers? What if the offer for debentures is given after allotment of equity shares but within the same financial year?

Answer

According to section 42 of the companies act, 2013 any private or public company may make private placement through issued of a private placement offer letter.

But the offer shall be made to persons not exceeding fifty or such higher number as may be prescribed, in a financial year. For counting number of persons qualified institutional buyers and employees under employees stock option scheme will not be considered.

Here rules prescribed limit as 200 persons in a financial year. But this limit should be counted separately for each type of security.

If a company makes an offer or invitation to more than the prescribed number of persons it shall be deemed to be an offer to the public and shall be governed by the provisions related to prospectus.

Also a company can not make fresh offer under this section if allotments with respect to any offer made earlier have been completed or that offer has been withdrawn or abandoned by the company. This rule is applicable even if the issue is of different kind of security.

Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions will apply accordingly.

In the given case PQR limited is a public company and looking at above provisions we can say that even a public company can make private placement. Company has given offer to 55 persons out of which 4 are qualified institutional buyers hence the offer is given to effectively 51 persons which is well within the limit of 200 persons. From this angle company is in compliance with private

placement rules.

But company has given another private placement offer which is non compliance of provisions of section 42 hence the offers given by company will be treated as public offer and will be governed accordingly.

But if the company gives offer for debentures in the same financial year after allotment of equity shares is complete then both the offers can well be treated as private placement offers. Here we should not add 51 and 155 persons for checking the limit of 200 because this limit should be checked

Question 3

State in what way does the Companies Act, 2013 regulate and restrict the following in respect of a company going for public issue of shares:

(i) Minimum Subscription, and

(ii) Application Money payable on shares being issued?

Answer

The Companies Act, 2013 by virtue of provisions as contained in Section 39 (1) and (2) regulates and restricts the minimum subscription and the application money payable in a public issue of shares as under:

Minimum subscription [Section 39 (1)]

No Allotment shall be made of any securities of a company offered to the public for subscription; unless; -

(i) the amount stated in the prospectus as the minimum amount has been subscribed; and

(ii) the sums payable on application for such amount has been paid to and received by the company-

Application money: Section 39 (2) provides that the amount payable on application on each security shall not be less than 5% of the nominal amount of such security or such amount as SEBI may prescribe by making any regulations in this behalf.

Further section 39 (3) provides that if the stated minimum amount is not received by the company within 30 days of the date of issue of the prospectus or such time as prescribed by SEBI, the company will be required to refund the application money received within such time and manner as may be prescribed.

In case of any default under sub-section, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

Section 40 (3) provides that all moneys received on application from the public for subscription to the securities shall be kept in a separate bank account maintained with a scheduled bank.

Question 4

The Board of Directors of Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus with the Registrar of Companies, Mumbai. Explain the remedy available to the investors in this regard.

Answer

According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the registration of the prospectus with the Registrar before its issue.

In the given case, the company has violated with the above provisions of the Act and hence the allotment made is void. The company will have to refund the entire moneys received and will also be punishable under section 26 (9) of the Act.

Question 5

An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them. Is the Director liable under the circumstances? Decide referring to the provisions of the Companies Act, 2013.

Answer

Yes, the Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such mis statements.

The only situations when a director will not incur any liability for mis statements in a prospectus are as under:

(a) No criminal liability under section 34 shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

(b) No civil liability for any mis statement under section 35 shall apply to a person if he proves that:

(1) 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

(2) 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.

Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus. He will be liable for mis-statements in the prospectus.

CHAPTER 4

SHARE CAPITAL AND DEBENTURES

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Know the Kinds of share capital
- Explain the basic requirements for issue of share certificates, Voting rights & Variation of shareholders' rights
- Explain calls on unpaid shares
- Know about application of securities premium
- Identify prohibition on issue at discount, Sweat Equity shares & Issue and redemption of Preference Shares
- Know about the Transfer and transmission of securities, refusal and appeal thereof
- Identify Authorised, subscribed and paid up capital
- Explain the concept related to the alteration of share capital and notice to Registrar thereof
- Know about the concept related to Further issue of share capital, Issue of bonus shares, Reduction of share capital, buy back of shares and restrictions thereon
- Know about Issue of debentures, Capital Redemption Reserve & Debenture Redemption Reserve
- Identify the Punishments and penalties for various offences including impersonation.

CHAPTER OVERVIEW

Share capital and debentures (Section 43- 72*)	
Concepts related to shares (Section 43- 70)	Concepts related to debentures (Section 71)

*Section 72 is not applicable for students

1. INTRODUCTION

The **share capital is the lifeblood** for running the affairs of the company. Sometimes after the issue of capital a company may either alter or reduce the share capital depending upon the exigencies of the situation. For desired share capital, a company may also raise a debenture which have to be registered as a charge.

Shares and debentures are financial instruments for raising funds for the company. Under the Companies Act, 2013, these are **jointly referred to as "Securities"**.

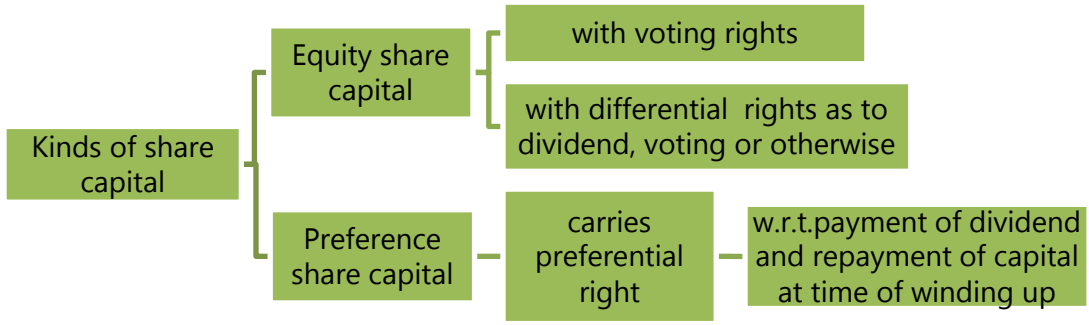
Generally, shares depict ownership interest in a company with entrepreneurial risks and rewards whereas debentures depict lender's interest in the company with limited risks and returns.

Both these financial instruments are presented on the liabilities side of the issuer company and on the assets side of the investor or lender respectively.

Legal provisions related to these instruments are covered in Chapter IV of the Companies Act, 2013 (comprising sections 43 to 72) and the *Companies (Share Capital & Debentures) Rules, 2014* as amended from time to time along with endorsement in the company formation documents or approved by suitable company forum, wherever necessary.

2 SHARE CAPITAL-TYPES [SECTION 43][1]&[2]

Section 2(84) of the Companies Act, 2013 defines share as a share in the share capital of a company and includes stock.



Broadly, there are two kinds of share capital of a company limited by shares:

- Equity share capital
- Preference share capital.

The Act defines **preference share capital** as instruments which have preferential right to dividend payment (absolute/fixed or ad-valorem / %) and preferential repayment during winding up of the company. These shareholders could also participate in equity pool post the preferential entitlements.

Shares which are not preference shares are termed as **equity shares**.

Equity shares are further classified as plain vanilla (same voting rights) or Differential equity shares (with differences w.r.t. dividend or voting rights or otherwise)

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[1] **Exemption**: In case of Private Company- Section 43 shall not apply where memorandum or articles of association of the private company so provides. - *Notification dated 5th June, 2015.* The above mentioned exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar. *Notification dated 13th June, 2017.*

[2] In case of Specified IFSC Public Company - Section 43 Shall not apply to a Specified IFSC public company, where memorandum of association or articles of association of such company provides for it. - *Notification Date 4th January, 2017*

In Indian listed companies, there are two companies which have issued differential voting rights shares (DVRs):

- Tata Motors
- Future Retail

Empirically, aforesaid DVRs (no voting rights) are traded at lower valuations vis-à-vis their counterparts with voting rights, other things being equal.

Extract of the Act:

"According to **section 43**, the share capital of a company limited by shares shall be of two kinds, namely:—

(a) equity share capital—

(i) with **voting** rights; or

(ii) with **differential** rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and

(b) preference share capital:

Provided that nothing contained in this Act shall affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

Explanation.—For the purposes of this section,—

(i) "equity share capital", with reference to any company limited by shares, means all share capital which is not preference share capital;

(ii) "preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

(a) payment of **dividend**, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

(b) **repayment**, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

(iii) capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

(a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid."

Rule 4 of the *Companies (Share capital and Debenture) Rules, 2014* states about equity shares with differential rights.

Conditions for the issue of equity shares with differential rights: No company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions, namely:

(a) the **articles** of association of the company authorizes the issue of shares with differential rights;

(b) the issue of shares is authorized by an **ordinary resolution** passed at a general meeting of the shareholders:

Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through **postal ballot**;

(c) the shares with differential rights shall **not exceed twenty-six percent** of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

(d) the company having consistent track record of distributable **profits** for the **last three years**;

(e) the company has **not defaulted** in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

(f) the company has **no subsisting default** in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or

payment of interest on such deposits or debentures or payment of dividend;

(g) the company has **not defaulted** in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

Provided that a company may issue equity shares with differential rights upon expiry of five years from the end of the financial Year in which such default was made good.

(h) the company has **not been penalized** by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

Restriction on conversion of equity share capital with voting rights into equity share capital carrying differential voting rights: Further Rule 4(3) specifies that the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice–versa.

Rights to the holders of the equity shares with differential rights: Rule 4 (5) states that the holders of the equity shares with differential rights shall **enjoy all other rights** such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

Particulars of shares to be maintained in the register of members: Rule 4 (6) Where a company issues equity shares with differential rights, the Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

3. BASIC REQUIREMENTS [SECTION 46]

Extract of the Act:

"Section 46: (1) A certificate, issued under the common seal, if any, of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary, specifying the shares

held by any person, shall be **prima facie** evidence of the title of the person to such shares.

(2) A **duplicate** certificate of shares may be issued, if such certificate —

(a) is proved to have been **lost** or destroyed; or

(b) has been defaced, **mutilated** or torn and is surrendered to the company.

(3) Notwithstanding anything contained in the **articles** of a company, the manner of issue of a certificate of shares or the duplicate thereof, the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed.

(4) Where a share is held in depository form, the record of the **depository** is the prima facie evidence of the interest of the **beneficial owner.**

(5) If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with **fine** which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section **447**."

Physical entitlement to a particular portion of share capital is *prima facie* evidenced by way of a share certificate which has to be

- **Distinctively numbered**; &
- To be issued under **common seal** of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

In case required, duplicate certificate could be issued post necessary compliances and investigations.

The aforesaid requirements are not there in case of dematerialised shares or shares held in electronic form with any depository. In that case records of the depository will be treated as *prima facie* evidence of the right involved.

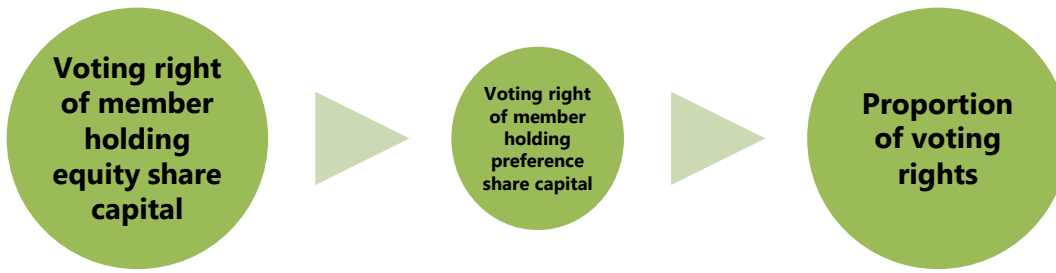
Demat—Now-a-days most of the listed shares are held in electronic format. Even banks and financial institutions now insist for demat of securities for charge creation to facility corroboration with central registry for loans and mortgages. Physical securities are mostly limited to private limited companies and closely held companies.

At present, there are **two depositories in India**: **NSDL** and **CDSL** with various depository participants (DPs) linked to them. Dematerialised securities are held by investors in their respective accounts with the DP. The DP keeps a track of transfer, transmission, charge creation etc. There are necessary enabling legal enactments to facilitate all these procedures.

An intelligent reader would observe that the share certificate issues by a company could be in a way compared to currency notes issued by the Central Bank. Therefore, strict penal provisions are there against fraudulent activities. In such cases, the wrong-doer company and every officer in default is punishable under section 447.

4. RIGHTS AND VARIATION OF RIGHTS [SECTION 47 & 48]

[3]Voting Rights [Section 47]



Section 47 governs the voting rights of members. Accordingly, section provides:

(i) Voting right of member holding equity share capital: Subject to the provisions of section 43, sub-section (2) of section 50 and sub-section (1) of section 188-

(a) every **member** of a company limited by shares and **holding equity share capital** therein, shall have a **right to vote** on every resolution placed before the company; and

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[3] *In case of Specified IFSC Public Company – Section 47 shall not apply to a Specified IFSC public company, where memorandum of association or articles of association of such company provides for it. - Notification Date 4th January, 2017.*

(b) his voting right on a **poll shall be in **proportion** to his share in the paid-up equity share capital of the company.

****Exemption to Nidhi company**- clause (b) of Sub-section (1) of Section 47 shall apply, subject to the modification that no member shall exercise voting rights on poll in excess of five per cent, of total voting rights of equity shareholders. (*Notification dated 5th June, 2015.)*

(ii) Voting right of member holding preference share capital: Every member of a company limited by shares who is holding any preference share capital shall, in respect of such capital, have—

- a right to vote only on resolutions placed before the company which **directly affect** the rights attached to his preference shares, and
- any resolution for the **winding up** of the company, or
- for the repayment or **reduction** of its equity or preference share capital

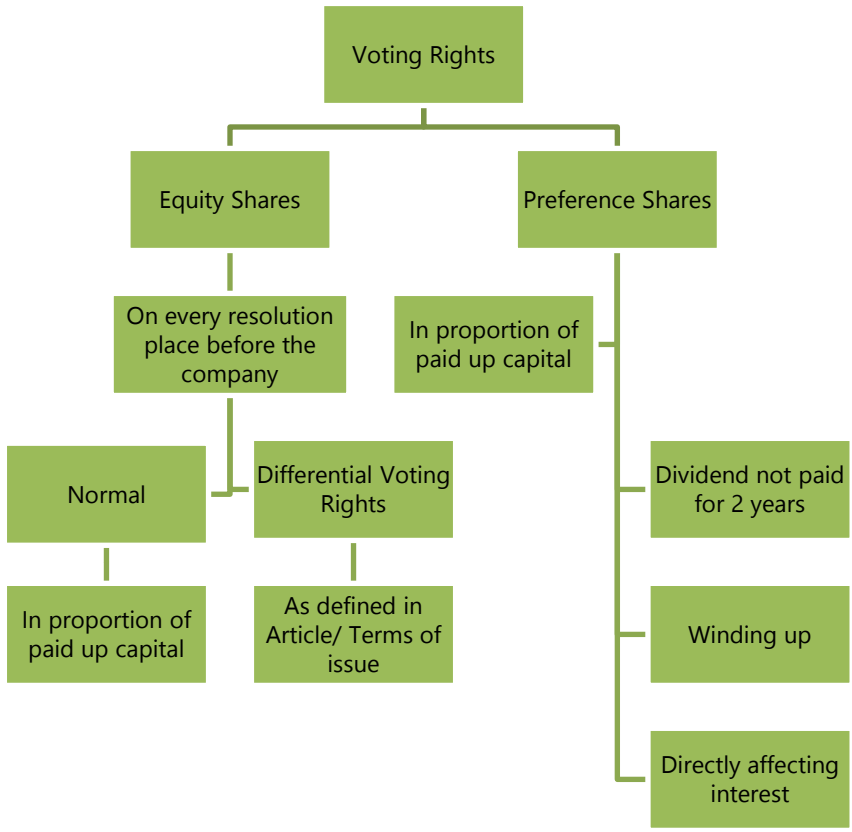
and his voting right on a poll shall be in **proportion** to his share in the paid-up preference share capital of the company.

(iii) Proportion of voting rights: The proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same **proportion** as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

Where the **dividend** in respect of a class of preference shares has not been paid for a period of **two years** or more, there such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

On analysis of above provision, in case of equity shares other than equity shares with differential voting rights, each shareholder is entitled to vote on any resolution placed before the company i.e., in the annual general meeting (AGM) or Extra-ordinary general meeting (EGM) of the members of the company. The voting right shall be proportionate to the paid up capital of the class of shares involved.

In a nutshell, voting rights for securities are not based on the principles of adult / universal franchise i.e. one person one vote but these are based on the class of shares and on the monetary value of investments at face value.



Exemption to Private Company- In case of private company - Section 47 shall not apply where memorandum or articles of association of the private company so provides. (*Notification dated 5th June, 2015).*

The above mentioned exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar. (*Notification dated 13th June, 2017)*

Thus, Private company could be more innovative in terms of voting rights if permitted by their Memorandum of Association or Article of Association.

Variations of shareholders' rights [Section 48]

Where share capital of a company is divided into different classes of shares, it may sometimes be necessary for it to amend the rights attached to one or more classes of shares. The Companies Act states the following laws on the variations of shareholders' right:

(1) Variation in rights of shareholders with consent: Where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in **writing** of the holders of not less than three-fourths of the issued shares of that class or by means of a **special** resolution passed at a separate meeting of the holders of the issued shares of that class,—

(a) if provision with respect to such variation is contained in the **memorandum** or **articles** of the company; or

(b) in the absence of any such provision in the memorandum or **articles**, if such variation is not prohibited by the **terms of issue** of the shares of that class:

Provided that if variation by one class of shareholders affects the rights of any **other class** of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

(2) No consent for variation: Where the holders of not less than **ten per cent** of the issued shares of a class did not consent to such variation or vote in favour of the special resolution for the variation, they may apply to the **Tribunal** to have the variation cancelled, and where any such application is made, the variation shall not have effect unless and until it is confirmed by the Tribunal:

Provided that an application under this section shall be made within **twenty-one** days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose. [Sub – section (2)]

(3) Binding decision of tribunal: The decision of the Tribunal on any application under sub-section (2) shall be **binding** on the shareholders.

(4) Filing copy of order with the Registrar: The Company shall, within **thirty days** of the date of the order of the Tribunal, file a copy thereof with the **Registrar**.

(5) Default in compliance with the provision: Where any default is made in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with **fine** which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with **both**.

5. CALLS AND INCIDENTAL MATTERS [SECTION 49 TO SECTION 51]

Calls are made by the company on security holders to pay the amount called up in respect of partly paid up securities.

As per **Section 49**, these calls have to **uniformly** made and there should be no differentiation for a given class of security holders.

Explanation.—For the purposes of this section, shares of the **same nominal value** on which different amounts have been paid-up shall **not** be deemed to fall under the same class (i.e. the provision is not applicable in case where different amounts are paid for a same class for security.)

Calls in Advance

As per **Section 50**, a company may, if so authorised by its **articles**, accept from any member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up (i.e. if authorised by the articles, a company can keep advance subscription or call money received in advance.)

However, in case of member of a company limited by shares there would be **no voting** right on that advance amount till the amount is duly called for and adjusted.

The company could pay proportionate dividends in proportion to amount paid on each share, if authorised by the articles **[Section 51].**

In other words, advance payment will never lead to increased voting rights but delayed payment of call money could be the reason of decreased voting rights.

Example: "Moonstar Ltd" is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'A', a shareholder of the Moonstar Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Moonstar Ltd.".In the given case Mr. A, has deposited in advance the remaining amount due on his shares without any calls made by 'Moonstar Ltd'. So, 'Moonstar Ltd' was authorized to accept the unpaid calls by its articles. Hence, this is a valid transaction.

6. ISSUE OF SHARES AT PREMIUM OR DISCOUNT [SECTION 52 TO SECTION 55]

Under the concepts of financial management fair value of a share may be equal to, less than or more than the face of a shares. If a security is issued to new investors at a price lower than the fair value then existing shareholders can make an objection. Also issuing a share at value more than or less than the fair value may have adverse consequences under Income Tax act or under FEMA.

When a security of a given face value is issued at price higher than its face value, the issue is called as issue at premium and the differential amount as premium.

Where the issue price is lower to the face value, the issue is regarded at discount and the differential known as discount.

There are precautionary provisions covered in **section 52 and 53** for both these scenarios (premium or discount) respectively to safeguard the issuer company and its stakeholders.

Application of premiums received on issue of shares [Section 52]

Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be **transferred to a securities premium account** and the provisions of this Act relating to reduction of share capital (which are very stringent) of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.

Application of securities premium account: The securities premium account may be applied by the company—

(a) towards the issue of unissued shares of the company to the members of the company as fully paid **bonus** shares;

(b) in writing off the **preliminary** expenses of the company;

(c) in writing off the **expenses** of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the **redemption** of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its **own shares** or other securities under section 68.

Who may apply the securities premium account: The securities premium

account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

(a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid **bonus shares**; or

(b) in writing off the expenses of or the **commission** paid or **discount** allowed on any issue of equity shares of the company; or

(c) for the **purchase of its own shares** or other securities under section 68.

Prohibition on issue of shares at discount [Section 53]

A company cannot issue shares in disregard of Section 53 of the Companies Act, 2013.

1. According to section 53, a company shall **not issue** shares at a discount, except in the case of an issue of sweat equity shares given under section 54 of the Companies Act, 2013. [Sub section (1)]

2. Any share issued by a company at a discount shall be **void**. [Sub section (2)]

3. **Exception**: Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its **creditors** when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

4. Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a **penalty** which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

It is clear for the reading of section **52 and 53** that these restrictions are only on issue of shares, it could be **equity or preference** but not on any debt related products like bonds or debentures whose pricing is more governed by YTM (yield to maturity) considerations.

Issue of Sweat equity shares [Section 54]

Sweat equity is issued to keep the employees of a company motivated by making them partner in growth of the company.

As per **Section 2(88)—sweat equity shares** means such equity shares as are issued by a company to its **directors** or **employees** at a **discount** or for consideration, **other than cash**, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;

As per **Section 2(37)—employees' stock option** means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or **right to purchase**, or to subscribe for, the shares of the company at a future date at **a pre-determined price**;

Section 54 of the Companies Act, 2013 provides the conditions where a company may issue sweat equity shares of a class of shares **already issued**.

Conditions: A company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely—

(a) the issue is authorised by a **special resolution** passed by the company;

(b) the **resolution specifies** the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

[4](d) where the equity shares of the company are **listed on a recognised stock** exchange, the sweat equity shares are issued in accordance with the **regulations** made by the **Securities and Exchange Board** in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as prescribed under Rule 8 of the *Companies (Share and Debentures) Rules, 2014,*

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall **rank *pari passu*** with other equity shareholders.

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[4] clause (*c*) to section 54 has been omitted. [Via Companies (Amendment) Act, 2017, **Enforcement Date: 7th May, 2018]**

As per the Rule 8 of the Companies (Share and Debentures) Rules, 2014,

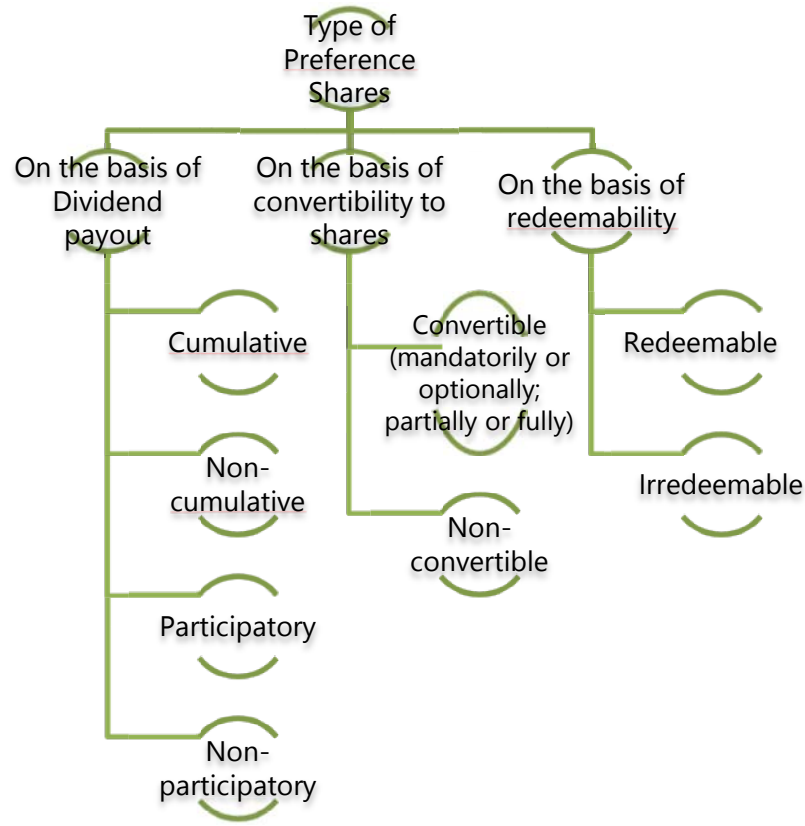
''Employee'' means-(a) a permanent employee of the company who has been working in India or outside India; or

(b) a director of the company, whether a whole- time director or not; or

(c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company;

Whereas the expression 'Value additions' means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Preference shares - Issue and redemption [Section 55]



According to **Section 55:**

- **Company to issue redeemable preference shares:** No company limited by shares shall issue any preference shares which are irredeemable;

  Period for redeem of preference shares: A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding **twenty years** from the date of their issue subject to such conditions as prescribed under Rule 9 of the *Companies (Share Capital and Debentures) Rules, 2014*.

  Exceptions: A company may issue preference shares for a period exceeding twenty years (but not exceeding **thirty years**) for **infrastructure projects** (specified in schedule VI), subject to the redemption of **10 %** of shares beginning 21st year at the option of such preferential shareholders;

- **Shares to be redeemed out of the profits only:** No such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

- **Redeemed shares to be fully paid:** no such shares shall be redeemed unless they are fully paid;

- **Proposed shares to be redeemed shall be transferred to the CRR account:** Where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the **nominal** amount of the shares to be redeemed, to a reserve, to be called the **Capital Redemption Reserve(CRR)** Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and

- **Class of companies whose financial statement complies with Accounting standards:** In case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under **section 133**, the **premium**, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed: Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be

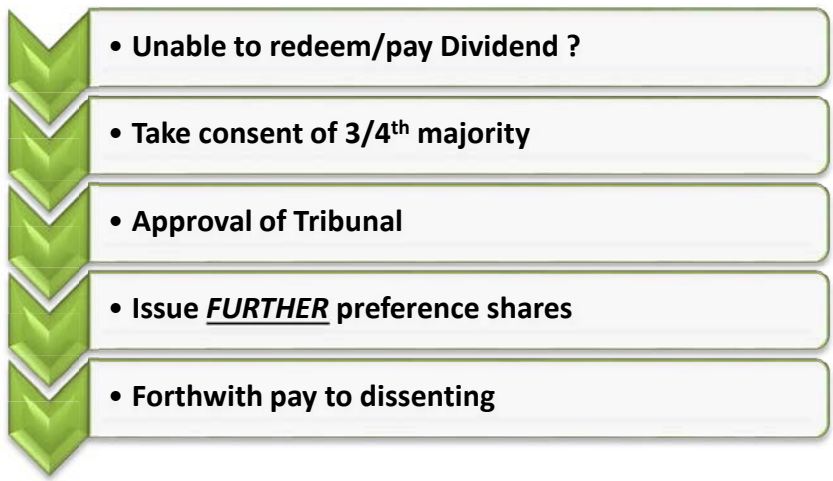
provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

In a case not meeting above criteria, the premium, if any, payable on redemption shall be provided for out of the **profits** of the company or out of the company's **securities premium** account, before such shares are redeemed.

- **In case of unredeemed preference shares:** Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may—
  - with the consent of the holders of **three-fourths** in value of such preference shares, and
  - with the approval of the **Tribunal** on a petition made by it in this behalf,

  issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:

  Provided that the Tribunal shall, while giving approval under this sub-section, order the redemption **forthwith** of preference shares held by such persons who have **not consented** to the issue of further redeemable preference shares.



For the removal of doubts, it is hereby declared that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

- **Paying of un-issued shares to members:** The capital redemption reserve account may, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid **bonus shares.**

7. TRANSFER AND TRANSMISSION OF SECURITIES AND THE ALLIED PROVISIONS [SECTION 56 TO SECTION 59]

Section 56 of the Companies Act, 2013 deals with the transfer and transmission of securities or interest of a member in the company.

Requirement for registering the transfer of securities [Section 56(1)]: According to the law, a company shall not register a transfer of securities of the company, or the interest of a member in the company in the case of a company having no share capital, unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee (except where the transfer is between persons both of whose names are entered as holders of beneficial interest in the records of a depository), specifying the name, address and occupation, if any, of the transferee, has been delivered to the company by the transferor or the transferee within a period of 60 days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.

Instrument of transfer lost/ not delivered [First proviso to section 56(1)]: Where the instrument of transfer has been **lost** or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to **indemnity** as the Board may think fit.

[5]**In case of Government company –** It is further provided that the provisions of this sub-section [i.e. section 56(1)], in so far as it requires a proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee, shall not apply with respect to bonds issued by a Government company, provided that an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if no such certificate is in existence, along with the letter of allotment of the bond:

Provided also that the provisions of this sub-section shall not apply to a Government Company in respect of securities held by nominees of the Government.

Power of company to register: Power of company to register shall not be effected by above provision (given under sub- section 1) on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

Transmission of securities on an application of transferor alone: Where an application is made by the transferor alone and relates to **partly paid** shares, the

[5] Notification dated 5th June, 2015.

transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.

Company delivering the certificate: Every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted—

Different conditions	Period of the delivering the certificates
In the case of subscribers to the memorandum;	Within **2 months** from the date of incorporation
In the case of any allotment of any of its shares	Within a period of **two months** from the date of allotment
In the case of a transfer or transmission of securities	Within a period of **one month** from the date of receipt by the company of the instrument of transfer or the intimation of transmission
In the case of any allotment of debenture	Within a period of **six months** from the date of allotment

Provided that where the securities are dealt with in a **depository**, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.[6]

Transfer of security of the deceased: The transfer of any security or other interest of a deceased person in a company made by his **legal representative** shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

Default in compliance of the provisions: Where any default is made in complying with the provisions of sub-sections (1) to (5), the company shall be **punishable** with fine varying from 25,000 rupees to 5 lakh rupees and every

[6] (In case of Specified IFSC Public or Specified IFSC Private Company - after the proviso, the following proviso shall be inserted, namely:- "Provided further that a Specified IFSC public company/ Specified IFSC Private Company shall deliver the certificates of all securities to subscribers after incorporation, allotment, transfer or transmission within a period of sixty days." - *Notification Dated 4th January, 2017)*

officer of the company who is in default shall be punishable with fine with the minimum of 10 thousand rupees extending to 1 one lakh rupees.

Liability of depository: Where any **depository** or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under section **447** of the Companies Act, 2013 with the liability mentioned under the Depositories Act, 1996.

Punishment for personation of shareholder [Section 57]

If any person deceitfully **personates** as—

- an owner of any security or interest in a company, or
- of any share warrant or coupon issued in pursuance of this Act, and

thereby obtains or attempts to obtain any such **security or interest** or any such share warrant or coupon, or receives or attempts to receive **any money due to any such owner**,

Such person shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Refusal of registration and appeal against refusal [Section 58]

Section 58 of the Companies Act, 2013, deals with process of the company to be followed by on refusal to register the transfer of securities.

(i) If a private company limited by shares refuses, to register the transfer of, or the transmission of the right to any securities or interest of a member in the company, then the company shall send notice of the refusal to the transferor and the transferee or to the person giving intimation of such transmission, within a period of **thirty days** from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company.

The securities or other interest of any member in a **public** company are **freely transferable**, subject to the contract/arrangement.

Extract of Act [Section 58(1) and 58(2)]

"(1) If a private company limited by shares refuses, whether in pursuance of any power of the company under its articles or otherwise, to register the transfer of, or the transmission by operation of law of the right to, any securities or interest of a member in the company, it shall within a period of thirty days from the date on

which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferor and the transferee or to the person giving intimation of such transmission, as the case may be, giving reasons for such refusal.

(2) Without prejudice to sub-section (1), the securities or other interest of any member in a public company shall be freely transferable:

Provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract."

(ii) The transferee may appeal to the Tribunal against the refusal within a period of **thirty** days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of **sixty days** from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company.

(iii) If a public company without sufficient cause refuses to register the transfer of securities within a period of thirty days from the date on which the instrument of transfer or the intimation of transmission, is delivered to the company, the transferee may, within a period of **sixty days** of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, **appeal** to the Tribunal.

(iv) The Tribunal, while dealing with an appeal may, after hearing the parties, either **dismiss the appeal**, or by order—

(a) **direct that the transfer or transmission shall be registered by the company** and the company shall comply with such order within a period of **ten days** of the receipt of the order; or

(b) **direct rectification of the register** and also direct the company to pay damages, if any, sustained by any party aggrieved.

(v) If a person contravenes the order of the Tribunal he shall be punishable with imprisonment for a term not less than one year but may extend to three years **and** with fine not less than one lakh rupees which may extend to five lakh rupees.

Rectification of register of member [Section 59]

Section 59 of the Companies Act, 2013 provides the procedure for the rectification of register of members after the transfer of securities. The provision states that-

(i) **Remedy to the aggrieved for not carrying the changes in the register of members:** If the name of any person is, without sufficient cause, **entered** in the register of members of a company, or after having been entered in the register, is, **omitted** there from, or if a default is made, or unnecessary **delay** takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved, or any member of the company, or **the company may appeal in such form as may be prescribed, to the Tribunal,** or to a competent court outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India**, for rectification** of the register.

(ii) **Order of the Tribunal:** The Tribunal may, after hearing the parties to the appeal by order, either **dismiss** the appeal or direct that the transfer or transmission shall be registered by the company within a period of **ten days** of the receipt of the order, or direct **rectification** of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

(iii) The provisions of this section shall not restrict the right of a holder of

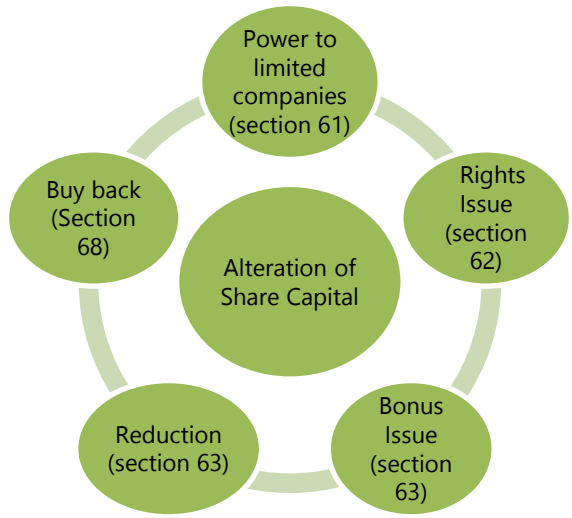
securities, to transfer such securities and any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

(iv) **Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992** or this Act or any other law for the time being in force, there the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to **set right the contravention** and rectify its register or records concerned.

(v) **Default in complying with the order:** If any default is made in complying with the order of the Tribunal under this section, the company shall be **punishable** with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

8. ALTERATION IN SHARE CAPITAL [SECTIONS 61-68]

Section 2(8) defines **authorised capital or nominal capital** means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company. Whereas Section 2(15) states that **called-up capital** means such part of the capital, which has been called for payment.



Alteration of share capital [Section 61]

According to section 61 of the Companies Act, 2013 a limited company having a share capital may alter its capital part of the memorandum.

(1) A **limited company** having a share capital may, if so authorised by its **articles**, alter its memorandum in its general meeting to—

(a) **increase its authorised share capital** by such amount as it thinks expedient;

(b) **consolidate and divide** all or any of its share capital into shares of a larger amount than its existing shares,

Provided that no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;

(c) **convert all or any of its fully paid-up shares into stock,** and reconvert that stock into fully paid-up shares of any denomination;

(d) **sub-divide its shares**, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount 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.

(e) **cancel shares** which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

(2) The **cancellation of shares** shall **not be deemed to be a reduction** of share capital.

A company shall within 30 days of the shares having been consolidated, converted, sub-divided, redeemed, or cancelled or the stock having been reconverted, notice should be given to the Registrar in the prescribed form along with an altered memorandum **[Section 64 of the Companies Act, 2013].**

Further issue of share capital – Rights Issue; Preferential Allotment [Section 62][7]

A rights issue involves pre-emptive subscription rights to buy additional securities

[7] In case of Nidhi company - Section 62 shall not apply - *Notification dated 5th june, 2015.*

in a company offered to the company's existing security holders. It is a non-dilutive pro rata way to raise capital.

Example: 1:8 rights issue means an existing investor can buy one extra share for every eight shares already held by him/her. Usually the price at which the new shares are issued by way of rights issue is less than the prevailing market price of the stock to encourage subscription.

A public company may issue securities through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder as per section 23(1)(c) of the Companies Act, 2013.

A private company may issue securities by way of rights issue or bonus issue in accordance with the provisions of this Act as per the section 23(2)(a).

As per the section 62 of the Companies Act, 2013-

(1) where at **any time**, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered—

[8](a) **to persons who**, at the date of the offer, **are holders of equity shares** of the company in proportion, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

(i) **the offer shall be made by notice** specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

In case of private company- where ninety percent, of the members of a private company have given their consent in writing or in electronic mode, the periods lesser than those **specified** in the above said sub- clause or sub-section (2), shall apply.

(ii) **unless the articles of the company otherwise provide**, the offer aforesaid shall be deemed to include a right exercisable by the person

[8] Provided that notwithstanding anything contained in sub-clause (i), in case of a Specified IFSC public company, the periods lesser than those specified in the said sub-clause shall apply if ninety per cent. of the members have given their consent in writing or in electronic mode.". - *Notification Date 4th January, 2017*

concerned to **renounce** the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;

(iii) **after the expiry of the time specified in the notice** aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he **declines** to accept the shares offered, the Board of Directors may **dispose** of them in such manner which is not dis-advantageous to the shareholders and the company;

(b) **to employees under a scheme of employees' stock option,** subject to [9]& [10]**special resolution** passed by company and subject to the conditions as may be prescribed; or

(c) **to any persons, if it is authorised by a special resolution**, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

This clause authorises company to issue shares to persons other than its existing shareholders and to employees under ESOP. However, the process to issue those shares is provided under section 42 of the Act (Private placement).

(2) The notice referred to in sub-clause (i) of clause (a) of sub-section (1) shall be **dispatch**ed through registered post or speed post or through electronic mode or courier or any other mode having proof of delivery to all the existing shareholders at least three days before the opening of the issue.

(3) Exception: This section shall not apply to the increase of the subscribed capital of a company caused by the exercise of an option attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company.

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[9] In case of private company - In clause (b) of Sub-section (1) of Section 62 for the words "special resolution", the words "ordinary resolution" shall be substituted. - *Notification dated 5th june, 2015.*

[10] In case of Specified IFSC Public Company - Clause (b) of Sub- section (1) of section 62 for the words "special resolution" read as "ordinary resolution". - *Notification Date 4th January, 2017.*

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a **special resolution** passed by the company in general meeting.

(4) Conversion of debentures/loan into shares : Where any debentures have been issued, or loan has been obtained from any **Government** by a company, and if that Government considers it necessary in the public interest, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion.

Term of conversion not acceptable to the company: Where the terms and conditions of such conversion are not acceptable to the company, it may, within 60 days from the date of communication of such order, **appeal** to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

(5) Points to be taken into consideration for the term of conversion: In determining the terms and conditions of conversion, the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary.

(6) When memorandum of company stand altered and increases authorized share capital: Where the Government has, by an order directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal or where such appeal has been dismissed, then the memorandum of company shall, by such order having the effect of increasing the **authorised** share capital of the company, stand altered and the authorised share capital of such company shall **stand increased** by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.

Example: A listed company at Bombay Stock Exchange, intends to offer its new shares to non-members. All the existing members of the company were against the same pointing on the validity of the same. Here in the given case, section 62 (1) (a) (iii), (b) and (c) further shares in a company limited by shares may be issued to non -members under certain circumstances. In compliance with the provision, offer of new shares to non-members is valid.

Issue of bonus shares [Section 63]

Bonus shares are shares issued proportionately by a company to its current shareholders as fully paid shares free of any cost to them.

Example: 1:3 bonus issue means an existing shareholder will get one extra free share for every three shares already held by him/her.

This section 63 of the Companies Act, 2013 deals with the condition and the manner of issue of fully paid-up bonus shares by a company to its members.

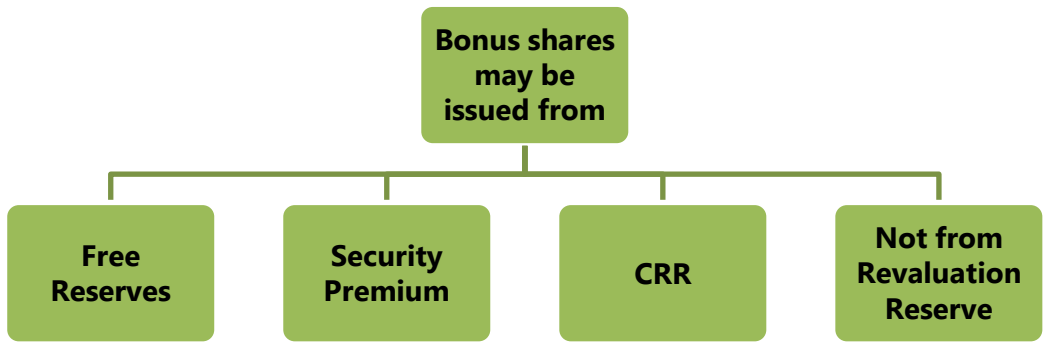
(1) Section 63 says that a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account:

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.



(2) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares unless—

(a) it is authorised by its **articles**;

(b) it has on the recommendation of the **Board**, been authorised in the **general meeting** of the company;

(c) it has **not defaulted** in payment of interest or principal in respect of fixed deposits or **debt** securities issued by it;

(d) it has **not defaulted** in respect of the payment of statutory dues of the **employees**, such as, contribution to provident fund, gratuity and bonus;

(e) the partly paid-up shares, if any outstanding on the date of allotment, are made **fully paid-up;**

(f) it complies with such conditions as may be **prescribed***.

(3) The bonus shares shall not be issued in lieu of dividend.

It can only be done if the articles of the company contain provisions in regard thereto. It means that profits which otherwise are available for distribution among the members, are not divided among them in cash, but the shareholders are allotted further shares (bonus shares). Capital profits, shares premium and capital redemption reserve account can also be used for the purpose of issuing fully paid bonus shares.

Note: According to the proviso to Section 123(5) of the Companies Act, 2013, it is permissible for a company to capitalise its profits or reserves for the purpose of issuing fully paid up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

*The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same [Rule 14 of the *Companies (Share capital and debenture) Rules, 2014]*

Notice to be given to Registrar for Alteration of Share Capital [Section 64]

Where–

- a company alters its share capital in any manner specified in section 61 (1),
- an order made by the Government under section 62(4) read with 62(6) has the effect of increasing authorised capital of a company; or
- a company redeems any redeemable preference shares,

the company shall file a notice in the prescribed form with the Registrar within a period of thirty days of such alteration or increase or redemption, as the case may be, along with an altered memorandum.

In default: "Where any company fails to comply with the provisions of sub-section (1), such company and every officer who is in default shall be liable to a **penalty** of one thousand rupees for each day during which such default continues, or five lakh rupees whichever is less."

Reduction of share capital [Section 66]

Accumulated business losses, assets of reduced or doubtful value or having paid up capital in excess of wants of the company could lead to the need of reducing share capital.

Section 66 deals with the reduction of share capital.

(1) Reduction of share capital by special resolution: Subject to confirmation by the **Tribunal** on an application by the company, a company **limited** by shares or limited by guarantee and having a share capital may, by a **special** resolution, reduce the share capital in any manner and in particular, may—

(a) extinguish or reduce the liability on any of its shares in respect of the share capital **not paid-up**; or

(b) either with or without extinguishing or reducing liability on any of its shares,—

(i) **cancel any paid-up** share capital which is lost or is unrepresented by available assets; or

(ii) **pay off any paid-up** share capital which is in excess of the wants of the company, alter its memorandum by reducing the amount of its share capital and of its shares accordingly:

No reduction shall be made: Section further Provides that no such reduction shall be made if the company is in arrears in the repayment of any **deposits** accepted by it, either before or after the commencement of this Act, or the interest payable thereon.

(2) Issue of Notice from the Tribunal : The Tribunal shall give notice of every application made to it under sub-section (1) to the [11]**Central Government**, **Registrar** and to the **S**ecurities and **E**xchange **B**oard, in the case of listed companies, and the **creditors** of the company and shall take into consideration the **representations**, if any, made to it by that *Government,

[11]&* The powers of Central Government has been delegated to Regional Directors. *Notification dated 6th September, 2017.*

Registrar, the Securities and Exchange Board and the creditors within a period of **three months** from the date of receipt of the notice:

Provided that where no **representation** has been received from the *Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have **no objection** to the reduction.

(3) **Order of tribunal:** The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been **discharged** or determined or has been **secured** or his **consent** is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit:

Provided that no application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the **accounting standards** specified in section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

(4) **Publishing of order of confirmation of tribunal:** The order of confirmation of the reduction of share capital by the Tribunal under sub-section (3) shall be **published** by the company in such manner as the Tribunal may direct.

(5) **Delivery of certified copy of order to the registrar:** The company shall deliver a certified copy of the order of the Tribunal under subsection (3) and of a **minute** approved by the Tribunal showing—

(a) the **amount** of share capital;

(b) the **number** of shares into which it is to be divided;

(c) the amount of **each** share; and

(d) the amount, if any, at the date of registration deemed to be **paid**-up on each share,

to the Registrar within **thirty days** of the receipt of the copy of the order, who shall register the same and issue a **certificate** to that effect.

(6) **Not**hing in this section shall **apply to buy-back** of its own securities by a company under section 68.

(7) **No liability of member:** A member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

(8) **In case where creditor is entitled to object:** Where the name of any creditor entitled to object to the reduction of share capital under this section is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim-

(a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to 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 winding up on the day immediately before the said date; and

(b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle 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.

(9) Nothing in sub-section (8) shall affect the **rights of the contributories among themselves.**

(10) **Liability of officer:** If any officer of the company—

(a) knowingly conceals the name of any creditor entitled to object to the reduction;

(b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or

(c) abets or is privy to any such concealment or misrepresentation as aforesaid, he shall be liable under section 447.

(11) In case of failure to publish the order of confirmation of the reduction of shares: If a company fails to comply with the provisions of sub-section (4), it shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees

[12] & [13]Restriction on purchase by company or giving of loans by it for purchase of its shares [Section 67]

A fundamental principle of Company Law was that a Company cannot buy its own shares. This is laid by Section 67 of the Companies Act, 2013.

[14]Section 67(1) lays down that no company limited by shares or by guarantee and having a share capital shall have power to **buy** its own shares unless the consequent reduction of share capital is effected under the provisions of this Act.

(2) No **public** company shall give, whether directly or indirectly and whether by

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[12] **In case of private companies** - Section 67 shall not apply to a private company-
(a) in whose share capital **no other body corporate** has invested any money;
(b) if the **borrowings** of such a company from banks or financial institutions or any body corporate is less than twice its paid up share capital or fifty crore rupees, whichever is lower; and
(c) such a company is **not in default** in repayment of such borrowings subsisting at the time of making transactions under this section. *Notification dated 5th June, 2015.*

[13] In case of Specified IFSC Public Company - Section 67 Shall not apply to a Specified IFSC public company-
(a) in whose share capital no other body corporate has invested any money;
(b) if the borrowings of such company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
(c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section. - *Notification Date 4th January, 2017*

[14] **In case of Nidhi company** - Sub-section (1) of Section 67 shall not apply, when shares are purchased by the company from a member on his ceasing to be a depositor or borrower and it shall not be considered as reduction of capital under section 66 of the Companies Act, 2013. - *Notification dated 5th June, 2015*

means of a **loan**, **guarantee**, the provision of **security** or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

(3) Exceptions: There are, however, certain exceptions where the company may provide the financial assistance, namely:

(a) the lending of money by a **banking** company in the ordinary course of its business;

(b) the provision is made by a company for lending of money in accordance with any scheme approved by company through **special resolution** with such requirements as may be prescribed, for the purchase of, or subscription for, fully paid up shares in the company or its holding company, if the purchase of, or the subscription for, the shares held by **trustees** for the benefit of the employees or such shares held by the employee of the company;

(c) the giving of loans by a company to **persons** in the **employment** of the company other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership.

However, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report in such manner as may be prescribed. [Section 67].

(4) nothing in Section 67 shall affect the right of a company to **redeem any preference shares** issued under this Act or under any previous Companies law.

(5) If a company contravenes the provisions of this section, it shall be **punishable** with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees **and** every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

BUY BACK OF SECURITIES [Sections 68- 70]

Buy back is the re-acquisition by a company of its own securities. It is a way of returning money to its investors.

Example: Tata Consultancy Services (TCS), announced India's biggest buyback offer till date. The software major plans bought back up to 5.61 crore equity shares at ₹ 2,850 per share. The buyback is being made through the tender offer route, which means the existing shareholders can tender their shares through the stock exchange. The buyback offer price of ₹ 2,850 represents a 13.7% premium to ₹ 2,506.50, the closing price on February 20 when the announcement was made.

Section 68 to Section 70 contains provisions for buy back of securities by the issuer company.

Power of company to purchase its own securities [Section 68]

Section 68 of the Companies Act, 2013 provides the power of a company to purchase its own securities subject to certain conditions.

(1) Sources of funds for buy-back of shares: A company can purchase its own shares or other specified securities. The purchase should be out of:

(i) its **free** reserves; or

(ii) the securities **premium** account; or

(iii) the **proceeds** of the issue of any shares or other specified securities.

However, buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the **same** kind of shares or same kind of other specified securities [Section 68(1)].

"Specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

(2) Conditions for buy-back: The company shall not purchase its own shares or other specified securities unless:

(a) the buy-back is authorised by its **articles**;

(b) a **special resolution** authorising the buy-back is passed in general meeting of the company; (except where— (i) the buy-back is, ten per cent. or less of the total paid-up equity capital and free reserves of the company; and (ii) such buy-back has been authorised by the Board by means of a resolution passed at its meeting;

(c) the buy-back is **25% or less** of the aggregate of paid-up capital and free reserves of the company;

Provided that the buy-back of equity shares in any financial year shall not exceed **25%** of its total paid up equity capital in that financial year.

(d) the ratio of the aggregate **debts**(secured and unsecured) owed by the company after buy back is not more than **twice** the paid up capital and its free reserves;

Provided that the Central Government may prescribe a **higher** ratio of the debt to capital and free reserves for a class or classes of companies;

The expression "free reserves" for the purposes of this section, includes securities premium account.

(e) all the shares or other specified securities for buy-back are **fully paid-up**;

(f) the buy-back of the shares or other specified securities **listed** on any recognised stock exchange is in accordance with the regulations made by SEBI in this behalf;

(g) the buy-back in respect of shares or other specified securities other than those specified in Clause (f) is in accordance with **rules** as may be prescribed. [Sections 68(2)]

Provided that **no** offer of **buy-back**, shall be made within a period of **one year** from the date of the closure of the preceding offer of buy-back, if any.

(3) Procedure before buy-back: The **notice** of the meeting at which special resolution is proposed to be passed shall be accompanied by an **explanatory statement** stating -

(a) a full and complete disclosure of all the **material facts;**

(b) the **necessity** for the buy-back;

(c) the class of shares or **securities** intended to be purchased under the buy back;

(d) the **amount** to be invested under the buy-back; and

(e) the **time** limit for completion of buy-back. [Sections 68(3)]

(4) Time limit for completion of buy-back: Every buy-back shall be completed within **twelve months** from the date of passing the special resolution or a resolution passed by the Board at general meeting authorising the buy-back. [Sections 68(4)].

(5) Buy-Back from Whom?: The buy-back under Sub-section (1) may be—

(a) from the existing share holders or security holders on a **proportionate** basis; or

(b) from the **open** market; or

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or **sweat equity**. [Sections 68(5)]

(6) Declaration of Solvency: Where a company has passed a special resolution under clause (b) of Sub-section (2) or the Board has passed a resolution under the first proviso to clause (b) of Sub Section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the af-fairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and **will not be rendered insolvent** within a period of **one year** of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any;

Provided that no declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange. [Sections 68(6)].

(7) Extinguishment of Securities: Where a company buys-back its own securities or other specified securities, it shall extinguish and physically **destroy** the shares or securities so bought-back within **seven days** of the last date of completion of buy-back. [Sections 68(7)]

(8) Cooling Period : Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allot-ment of further shares under clause (a) of Sub-section (1) of Section 62 or other specified securities within a period of **six months except** by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares. [Sections 68(8)]

(9) Register of Buy Back: Where a company buys-back its shares or other specified securities under this section, it shall maintain a **register** of the shares or securities so bought, the consideration paid for the shares or securities bought-back, the date of cancellation of shares or securities, the date of extinguishing and

physically destroying the shares or securities and such other particulars as may be prescribed. [Sections 68(9)]

(10) Filing of Buy-back Return: A company shall, after completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a **return** containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed:

Provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange. [Sections 68(10)]

(11) Penalty for Default: If a company makes default in complying with the provisions of this section or any regulations made by SEBI under clause (f) of Sub-section (2), the company shall be **punishable** with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both. [Sections 68(11)]

Transfer of certain sums to Capital Redemption Reserve account [Section 69]

Where a company purchases its own shares out of free reserves or securities premium account, then a sum equal to the nominal value of the share so purchased shall be transferred to the **capital redemption reserve** account and details of such transfer shall be **disclosed** in the balance sheet.

The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as **fully paid bonus shares**.

Prohibition for buy-back in certain circumstances [Section 70]

This section of the Companies Act, 2013 prohibits the company for buy back in the certain circumstances.

(1) The provision says that no company shall directly or indirectly purchase its own shares or other specified securities-

(a) through any **subsidiary** company including its own subsidiary companies; or

(b) through any **investment** company or group of investment companies; or

(c) if a default, is made by the company, in repayment of **deposits** or interest payment thereon, **redemption** of debentures or prefer-ence shares or payment of **dividend** to any shareholder or repayment of any **term loan** or interest payable thereon to any finan-cial institutions or banking company;

But where the default is **remedied** and a period of three years has lapsed after such default ceased to subsist, there such buy-back is not prohibited.

(2) No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92 (Annual Report), 123 (Declaration of dividend), 127 (Punishment for failure to distribute dividends), and section 129 (Financial Statements).

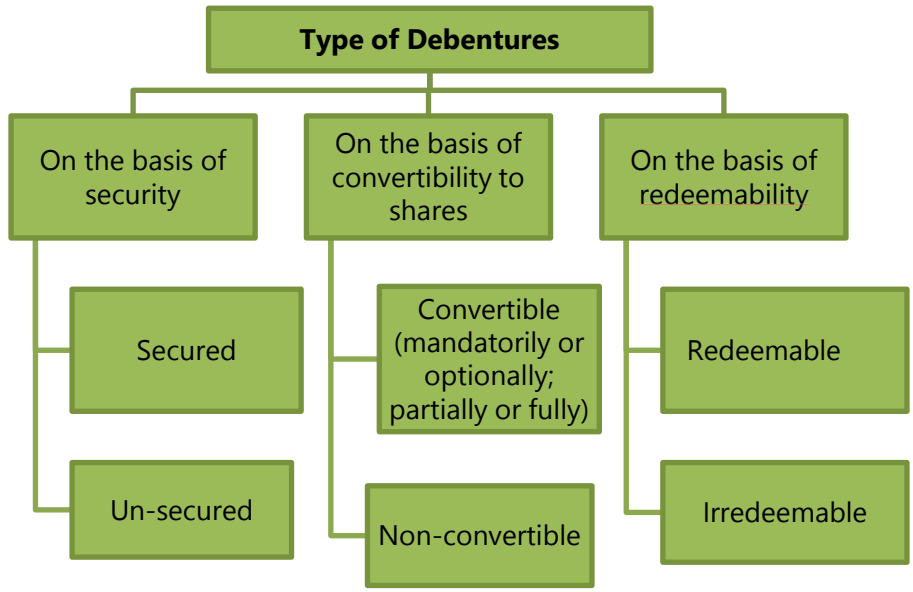
DEBENTURES [Sections 71]

As per Section 2(30), debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Provided that— (a) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

(b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company,

shall not be treated as debenture;



Section 71 of the Companies Act, 2013 provides the manner in which a company may issue debentures. According to the provision—

(1) Issue of debentures with an option to convert: A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a **special resolution** passed at a general meeting.

(2) No company shall issue any debentures carrying any **voting** rights.

(3) Issue of secured debentures: Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed in Rule 18 of the *Companies (Share Capital and Debentures) Rules, 2014*.

(4) Creation of debenture redemption reserve (DRR) account: Where debentures are issued by a company under this section, the company shall create a **debenture redemption reserve account** out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

(5) Limitation on the issue of prospectus/ offer / invitation to the public: No company shall issue a prospectus or make an offer or invitation to the public or to its members **exceeding five hundred** for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more **debenture trustees** and the conditions governing the appointment of such trustees shall be such as may be prescribed.

(6) Debenture trustee to protect the interest of debenture holders: A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.

(7) Liability of debenture trustee: Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be **void** in so far as it would have the effect of **exempting** a **trustee** thereof from, or indemnifying him against, any liability for **breach of trust**, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion:

Provided that the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

(8) To pay interest and redeem the debentures: A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

(9) Filing of petition before the Tribunal by the debenture trustee: Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a **petition** before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

(10) On failure to redeem the debentures/ to pay interest on the debentures: Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the **Tribunal** may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures **forthwith** on payment of principal and interest due thereon.

(11) Default in compliance of order of the Tribunal: If any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be **punishable** with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both.

(12) Specific performance of the contract: A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for **specific performance**.

(13) Procedure to be prescribed by the Central Government: The Central Government may prescribe the **procedure**, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

As per the Companies (**Share Capital and Debentures**) Rules, 2014, the company shall create a **Debenture Redemption Reserve** for the purpose of redemption of debentures, in accordance with the conditions given below-

(a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;

(b) the company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:-

	Public Issue	**Private Placement**
All India Financial Institutions	-	-
NBFCs including FIs	25% of Debentures	-
Companies	25% of Debentures	25% of Debentures

Also company shall (on or before the 30th day of April in each year) **deposit** minimum **fifteen percent** of the amount of its debentures maturing during the year in any one or more of the following methods, namely:-

(i) in deposits with any **scheduled bank**;

(ii) in securities of the Central **Government** or of any State Government;

(iii) in securities mentioned in section 20 of the Indian **Trusts Act**, 1882;

Above investments can not be charged for securing any loan etc. Also it should be used only for redemption of debentures.

Also it should not at any time fall below 15% of the amount of the debentures maturing during the year ending on the 31st day of March of that year;

in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture.

SUMMARY

- There are broadly two kinds of long term capital to run a business viz., **owners'** capital and **lender's** capital. Working capital is the short term capital which is excess of current assets over current liabilities
- Each type of capital is denominated by different securities with applicable **rights** which could be varied by following due course of law

- Most of the requirements to be in accordance with the **AOA or MOA** or with the decisions of the members' body which are subject to the requirements of the Companies Act.
- There are mandated provisions related to premium and discount at the time of issue or redemption
- ESOP (Employee Stock Option Plan) is governed by Sec. 54 on Sweat equity
- Power to **alter** share capital is envisaged under Sec. 61
- Companies could issue right shares in accordance with Sec. 62
- Bonus shares could be issued in accordance with sec. 63
- A company is **restricted** to purchase or give **loans** for purchase of its shares (other than under buy back provisions)
- Capital Redemption Reserve A/c is created to meet the funds requirements for redemption of preference shares and to earmark funds for future use in the prescribed manner.
- Debenture Redemption Reserve A/c is created to ring fence funds requirement for redemption of Debentures

TEST YOUR KNOWLEDGE

Multiple Choice Question

1. The subscribed capital of a company is :
   (a) never more than the issued capital
   (b) never less than the issued capital
   (c) always equal to the issued capital
   (d) prescribed percentage of the issued capital
2. A company may convert all or any of its fully paid up shares into stock :
   (a) by passing a special resolution
   (b) by passing a ordinary resolution
   (c) with the approval of the Tribunal
   (d) All of the above

3. Part of the capital for which application have been received from the public and shares allotted to them :

   (a) Nominal capital

   (b) Issued capital

   (c) Subscribed capital

   (d) Called up capital

4. Shares which are issued by a company to its directors or employees at a discount or for a consideration :

   (a) Equity Shares

   (b) Preference Shares

   (c) Sweat Equity Shares

   (d) Redeemable preference shares

5. Article of association of a private company states that; it will issue preference shares which will have preference of dividend only but no preference of repayment of capital. Can it issue such preference shares?

   (a) No; as per section 43 preference shares should have both preference

   (b) No; this will become equity share as per section 43

   (c) Yes because as per section 43 preference shares should have any one preference.

   (d) Yes; because AOA allows issue of such preference shares and it is a private company.

6. A company issued 10% dividend shares with right to participate in surplus profit every year. Though these shares does not have preference of repayment of capital but they have preference of payment of arrear of dividend at the time of winding up. These shares are:

   (a) Equity shares

   (b) Preference Shares

   (c) DVR

   (d) None of the above

7. AOA of a company limited by guarantee and having a share capital states that preference shareholders will have right to vote on every resolution. Can this company issue such preference shares?

(a) No; because as per section 6 anything in AOA against act is void

(b) No; because guarantee company can't issue preference shares

(c) Yes; because provision of section 47 are applicable only to a company limited by shares

(d) Yes; because provisions of section 47 are applicable to a guarantee company subject to AOA

8. A general meeting of the company is to held on 30th April; 2020. The company has not paid dividend for the financial year ending 2019; also it has not yet paid dividend for the year ending; 2020. Articles does not specifies any last date for payment of dividend. In this case preference shareholders:

(a) will not have the right to vote because the dividend for only last one year has not been paid

(b) will have the right to vote because dividend for last two years have not been paid

(c) will not have the right to vote because only equity shareholders can vote in general meetings

(d) will have right to vote because preference shareholder have the right to vote in general meetings

9. If change of right of one class also affect right of other class then:

(a) A resolution should be passed in general meeting in this case

(b) company need not to do anything else

(c) Consent of three fourth majority of that other class should also be obtained

(d) a resolution in combined meeting of both class should be passed

10. Identify the false statement with respect to issue of sweat equity shares by a company:

(a) company should pass a special resolution

(b) There is not limit as to maximum rate of discount

(c) company should seek approval of Central Government

(d) sweat equity shares means the equity shares issued by the company to the directors or employees at a discount or for consideration other than cash

11. Rajesh infrastructure limited wants to issue preference shares for a period of more than 20 years for its infrastructure project. On the basis of which statement company can do so?

(a) yes; company can issue irredeemable preference shares by passing special resolution

(b) yes; company can issue preference shares for a period of more than 20 years with the prior approval of Central Government

(c) yes; company can issue irredeemable preference shares for infrastructure project

(d) yes; company can issue preference shares for infrastructure project for a period upto 30 years.

12. If a company have authorised share capital of ₹ 6,00,000; paid up share capital of ₹ 5,00,000; and a Loan from government of ₹ 2,00,000. Government ordered the company to convert its loan into shares. In this case; such order has the effect of increasing -

(a) the subscribed share capital of the company

(b) the paid up share capital of the company

(c) the authorised share capital of the company

(d) all of the above

13. A company bought back 10% of its equity shares in March 2020; it wants to buy back further 10% equity shares in April; 2020.

(a) it can; subject to fulfilment of other conditions; because maximum buyback in a financial year can be 25%

(b) It can't; because there must be time gap of 12 months between two buybacks

(c) It can; but it will have to pass special resolution in place of board resolution

(d) It can't; because other conditions might not have fulfilled

14. For debenture redemption reserve which of the following statements is least likely to be true:

(a) NBFCs should make DRR equal to 25% for any allotment of debentures

(b) A company should make DRR equal to 25% for any allotment of debentures

(c) DRR should be created out of profits freely available for distribution of dividend only

(d) All of the above are true

Answer to MCQs

1.	(a)	**2.**	(b)	**3.**	(c)	**4.**	(c)	**5.**	(d)	**6.**	(a)
7.	(c)	**8.**	(b)	**9.**	(c)	**10.**	(c)	**11.**	(d)	**12.**	(d)
13.	(b)	**14.**	(a)								

Question and Answer

Question 1

VRS Company Ltd. is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2017) decided to raise the share capital by issuing further Equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd, on the ground that it was already holding a high percentage of the total number of shares already issued, in SV Company Ltd. The Articles of Association of SV Company Ltd. provides that the new shares be offered to the existing shareholders of the company. On March 1, 2017 new shares were offered to all the shareholders except VRS Company Ltd. Referring to the provisions of the Companies Act, 2013 examine the validity of the decision of the Board of Directors of SV Company Limited of not offering any further shares to VRS Company Limited.

Answer

The legal issues in the presented problem in the question is covered under Section 62 (1) of the Companies Act, 2013.

Section 62 (1) (a) of the Companies Act, 2013 provides that if, at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares should be offered to the existing equity shareholders of the company as at the date of the offer, in proportion to the paid up capital on those shares. Hence, the company cannot ignore a section of the existing shareholders and **must offer the shares to the existing equity shareholders in proportion to their holdings**.

As per facts of the case, the articles of SV company Ltd. provided that the new shares should first be offered to the existing shareholders. However, the company offered new shares to all shareholders excepting VRS company Ltd., which held a major portion of its shares. Also, under the Companies Act, SV company Ltd. had no legal authority to do so.

Therefore, in the given case, SV Ltd.'s decision not to offer any further shares to VRS Co. Ltd on the ground that VRS Co. Ltd already held a high percentage of shareholding in SV Co. Ltd. is **not valid** for the reason that it is violation of the provisions of Section 62 (1) (a).

Question 2

The Directors of Mars India Ltd. desire to alter capital clause of Memorandum of Association of their company. Advise them, under the provisions of the Companies Act, 2013 about the ways in which the said clause may be altered.

Answer

Alteration of Capital: Under section 61 (1) a limited company having a share capital may, if authorized by its Articles, alter its Memorandum in its general meeting to:

(i) **increase** its authorized share capital by such amount as it thinks expedient;

(ii) **consolidate** and divide all or any of its share capital into shares of a larger amount than its existing shares

However, no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner.

(iii) convert all or any of its paid- up shares into **stock** and reconvert that stock into fully paid shares of any denomination

(iv) **sub-divide** the whole or any part of its shares into shares of smaller amount than is fixed by the Memorandum

(v) **cancel** shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

Further, under section 64 where a company alters its share capital in any of the above mentioned ways, the company shall **file a notice** in the prescribed form with the Registrar within a period of thirty days of such alteration or increase or redemption, as the case may be, along with an altered memorandum. The memorandum shall be altered by a special resolution and in compliance with other relevant provisions of section 13 of the Companies Act, 2013.

Question 3

Ramesh, who is a resident of New Delhi, sent a transfer deed, for registration of transfer of shares to the company at the address of its Registered Office in Mumbai. He did not receive the shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 2013, whether the Court at New Delhi is competent to take action in the said matter?

Answer

Jurisdiction of Court, now Tribunal, the Companies Act, 2013: According to Section 56 (4) of the Companies Act, 2013 every company, unless prohibited by any provision of law or of any order of court, Tribunal or other authority, shall deliver the certificates of all shares **transferred** within a period of **one month** from the date of receipt by the company of the instrument of transfer.

Further under section 56 (6), where any default is made in complying with the provisions of sub-sections (1) to (5) of section 56 (which deals with transfer and transmission of shares), the company shall be **punishable** with fine which shall not be less than 25,000 rupees but which may extend to 5 lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than 10,000 rupees but which may extend to one lakh rupees.

The jurisdiction binding on the company is that of the state in which the registered office of the company is situated. Hence, in the given case the **Delhi court is not competent to take action in the matter**.

Question 4

Mr. 'Y', the transferee, acquired 250 equity shares of BRS Limited from Mr. 'X', the transferor. But the signature of Mr. 'X', the transferor, on the transfer deed was forged. Mr. 'Y' after getting the shares registered by the company in his name, sold 150 equity shares to Mr. 'Z' on the basis of the share certificate issued by BRS Limited. Mr. 'X' and 'Z' were not aware of the forgery. State the rights of Mr. 'X', 'Y' and 'Z' against the company with reference to the aforesaid shares.

Answer

According to Section 46(1) of the Companies Act, 2013, a share certificate once issued under the common seal, if any, of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary, specifying the shares held by any person, shall be **prima facie evidence** of the title of the person to such shares. Therefore, in the normal course the person named in the share certificate is for all practical purposes the legal owner of the shares therein and the company cannot deny his title to the shares.

However, a **forged transfer is a nullity**. It does not give the transferee (Y) any title to the shares. Similarly, any transfer made by Y (to Z) will also not give a good title to the shares as the title of the buyer is only as good as that of the seller.

Therefore, if the company acts on a forged transfer and removes the name of the real owner (X) from the Register of Members, then the **company is bound to restore** the name of X as the holder of the shares and to pay him any dividends which he ought to have received.

In the above case, 'therefore, X has the right against the company to get the shares recorded in his name. However, **neither Y nor Z have any rights against the company** even though they are bona fide purchasers. But as Z acted on the faith of share certificate issued by company, he can demand compensation.

However, since Y seems to be the perpetrator of the forgery, he will be liable both criminally and for compensation to X , Z and the company.

Question 5

Data Limited (listed on Stock Exchange) was incorporated on 1st October, 2018 with a paid- up share capital of ₹ 200 crores. Within this small time of 4 months it has earned huge profits and has topped the charts for its high employee friendly

environment. The company wants to issue sweat equity to its employees. A friend of the CEO of the company has told him that they cannot issue sweat equity shares as 2 years have not elapsed since the time company has commenced its business. The CEO of the company has approached you to advise them about the essential conditions to fulfilled before the issue of sweat equity shares especially since their company is just a few months old.

Answer

Sweat equity shares of a class of shares already issued.

According to section 54 of the Companies Act, 2013, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely—

(i) the issue is **authorised by a special resolution** passed by the company;

(ii) the **resolution specifies** the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(iii) where the equity shares of the company are **listed** on a recognised stock exchange, the sweat equity shares are issued in accordance with the **regulations** made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as prescribed under Rule 8 of the *Companies (Share and Debentures) Rules, 2014,*

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

Data Limited can issue Sweat equity shares by following the conditions as mentioned above. It does not make a difference that the company is just a few months old because no such time limit of 2 years is specified under setion 54.

Question 6

Walnut Limited has an authorized share capital of 1,00,000 equity shares of ₹ 100 per share and an amount of ₹ 3 crores in its Share Premium Account as on 31-3-2018. The Board of Directors seeks your advice about the application of share premium account for its business purposes. Please give your advice.

Answer

According to section 52 of the Companies Act, 2013, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.

The securities premium account may be applied by the company—

(a) towards the issue of unissued shares of the company to the members of the company as fully paid **bonus shares**;

(b) in writing off the **preliminary** expenses of the company;

(c) in writing off the expenses of, or the **commission** paid or **discount** allowed on, any issue of shares or debentures of the company;

(d) in providing for the **premium** payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its **own shares** or other securities under section 68

The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

(a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid **bonus shares**; or

(b) in writing off the expenses of or the **commission** paid or **discount** allowed on any issue of equity shares of the company; or

(c) for the **purchase of its own shares** or other securities under section 68.

Question 7

OLAF Limited, a subsidiary of PQR Limited, decides to give a loan of ₹ 4,00,000 to the Human Resource Manager, who is not a Key Managerial Personnel of OLAF Limited, drawing salary of ₹ 30,000 per month, to buy 500 partly paid-up Equity Shares of ₹ 1000 each in OLAF Limited. Examine the validity of company's decision under the provisions of the Companies Act, 2013.

Answer

Restrictions on purchase by company or giving of loans by it for purchase of its share: As per section 67 (3) of the Companies Act, 2013 a company is allowed to give a loan to its employees subject to the following limitations:

(a) The employee must **not** be a **Key** Managerial Personnel;

(b) The amount of such loan shall not exceed an amount equal to **six months' salary** of the employee.

(c) The shares to be subscribed must be **fully paid** shares

In the given instance, Human Resource Manager is not a KMP of the OLAF Ltd. He is drawing salary of ₹ 30,000 per month and loan taken to buy 500 partly paid up equity shares of ₹ 1000 each in OLAF Ltd.

Keeping the above provisions of law in mind, the company's (OLAF Ltd.) **decision is invalid** due to two reasons:

i. The amount of loan being **more than 6 months' salary** of the HR Manager, which should have restricted the loan to ₹ 1.8 Lakhs.

ii. The shares subscribed are **partly paid** shares whereas the benefit is available only for subscribing fully paid shares.

Question 8

Mars India Ltd. owed to Sunil ₹1,000. On becoming this debt payable, the company offered Sunil 10 shares of ₹100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil. Examine the validity of this allotment in the light of the provisions of the Companies Act, 2013

Answer

Under section 62 (1) (c) of the Companies Act, 2013 where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, either for cash or for a consideration other than cash, such shares may be offered to any persons, if it is authorised by a special resolution and if the price of such shares is determined by a **valuation report** of a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

In the present case, Mars India Ltd is **empowered to allot** the shares to Sunil in settlement of its debt to him. The issue will be classified as issue for consideration other than cash must be approved by the members by a **special resolution**.

Further, the valuation of the shares must be done by a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

Question 9

What are the provisions of the Companies Act, 2013 relating to the appointment of 'Debenture Trustee' by a company? Whether the following can be appointed as 'Debenture Trustee':

(i) A shareholder who has no beneficial interest.

(ii) A creditor whom the company owes Rs.499 only.

(iii) A person who has given a guarantee for repayment of amount of debentures issued by the company?

Answer

Appointment of Debenture Trustee: Under section 71 (5) of the Companies Act, 2013, no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding **five hundred** for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

The rules framed under the Companies Act for the issue of secured debentures provide that before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures.

Further according to the rules, **no person** shall be appointed as a debenture trustee, if he-

(i) Beneficially holds **shares** in the company;

(ii) Is a promoter, **director** or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) Is beneficially entitled to **moneys** which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(iv) Is **indebted** to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) Has furnished any **guarantee** in respect of the principal debts secured by the debentures or interest thereon;

(vi) Has any **pecuniary** relationship with the company amounting to two percent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vii) is a **relative** of any promoter or any person who is in the employment of the company as a director or key managerial personnel;

Thus, based on the above provisions answers to the given questions are:

(i) A shareholder who has no beneficial interest, **can be** appointed as a debenture trustee.

(ii) A creditor whom company owes Rs.499 **cannot be** so appointed. The amount owed is immaterial.

(iii) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also **cannot** be appointed as a debenture trustee.

Question 10

Mr Nilesh has transferred 1000 shares of Perfect Ltd. to Ms. Mukta. The company has refused to register transfer of shares and does not even send a notice of refusal to Mr. Nilesh or Ms. Mukta respectively within the prescribed period. Discuss as per the provisions of the Companies Act, 2013, whether aggrieved party has any right(s) against the company for such refusal?

Answer

The problem as asked in the question is governed by Section 58 of the Companies Act, 2013 dealing with the refusal to register transfer and appeal against refusal.

In the present case the company has committed the **wrongful act** of not sending the notice of refusal of registering the transfer of shares.

Under section 58 (4), if a public company without sufficient cause refuses to register the transfer of securities within a period of thirty days from the date on which the instrument of transfer is delivered to the company, the transferee may, within a period of **sixty** days of such refusal or where no intimation has been

received from the company, within **ninety** days of the delivery of the instrument of transfer, appeal to the Tribunal.

Section 58 (5) further provides that the Tribunal, while dealing with an appeal made under sub-section (4), may, after hearing the parties, either dismiss the appeal, or by order—

(a) direct that the **transfer** or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order; or

(b) direct **rectification** of the register and also direct the company to pay damages, if any, sustained by any party aggrieved;

In the present case Ms. Mukta **can make an appeal** before the tribunal and claim damages.

Question 11

Shree Ltd. is engaged in the manufacture of consumer goods and has got a good brand value. Over the years, it has built a good reputation and its Balance Sheet as at March 31, 2017 shows the following position:

Authorized Share Capital (25,00,000 equity shares of face value of ₹ 10/- each) ₹ 2,50,00,000

Issued, subscribed and paid-up capital (10,00,000 equity shares of face value of ₹10/- each, fully paid-up) ₹ 1,00,00,000

Free Reserves ₹ 3,00,00,000

The Board of Directors are proposing to declare a bonus issue of 1share for every 2 shares held by the existing shareholders. The Board wants to know the conditions and the manner of issuing bonus shares under the provisions of the Companies Act, 2013. Discuss.

Answer

According to Section 63 of the Companies Act, 2013, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of -

(i) its **free reserves**;

(ii) the securities premium account; or

(iii) the capital redemption reserve account.

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares: No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

(i) it is authorised by its **Articles**;

(ii) it has, on the recommendation of the **Board**, been authorised in the **general meeting** of the company;

(iii) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(iv) it has not defaulted in respect of payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

(v) the partly paid-up shares, if any outstanding on the date of allotment, are made **fully paid-up**;

(vi) it complies with such conditions as may be **prescribed**.

But the company has to ensure that the bonus shares shall not be issued in lieu of dividend.

To issue bonus shares company will need reserves of Rs.50,00,000 (half of Rs.1,00,00,000), which is available with the company. Hence, after following the above compliances on issuing bonus shares under the Companies Act, 2013, Shree Ltd. **may proceed** for a bonus issue of 1 share for every 2 shares held by the existing shareholders.

CHAPTER 5

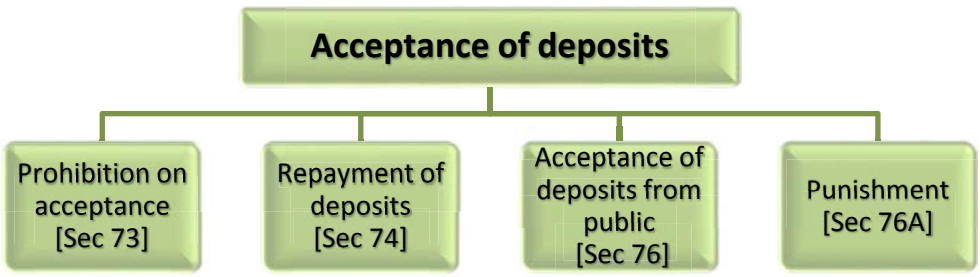
ACCEPTANCE OF DEPOSITS BY COMPANIES

LEARNING OUTCOMES

After studying this unit, you would be able to:

- Understand the meaning of the term 'Deposit'.
- Know the requirements for and restrictions on acceptance of deposits from members and public.
- Know about the 'eligible companies' which can accept deposits from public besides their members.
- Know the punishment for contravention of the provisions related to acceptance of deposits by companies.

CHAPTER OVERVIEW



1. INTRODUCTION

Acceptance of deposits from the members as well as public at large are an important source of finance for the corporate sector. It is, therefore, necessary to control the companies which invite deposits in order to safeguard the general and wider interest of all those persons who provide deposits out of their precious savings. The statutory provisions as contained in sections 73 to 76A of the Companies Act, 2103 (hereinafter referred to as 'the Act') and the *Companies (Acceptance of Deposits) Rules, 2014* (hereinafter referred to as 'the Rules') govern the acceptance of deposits and also renewal thereof.

2. CERTAIN IMPORTANT TERMS EXPLAINED

A. DEPOSIT

Definition: According to section 2 (31) of the Act, the term 'deposit' includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve bank of India.

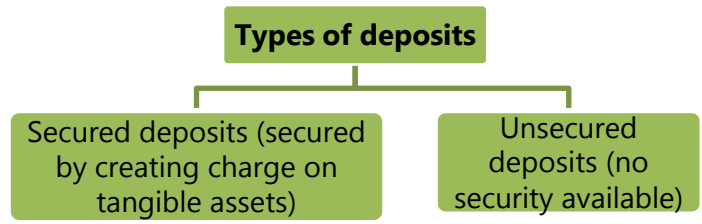
(i) The above definition of 'deposit' is inclusive one.

(ii) It includes any money received by way of:

- deposit; or
- loan; or
- in any other form.

(iii) Repayment of 'deposit' is time-bound.

(iv) It can be secured or unsecured.



(v) It does not include prescribed categories of amounts (given under the Rules).

(vi) A private company can accept deposits from its members only.

(vii) A public company can accept deposits from its members and also from the public if it fulfills certain parameters.

B. AMOUNTS NOT CONSIDERED AS DEPOSIT

Following categories of amounts are not considered as deposit *[Rule 2 (1) (c)]:*

(i) any amount received from the Central Government or a state Government, or from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature;

(ii) any amount received from foreign Governments, foreign or international banks, multilateral financial institutions etc. subject to the provisions of Foreign Exchange Management Act, 1999 and rules and regulations made thereunder;

(iii) any amount received as a loan or facility from any banking company or from State Bank of India or its subsidiary banks or from a notified baking institution or from any co-operative bank;

(iv) any amount received as a loan or financial assistance from Public Financial Institutions;

(v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) any amount received by a company from any other company;

(vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities (including share application money or advance towards allotment of securities, pending allotment), so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

It is clarified by way of Explanation that if the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit under these rules.

However, unless otherwise required under the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or rules or regulations made thereunder to allot any share, stock, bond, or debenture within a specified period, if a company had received any amount by way of subscriptions to any shares, stock, bonds or debentures before the 1st April, 2014 and disclosed in the balance sheet for the financial year ending on or before the 31st March, 2014 against which the allotment is pending on the 31st March, 2015, the company shall, by the 1st June, 2015, either return such amounts to the persons from whom these were received or allot shares, stock, bonds or debentures or comply with these rules.

Further, *it is clarified that* any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company or a relative of the director of the private company;

However, the director of the company or relative of the director of the private company, as the case may be, from whom money is received, is required to furnish to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's report;

(ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking *pari passu* with the first charge on any assets referred to in Schedule III[1] of the Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within 10 years;

However, if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer.

(ixa) any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognised stock

[1] Schedule III contains format of Balance Sheet.

exchange as per applicable regulations made by Securities and Exchange Board of India;

(x) any amount received from an employee of the company not exceeding his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit;

(xi) any non-interest bearing amount received or held in trust;

(xii) any amount received in the course of, or for the purposes of, the business of the company–

(a) as an **advance for the supply of goods or provision of services** accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from the date of acceptance of such advance:

However, in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply.

(b) as advance, accounted for in any manner whatsoever, received in connection with **consideration for an immovable property** under an agreement or arrangement, provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement;

(c) as **security deposit** for the performance of the contract for supply of goods or provision of services;

(d) as advance received under **long term projects** for **supply of capital goods** except those covered under item (b) above;

(e) as an advance towards consideration for providing **future services** in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;

(f) as an advance received and as allowed by any **sectoral regulator** or in accordance with directions of Central or State Government;

(g) as an advance for **subscription towards publication**, whether in print or in electronic to be adjusted against receipt of such publications;

However, *it is clarified that* if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules.

Further, by way of Explanation it is clarified that for the purposes of this sub-clause the amount shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

(xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to the fulfillment of following conditions:

(a) the loan is brought because of the stipulation imposed by the lending institutions on the promoters to contribute such finance;

(b) the loan is provided by the promoters themselves or by their relatives or by both; and

(c) such exemption shall be available only till the loans of financial institution or bank are repaid and not thereafter.

(xiv) any amount accepted by a **Nidhi** company in accordance with the rules made under section 406 of the Act;

(xv) any amount received by way of subscription in respect of a **chit** under the Chit Fund Act, 1982;

(xvi) any amount received by the company under any **collective investment scheme** in compliance with regulations framed by the Securities and Exchange Board of India;

(xvii) an amount of twenty five lakh rupees or more received by a **start-up company**, by way of a **convertible note** (convertible into equity shares or repayable within a period not exceeding five years from the date of issue) in a single tranche, from a person;

By way of Explanation it is clarified that:

1. *"Start-up company"* means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such

in accordance with *notification number G.S.R. 180(E) dated 17th February, 2016* issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry;

2. *"Convertible note"* means an instrument evidencing receipt of money initially as a debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument.

(xviii) any amount received by a company from Alternate Investment Funds, Domestic Venture Capital Funds, Infrastructure Investment Trusts, Real Estate Investment Trusts[2] and Mutual Funds registered with the Securities and Exchange Board of India in accordance with regulations made by it.

Note: Clarification regarding amounts received by private companies from their members, directors or their relatives before 1st April, 2014 – whether to be considered as deposits or not under the Companies Act, 2013 *(General Circular No. 5/2015, dated 30-03-2015)*

It is clarified that such amounts received by private companies prior to 1st April, 2014 **shall not be treated as 'deposits'** subject to the condition that relevant private company shall disclose in the notes to its financial statement the figure of such amounts and the accounting head in which such amounts have been shown.

However, any renewal or acceptance of fresh deposits on or after 1st April, 2014 shall be in accordance with the Companies Act, 2013 and the rules made thereunder.

C. DEPOSITOR

Definition:

As per Rule 2 (1) (d), the term 'Depositor' means:

(i) any member of the company who has made a deposit with the company in accordance with the provisions of sub-section (2) of section 73 of the Act, or

(ii) any person who has made a deposit with a public company in accordance with the provisions of section 76 of the Act.

[2] The words 'Real Estate Investment Trusts' have been inserted vide the Companies (Acceptance of Deposits) Amendment Rules, 2019 w.e.f. 22-01-2019.

In other words:

- any member of a private or public company who has deposited money with his company is a 'depositor'.
- any person (even if not a member of the company) who has deposited money with a public company is also a 'depositor'.

D. ELIGIBLE COMPANY

Definition:

As per Rule 2 (1) (e) the term "eligible company" means a public company as referred to in section 76 (1), having a **net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees** and which has obtained the prior consent in general meeting by means of a **special resolution** and also filed the said resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits:

However, an eligible company, which is accepting deposits within the limits specified under section 180 (1) (c), may accept deposits by means of an **ordinary resolution**.

A public company is 'eligible' to accept deposits from the public at large only if it meets the above-mentioned criteria. Accordingly,

- It should be a public company.
- It should have net worth of minimum ₹ 100 crores or a turnover of minimum ₹ 500 crores.
- It has obtained the prior consent by means of a special resolution passed in general meeting.
- The special resolution has been filed with the Registrar of Companies.
- An ordinary resolution is sufficient if an eligible company is accepting deposits within the limits specified under section 180 (1) (c).

3. PROHIBITIVE PROVISIONS AND EXEMPTED COMPANIES

A. Prohibitive Provisions

According to section 73 (1) of the Act, no company can accept or renew deposits from public unless it follows the manner provided under Chapter V *(contains*

provisions regarding acceptance of deposits by companies) of the Act for acceptance or renewal of deposits from public. Manner of acceptance of deposits from public is explained later in the Chapter.

B. Exempted Companies

According to the Proviso to Section 73 (1), the prohibition contained in sub-section (1) with respect to the acceptance or renewal of deposit from public shall not apply to the following types of companies:

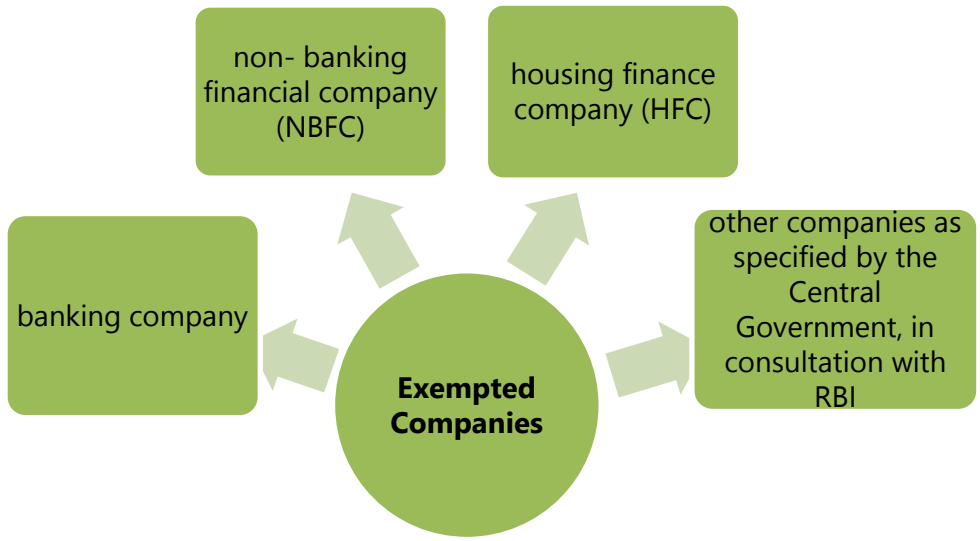
(i) any banking company;

(ii) any non-banking financial company (NBFC) as defined in the Reserve Bank of India Act, 1934;

(iii) any housing finance company (HFC) registered with the National Housing Bank established under the National Housing Bank Act, 1987; and

(iv) such other company as the Central Government may specify, after consultation with the Reserve Bank of India.

In other words, above referred companies [(i) to (iv)] are exempted from the 'deposit provisions'. This brings out the fact that 'deposit provisions' as contained in the Companies Act, 2013 are meant to regulate acceptance of deposits by non-banking non-financial companies *(i.e. manufacturing, trading companies, etc.)* only.



4. PROVISIONS REGARDING ACCEPTANCE OF DEPOSITS FROM MEMBERS

Any company may accept or renew deposits from its members by following the provisions as set out below:

(1) ***Passing of a Resolution:*** A company is required to pass a resolution in general meeting for acceptance of deposits from its members. *[section 73 (2)]*.

(2) ***Issuance of a Circular containing Statement:*** The company is required to issue a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in the prescribed form and manner. *[section 73 (2) (a)]*

According to Rule 4, the company shall issue such circular to all its members by registered post with acknowledgement due or speed post or by electronic mode in Form DPT-1.

Further, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

In addition, a certificate of the statutory auditor of the company shall be attached in Form DPT-1, stating that the company has not committed default in the repayment of deposits or in the payment of interest on such deposits accepted either before or after payment of interest on such deposits accepted either before or after the commencement of the Act. In case a company had committed a default in the repayment of deposits accepted either before or after the commencement of the Act or in the payment of interest on such deposits, a certificate of the statutory auditor of the company shall be attached in Form DPT-1, stating that the company had made good the default and a period of five years has lapsed since the date of making good the default as the case may be.

Such Circular shall be issued on the authority and in the name of Board of Directors of the company.

The advertisement shall remain valid till the earliest of the following dates:

(a) up to six months from the closure of the financial year in which it is issued; or

(b) the date on which the financial statements are laid before the company at the Annual General Meeting (AGM), or in case no AGM has been held, the latest day on which the AGM should have been held as per the relevant statutory provisions.

A fresh circular shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

(3) ***Filing of Circular:*** The company is required to file a copy of the circular containing the statement with the Registrar within 30 days before the date of issue of the circular. *[section 73 (2) (b)]*

(4) ***Requirement of Deposit Repayment Reserve Account:*** The company is required to deposit, on or before 30th of April each year, at least 20% of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account. *[section 73 (2) (c)]*

Proviso to Rule 13 states that such amount shall not at any time fall below twenty percent of the amount of deposits maturing during the financial year.

[3]**(5)** ***Certification as to No default in Repayment:*** The company needs to certify that it has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits.

In case a default had occurred, the company made good the default and a **period of five years had lapsed** since the date of making good the default. *[section 73 (2) (e)]*

(6) ***Provision of Security:*** The company may provide security, if any, for the due repayment of the amount of deposit or the interest thereon. Further, if security is provided, the company shall take steps for the creation of charge on the property or assets of the company.

It may be noted that in case a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as

[3] Clause (*d*) relating to 'deposit insurance' has been omitted vide the Companies (Amendment) Act, 2017 w.e.f. 15th August, 2018.

''unsecured deposits''. Accordingly, it shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits. *[section 73 (2) (f)]*

Exemption to certain private companies[4]:

Clauses (a) to (c) and (e) of sub-section (2) of section 73 with respect to issue of circular, filing the copy of such circular with the Registrar, depositing of certain amount and certification as to no default committed, shall not apply to a private company:

(A) which accepts from its members monies not exceeding one hundred per cent. of aggregate of the paid-up share capital, free reserves and securities premium account; or

(B) which is a start-up, for five years from the date of its incorporation; or

(C) which fulfils all of the following conditions, namely:

(a) which is not an associate or a subsidiary company of any other company;

(b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid-up share capital or fifty crore rupees, whichever is lower; and

(c) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this section.

However, such a company [as referred to in clauses (A), (B) or (C)] shall file the details of monies accepted to the Registrar in the specified manner (*i.e. in Form DPT-3*).

(7) ***Repayment of deposit*:** Every deposit accepted by a company shall be repaid with interest in accordance with the terms and conditions of the agreement. *[Section 73 (3)]*

[4] In terms of Notification No. GSR 464 (E), dated 05-06-2015 as amended from time to time. Further, in terms of Notification No. GSR 8(E), dated 04-01-2017, clauses (a) to (e) of section 73 (2) shall not apply to a **Specified IFSC public company** which accepts from its members, monies not exceeding 100% of aggregate of the paid-up share capital and free reserves, and such company shall file the details of monies so accepted with the Registrar in such manner as may be specified (i.e. in Form DPT-3).

(8) ***Application to Tribunal if the Company fails to Repay:*** In case a company fails to repay the deposit or part thereof or any interest thereon, the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit. *[Section 73 (4)]*

(9) ***Using the Amount of Deposit Repayment Reserve Account:*** The deposit repayment reserve account shall not be used by the company for any purpose other than repayment of deposits. [Section 73 (5)]

Rule 13 also states that the amount so deposited in the account shall not be used by the company for any purpose other than repayment of deposits.

(10) ***Tenure for which Deposits can be Accepted[5]:*** A company is not permitted to accept or renew deposits (whether secured or unsecured) which is repayable on demand or in less than six months. Further, the maximum period of acceptance of deposit cannot exceed thirty six months.

Example: A, a member of the company has deposited ₹ 1,00,000 with his company on 1st April, 2019. The earliest repayment date in this case shall be 30th September, 2019 and the latest repayment date shall be 31st March, 2022. Thus, the tenure will range between six months and thirty six months, as per the policy of the company.

Exception to the rule of tenure of six months: For the purpose of meeting any of its short-term requirements of funds, a company may accept or renew deposits for repayment earlier than six months subject to the condition that:

(i) such deposits shall not exceed ten per cent. of the aggregate of the paid-up share capital, free reserves and securities premium account of the company; and

(ii) such deposits are repayable only on or after three months from the date of such deposits or renewal.

(11) ***Maximum Amount of Deposits from Members[6]:*** A company is permitted to accept or renew any deposit from its members including other such deposits outstanding as on the date of acceptance or renewal maximum up to 35% of the aggregate of its paid-up share capital, free reserves and securities premium account.

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[5] As per Rule 3 (1).
[6] As per Rule 3 (3).

However, as an exception, a Specified IFSC Public company[7] and a private company may accept from its members monies not exceeding 100% of aggregate of the paid-up share capital, free reserves and securities premium account. Further, and such company shall file the details of monies so accepted to the Registrar in Form DPT-3.

In addition, the maximum limit in respect of deposits to be accepted from members shall not apply to following classes of private companies:

(i) a private company which is a start-up, for five years from the date of its incorporation;

(ii) a private company which fulfils all of the following conditions, namely:

(a) which is not an associate or a subsidiary company of any other company;

(b) the borrowings of such a company from banks or financial institutions or any body-corporate is less than twice of its paid-up share capital or fifty crore rupees, whichever is less; and

(c) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under section 73:

Note: It may be noted that all the companies accepting deposits shall file the details of monies so accepted with the Registrar in Form DPT-3.

(12) ***Appointment of Trustee for Depositors:*** As regards appointment of trustee, refer provisions given under 'Acceptance of Deposits from Public' **because same provisions are applicable.**

(13) ***Ceiling on Rate of Interest and Brokerage Payable on Deposits[8]:*** A company is permitted to invite or accept or renew any deposit at any rate of interest or pay any amount of brokerage but in no case, it shall exceed the maximum rate of interest or brokerage prescribed by the Reserve Bank of

[7] A Specified IFSC Public company means an unlisted public company which is licensed to operate by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act 2005 read with the Special Economic Zones Rules, 2006.

[8] As per Rule 3 (6).

India in case of non-banking financial companies (NBFCs) for acceptance of deposits.

Further, no brokerage shall be paid to any person except the person who is authorised in writing by the company to solicit deposits on its behalf and through whom deposits are actually procured.

(14) ***Filling of Application Form for making Deposits[9]:*** A company shall accept or renew any deposit, whether secured or unsecured, only when an application, as specified by the company, is submitted by the intending depositor for the acceptance of deposit.

The application shall contain a declaration made by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person.

(15) ***Deposits in Joint Names[10]:*** In case the depositors so desire, deposits may be accepted in joint names not exceeding three. A joint deposit may be accepted with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor". These clauses operate on maturity.

Example: A, B and C have jointly deposited ₹ 1,00,000 in a company.

- In case of 'Jointly' clause the repayment of deposit on maturity shall be made to all the three together i.e. A, B and C or the survivors.
- In case of 'Either or Survivor' clause, the repayment of deposit on maturity shall be made to either of the three i.e. either A or B or C or the survivor.
- In case of 'First named or Survivor' clause, the repayment of deposit on maturity shall be made to the first named person i.e. A if he is the first named person or the survivor.
- In case of 'Anyone or Survivor' clause, the repayment of deposit on maturity shall be as in the case of 'Either or Survivor'.

(16) ***Nomination[11]:*** Every depositor may nominate any person at any time. The nominee shall be the person to whom his deposits shall vest in the event of his death.

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[9] As per Rule 10.
[10] As per Rule 3 (2).
[11] As per Rule 11.

(17) ***Deposit Receipt***[12]***:*** Within a period of twenty one days from the date of receipt of money or realization of cheque or date of renewal, the company is required to furnish a deposit receipt to the depositor or his agent. The receipt shall be signed by the duly authorised officer and state the date of deposit, the name and address of the depositor, the amount of deposit, the rate of interest and the maturity date.

(18) ***Register of Deposits***[13]***:*** As regards Register of Deposits**,** refer provisions given under 'Acceptance of Deposits from Public' because same provisions are applicable.

(19) ***Premature Repayment of Deposits***[14]***:*** As regards premature repayment of deposits, refer provisions given under 'Acceptance of Deposits from Public' because same provisions are applicable.

(20) ***Filing of Return of Deposits with the Registrar***[15]*:* A duly audited return of deposits in DPT-3 (containing particulars as on 31st March of every year) shall be filed with the Registrar of Companies along with requisite fee on or before the 30th June of that year.

It is clarified by way of Explanation that DPT-3 shall be used to include particulars of deposits or particulars of transactions not considered as deposits or both by every company (other than a Government company).

(21) ***No Right to Alter***[16]***:*** The company has no right to alter any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract which may prove detrimental to the interest of the depositors after circular or circular in the form of advertisement is issued and deposits are accepted.

(22) ***Disclosures in Financial Statements***[17]***:*** A public company shall disclose in its financial statements by way of note about the money received from its directors. In case of a private company it shall disclose in its financial statements by way of note about the money received from the directors or the relatives of directors.

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[12] As per Rule 12.
[13] As per Rule 14.
[14] As per Rule 15.
[15] As per Rule 16.
[16] As per Rule 3 (7).
[17] As per Rule 16A.

As a onetime measure, every company (other than a Government company) shall file a onetime return of outstanding receipt of money or loan by a company not considered as deposits from 1st April 2014 till 31st March, 2019 in Form DPT-3 with the Registrar of Companies within ninety days from 31st March, 2019 along with requisite fee.

(23) ***Penal Rate of Interest***[18]*:* In case the company fails to repay deposits (both secured and unsecured) on maturity, after they are claimed, it shall pay penal rate of interest of eighteen per cent per annum for the overdue period.

(24) **Punishment for Contravention**[19]: If any company inviting deposits or any other person contravenes any of the 'deposit rules' for which no punishment is provided in the Act, the company and every officer-in-default shall be punishable as under:

- **with fine** extendable to five thousand rupees; and
- in case the contravention is a **continuing one**, with a further fine up to five hundred rupees for every day during which the contravention continues.

5. PROVISIONS REGARDING ACCEPTANCE OF DEPOSITS FROM PUBLIC BY ELIGIBLE COMPANIES

Only **'eligible companies'** are permitted to accept deposits from the public, in addition to their members.

It means not all the companies can access the public at large for raising deposits though they can accept deposits from their members.

Section 76 of the Act and the *Companies (Acceptance of Deposits) Rules, 2014* deal with acceptance of deposits from public by eligible companies.

The acceptance of deposits from public shall be subject to compliance with section 73 (2) and the prescribed rules.

These provisions are stated as under:

[18] As per Rule 17.
[19] As per Rule 21.

(1) ***Net Worth/Turnover Criterion***[20]*:* A public company, having net worth of not less than one hundred crore rupees or turnover of not less than five hundred crore rupees, may accept deposits from persons other than its members. Such type of public company is known as 'eligible company'.

(2) ***Passing of Special Resolution***[21]*:* The 'eligible company' is required to obtain the prior consent by means of a **special resolution** in general meeting and also file the said resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits.

However, an 'eligible company', which is accepting deposits within the limits specified under section 180 (1) (c), may accept deposits by means of an **ordinary resolution**.

(3) ***Obtaining of Credit Rating***[22]***:*** The 'eligible company' shall be required to obtain the rating (including its net-worth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency. The given rating which ensures safety shall be informed to the public at the time of invitation of deposits from the public. Further, the rating shall be obtained for every year during the tenure of deposits.

As per Rule 3 (8), copy of the credit rating which is being obtained at least once in a year shall be sent to the Registrar of Companies along with the return of deposits in Form DPT-3.

Further, the credit rating shall not be below the minimum investment grade rating or other specified credit rating for fixed deposits, from any one of the approved credit rating agencies as specified for Non-Banking Financial Companies in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 as amended from time to time.

(4) Charge Creation on Assets Necessary if the Deposits are Secured[23]: Every company which accepts secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets. The amount of charge shall not be less than the amount of deposits accepted. The charge shall be created in favour of the deposit holders in accordance with the prescribed rules.

In respect of creation of security *Rule 6* states that the company accepting secured deposits shall create security by way of charge on its tangible assets only.

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[20] As per Rule 2 (1) (e).
[21] As per Rule 2 (1) (e).
[22] As per first Proviso to section 76 (1).
[23] As per second Proviso to section 76 (1).

The other notable points are:

- The company cannot create charge on intangible assets *(i.e. goodwill, trade-marks, etc.)*.
- Total value of security should not be less than the amount of deposits accepted and interest payable thereon.
- The market value of assets subject to charge shall be assessed by a registered valuer.
- The security shall be created in favour of a trustee for the depositors on specific movable and immovable property of the company.

(5) ***Tenure for which Deposits can be Accepted[24]:*** A company is not permitted to accept or renew deposits (whether secured or unsecured) which is repayable on demand or in less than six months. Further, the maximum period of acceptance of deposit cannot exceed thirty six months.

Exception to the rule of tenure of six months: For the purpose of meeting any of its short-term requirements of funds, a company may accept or renew deposits for repayment earlier than six months subject to the condition that—

(i) such deposits shall not exceed ten per cent. of the aggregate of the paid-up share capital, free reserves and securities premium account of the company; and

(ii) such deposits are repayable only on or after three months from the date of such deposits or renewal.

(6) ***Appointment of Trustee for Depositors[25]:*** Following provisions are required to be observed in this respect:

- One or more trustees for depositors need to be appointed by the company for creating security for the deposits.
- A written consent shall be obtained from the trustee before their appointment.
- A statement shall appear in the circular or advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company for such appointment.

[24] As per Rule 3 (1).
[25] As per Rule 7.

- The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.
- No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee:
  (a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;
  (b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
  (c) has any material pecuniary relationship with the company;
  (d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;
  (e) is related to any person specified in clause (a) above.
- No trustee for depositors shall be removed from office after the issue of circular or advertisement and before the expiry of his term except with the consent of all the directors present at a meeting of the board. In case the company is required to have independent directors, at least one independent director shall be present in such meeting of the Board.

(7) Maximum Amount of Deposits[26]: An eligible company is permitted to accept or renew deposits as under:

- **From its members**: The amount of such deposit together with outstanding deposits from the members as on the date of acceptance or renewal can be **maximum ten per cent.** of the aggregate of its paid-up share capital, free reserves and securities premium account;
- **From Persons other than its Members**: The amount of such deposit together with the amount of outstanding deposits (excluding deposits from members) on the date of acceptance or renewal can be **maximum twenty-five per cent.** of the aggregate of its paid-up share capital, free reserves and securities premium account.

(8) ***Maximum Amount of Acceptable Deposit in case of an Eligible Government Company[27]:*** Such a company is permitted to accept or renew any

[26] As per Rule 3 (4).
[27] As per Rule 3 (5).

deposit together with the amount of other outstanding deposits as on the date of acceptance or renewal **maximum up to thirty-five per cent.** of the aggregate of its paid-up share capital, free reserves and securities premium account.

(9) ***Issuance of Circular in the Form of Advertisement***[28]*:* An 'eligible company' intending to invite deposits is required to issue a circular in the form of an advertisement in DPT-1.

Such advertisement shall be published in English in an English newspaper and in vernacular language in a vernacular newspaper. Both newspapers should have wide circulation in the State in which the registered office of the company is situated.

If the company has its website, the circular shall also be placed on the website.

Such advertisement shall be issued on the authority and in the name of Board of Directors of the company.

- **Filing with the Registrar***:* At least thirty days before the issue of the advertisement, its copy duly signed by a majority of the directors who approved the advertisement or otherwise signed by their duly authorised agents is required to be delivered to the Registrar of Companies for registration.
- **Validity of the Advertisement***:* The advertisement shall remain valid till the earliest of the following dates:
  - (a) up to six months from the closure of the financial year in which it is issued; or
  - (b) the date on which the financial statements are laid before the company at the Annual General Meeting (AGM), or in case no AGM has been held, the latest day on which the AGM should have been held as per the relevant statutory provisions.
- **Fresh Advertisement***:* A fresh advertisement shall be issued, in each succeeding financial year, for inviting deposits during that financial year.
- **Issue and Effective dates***:* The date on which the advertisement appeared in the newspaper shall be taken as the date of the issue of advertisement. Further, the effective date of issue of circular shall be the date on which the circular was dispatched.

(10) ***Maintenance and Using the Amount of Deposit Repayment Reserve Account:*** The company is required to deposit, on or before 30th of April each year,

[28] As per Rule 4.

at least 20% of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account. *[section 73 (2) (c)]*

Rule 13 states that the amount so deposited in the account shall not be used by the company for any purpose other than repayment of deposits. Further, it states that such amount shall not at any time fall below **twenty percent** of the amount of deposits maturing during the financial year.

(11) ***Ceiling on Rate of Interest and Brokerage Payable on Deposits[29]:*** An eligible company is permitted to invite or accept or renew any deposit at any rate of interest or pay any amount of brokerage but in no case, it shall exceed the maximum rate of interest or brokerage prescribed by the Reserve Bank of India in case of non-banking financial companies (NBFCs) for acceptance of deposits.

Further, no brokerage shall be paid to any person except the person who is authorised in writing by the company to solicit deposits on its behalf and through whom deposits are actually procured.

(12) ***Filling of Application Form for making Deposits[30]:*** A company shall accept or renew any deposit, whether secured or unsecured, only when an application, as specified by the company, is submitted by the intending depositor for the acceptance of deposit.

The application shall contain a declaration made by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person.

(13) ***Deposits in Joint Names[31]:*** In case the depositors so desire, deposits may be accepted in joint names not exceeding three. A joint deposit may be accepted with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor". These clauses operate on maturity.

(14) ***Nomination[32]:*** Every depositor may nominate **any person** at any time. The nominee shall be the person to whom his deposits shall vest in the event of his death.

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[29] As per Rule 3 (6).
[30] As per Rule 10.
[31] As per Rule 3 (2).
[32] As per Rule 11.

(15) ***Deposit Receipt[33]:*** Within a period of **twenty one days** from the date of receipt of money or realization of cheque or date of renewal, the company is required to furnish a deposit receipt to the depositor or his agent. The receipt shall be signed by the duly authorised officer and state the date of deposit, the name and address of the depositor, the amount of deposit, the rate of interest and the maturity date.

(16) ***Register of Deposits[34]:***

- Every company accepting deposits shall **maintain one or more separate registers** for deposits accepted or renewed at its registered office.

  Following **particulars** shall be entered separately in the case of each depositor:

  (a) name, address and PAN of the depositor/s;

  (b) particulars of the guardian, in case of a minor;

  (c) particulars of the nominee;

  (d) deposit receipt number;

  (e) date and the amount of each deposit;

  (f) duration of the deposit and the date on which each deposit is repayable;

  (g) rate of interest on such deposits to be payable to the depositor;

  (h) due date for payment of interest;

  (i) mandate and instructions for payment of interest and for non-deduction of tax at source, if any;

  (j) date or dates on which the payment of interest shall be made;

  [35](l) particulars of security or charge created for repayment of deposits;

  (m) any other relevant particulars.

- The entries shall be made within seven days from the date of issuance of the receipt duly authenticated by a director or secretary of the company or by any other officer authorised by the Board for this purpose.

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[33] As per Rule 12.

[34] As per Rule 14.

[35] Clause (k) relating to details of deposit insurance has been omitted. [Notification No. G.S.R. 612 (E), dated 5th July, 2018]

- The said register shall be preserved in good order for a period of **not less than eight years** from the financial year in which the latest entry is made in the register.

(17) ***Premature Repayment of Deposits***[36]*:* After the expiry of six months but before the actual date of maturity, if a depositor requests for premature repayment, the rate of interest payable shall be **one percent less than the rate** which would be payable for the period for which the deposit has actually run.

In this respect it is to be noted that the period for which the deposit has run, if it contains any part of the year which is less than six months then it shall be excluded; otherwise if that part is six months or more it shall be taken as one year.

Reduction of rate of interest is not applicable in the following cases:

- Where the deposit is prematurely repaid to comply with *Rule 3 i.e.* premature repayment made in order to reduce the total amount of deposits to bring it within the permissible limits; or
- Where the deposit is prematurely repaid to provide for war risk or other related benefits to the personnel of naval, military or air forces or to their families during the period of emergency declared under Article 352 of the constitution.

(18) ***Premature Closure of Deposit to Earn Higher Rate of Interest***[37]*:* In case a depositor desires to avail higher rate of interest by renewing the deposit before its actual maturity date, the company shall pay him the higher rate of interest only if the deposit is renewed for a period longer than the unexpired period of deposit.

(19) ***Filing of Return of Deposits with the Registrar***[38]*:* A duly audited return of deposits in DPT-3 (containing particulars as on 31st March of every year) shall be filed with the Registrar of Companies along with requisite fee on or before the 30th June of that year.

It is clarified by way of Explanation that DPT-3 shall be used to include particulars of deposits or particulars of transactions not considered as deposits or both by every company (other than a Government company).

(20) ***Disclosures in Financial Statements***[39]***:*** A public company shall disclose in its financial statement by way of note about the money received from its directors.

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[36] As per Rule 15.
[37] As per Rule 15 (Second Proviso).
[38] As per Rule 16.
[39] As per Rule 16A.

As a onetime measure, every company (other than a Government company) shall file a onetime return of outstanding receipt of money or loan by a company not considered as deposits from 1st April 2014 till 31st March, 2019 in Form DPT-3 with the Registrar of Companies within ninety days from 31st March, 2019 along with requisite fee.

(21) ***Penal Rate of Interest[40]:*** In case the company fails to repay deposits (both secured and unsecured) on maturity, after they are claimed, it shall pay penal rate of interest of **eighteen per cent per annum** for the overdue period.

(22) ***No Right to Alter[41]:*** The company has no right to alter any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract which may prove detrimental to the interest of the depositors after circular or circular in the form of advertisement is issued and deposits are accepted.

(23) ***Punishment for Contravention[42]:*** If any eligible company inviting deposits or any other person contravenes any of the 'deposit rules' for which no punishment is provided in the Act, the company and every officer-in-default shall be punishable as under:

- **with fine** extendable to five thousand rupees; and
- in case the contravention is a **continuing one**, with a further fine up to five hundred rupees for every day during which the contravention continues.

(24) ***Applicability of Section 73 and 74 to Eligible Companies:*** As per *Rule 19, p*ursuant to provisions of sub-section (2) of section 76 of the Act, the provisions of sections 73 and 74 shall, *mutatis mutandis*, apply to acceptance of deposits from public by eligible companies.

Provided further that the fresh deposits by every eligible company shall have to be in accordance with the provisions of Chapter V of the Act and these rules.

Note: Besides Rule 19, section 76 (2) of the Act states that the provisions of Chapter V shall, *mutatis mutandis*, apply to the acceptance of deposits from public under section 76.

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[40] As per Rule 17.
[41] As per Rule 3 (7).
[42] As per Rule 21.

6. PUNISHMENT FOR CONTRAVENTION OF SECTION 73 OR SECTION 76

According to section 76A of the Act, in case a company accepts or invites or allows any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder or if a company fails to repay the deposit or part thereof or any interest within the time specified under section 73 or section 76 or rules made thereunder or such further time as may be allowed by the Tribunal under section 73, then the following consequences will follow:

(a) **Punishment for the company**: The company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees or twice the amount of deposit accepted by the company, whichever is lower but which may extend to ten crore rupees; and

(b) **Punishment for officer-in-default:** Every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees.

Further, if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447 *(Punishment for fraud)*.

7. REPAYMENT OF DEPOSITS ACCEPTED BEFORE COMMENCEMENT OF THE COMPANIES ACT, 2013

The provisions regarding repayment of deposits accepted before commencement of the Companies Act, 2013, has been dealt with in section 74. These provisions are explained as under:

(i) **Filing of Statement of Deposits with the Registrar of Companies and Repayment Thereafter**: As per section 74 (1), in case any deposit was accepted by a company before the commencement of this Act *(i.e. before 1.4.2014)*, and the amount of such deposit or any interest remains unpaid as

on 1.4.2014 or becomes due at any time thereafter, the company shall take the following steps:

(a) ***file***, within a period of **3 months** from such commencement or from the date on which such payments are due, with the Registrar:

- a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment. This is to be done notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(b) ***repay within three years*** from such commencement or on or before expiry of the period for which the deposits were accepted, whichever is earlier.

Note 1: *As per Explanation to Rule 19* if the company has been repaying such deposits and interest thereon without any default on due dates for the remaining period of such deposit in accordance with the terms and conditions, point (b) above shall be deemed to have been complied with.

Note 2: It is to be noted that renewal of any such deposits shall be done in accordance with the provisions of Chapter V and the rules made thereunder.

(ii) **Extension of Time for Repayment of Deposits by the Tribunal***:* As per section 74 (2), the Tribunal may, on an application made by the company, after considering the financial condition of the company, the amount of deposit and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

(iii) **Punishment for Non-Repayment of Deposits***:* As per section 74 (3), if a company fails to repay the deposit or part thereof or any interest thereon within the time specified in section 74 (1) or such further extended time allowed by the Tribunal under section 74 (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable as under:

- **company:** with fine minimum of one crore rupees and maximum of ten crore rupees; and
- **every officer-in-default**: with imprisonment extendable to seven years or with fine minimum of twenty-five lakh rupees and maximum of two crore rupees, or with both.

SUMMARY

- Deposit includes any receipt of money by way of deposit or loan or in any other form by a company but does not include such categories of amount prescribed in consultation with RBI.
- Depositor means any member of the company or any other person (not being a member of the company) who has made a deposit.
- 'Eligible company' is the one which can accept deposits both from the public and its members.
- Section 73 prohibits a company to invite, accept or renew deposits from public if they are not accepted or renewed in the prescribed manner. This prohibition however shall not apply in case of certain exempted companies *i.e.*:
  - banking company;
  - non- banking financial company;
  - a housing finance company registered with NHB;
  - such other company as the Central Government may specify.
- If a company fails to repay the deposit or part thereof or any interest thereon, the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.
- The deposit repayment reserve account shall not be used by the company for any purpose other than repayment of deposits.
- In case of secured deposits, the company is required to create security of equivalent amount by way of charge on its tangible assets.
- A company shall not issue any circular or advertisement for inviting secured deposits unless it appoints one or more trustees.
- Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed.
- A public company shall disclose in its financial statements by way of note about the money received from its directors.

- A private company shall disclose in its financial statements by way of notes, about the money received from the directors, or relatives of directors.
- Every company shall pay a penal rate of interest of 18% p.a. for the overdue period in case of default in repayment.
- The Return of Deposits shall be filed in Form DPT-3 with the Registrar.
- In case of default in repayment, a company is punishable with fine and every *officer-in-default* shall be punishable with imprisonment and also fine. In case of willful default committed with the intention to deceive various stakeholders, he shall be liable for action under section 447.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. An eligible company as per section 76, which is accepting deposits within the limits specified under section 180 (1) (c) may accept deposits by means of _____.

   (a) ordinary resolution

   (b) unanimous resolution

   (c) Special resolution

   (d) Special resolution and approval of Central Government

2. Every company shall pay a penal rate of interest _____for the overdue period in case of deposits, both secured and unsecured, matured and claimed but remaining unpaid.

   (a) 9% p.a.

   (b) 10% p.a.

   (c) 12% p.a.

   (d) 18% p.a.

3. A reserve account that shall not be used by the company for any purpose other than repayment of deposits is called:

   (a) debenture redemption reserve

   (b) deposit repayment reserve

   (c) capital redemption reserve

(d) free reserve

4. Where depositors so desire, deposits may be accepted in joint names not exceeding ___

(a) 2

(b) 3

(c) 5

(d) 7

5. Normally no deposits are repayable earlier than _____ from the date of such deposits or renewal thereof.

(a) 3 months

(b) 6 months

(c) 12 months

(d) 1 year

6. A company shall execute a deposit trust deed at least --------days before issuing the circular or circular in the form of advertisement.

(a) 7

(b) 14

(c) 21

(d) 28

Answers to MCQs

1. (a) **2.** (d) **3.** (b) **4.** (b) **5.** (b) **6.** (a)

Question and Answer

Question 1

Discuss the following situations in the light of 'deposit provisions' as contained in the Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014, as amended from time to time.

(i) Samit, one of the directors of Zarr Technology Private Limited, a start-up company, requested his close friend Ritesh to lend to the company ₹ 30.00 lacs in a single tranche by way of a convertible note repayable within a period six years from the date of its issue. Advise whether it is a deposit or not.

(ii) Polestar Traders Limited received a loan of ₹ 30.00 lacs from Rachna who is one of its directors. Advise whether it is a deposit or not.

(iii) City Bakers Limited failed to repay deposits of ₹ 50.00 crores and interest due thereon even after the extended time granted by the Tribunal. Is the company or Swati, its officer-in-default, liable to any penalty?

(iv) Shringaar Readymade Garments Limited wants to accept deposits of ₹ 50.00 lacs from its members for a tenure which is less than six months. Is it a possibility?

(v) Is it in order for the Diamond Housing Finance Limited to accept and renew deposits from the public from time to time?

Answer

(i) In terms of Rule 2 (1) (c) (xvii) if a start-up company receives rupees twenty five lakh or more by way of a convertible note (convertible into equity shares or repayable within a period not exceeding five years from the date of issue) in a single tranche, from a person, it shall not be treated as deposit.

In the given case, Zarr Technology Private Limited, a start-up company, received ₹ 30.00 lacs from Ritesh in a single tranche by way of a convertible note which is repayable within a period of six years from the date of its issue. In view of Rule 2 (1) (c) (xvii) which requires a convertible note to be repayable within a period of five years from the date of its issue, the amount of ₹ 30.00 lacs shall be considered as deposit.

(ii) In terms of Rule 2 (1) (c) (viii), any amount received from a person who is director of the company at the time of giving loan to the company shall not be treated as deposit if such director furnishes to the company at the time of giving money, a written declaration to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and further, the company shall disclose the details of money so accepted in the Board's report.

In the given case, it is assumed that Rachna was one of the directors of Polestar Traders Limited when the company received a loan of ₹ 30.00 lacs from her. Further, it is assumed that she had furnished to the company at time of giving money, a written declaration to the effect that the amount was not being given out of funds acquired by her by borrowing or accepting loans or deposits from others and in addition, the company had disclosed the details of money so accepted in the appropriate Board's report.

If these conditions are satisfied ₹ 30.00 lacs shall not be treated as deposit.

(iii) By not repaying the deposit of ₹ 50.00 crores and the interest due thereon even after the extended time granted by the Tribunal, City Bakers Limited has contravened the conditions prescribed under Section 73 of the Act. Accordingly, following penalty is leviable:

- *Punishment for the company:* City Bakers Limited shall, in addition to the payment of the amount of deposit and the interest due thereon, be punishable with fine which shall not be less than ₹ one crore or twice the amount of deposit accepted by the company, whichever is lower but which may extend to ₹ ten crores.
- *Punishment for officer-in-default:* Swati, being the officer-in-default, shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than rupees twenty-five lakhs but which may extend to ₹ two crores.

Further, if it is proved that Swati had contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, she will be liable for action under section 447 *(Punishment for fraud)*.

(iv) According to Rule 3 (1), a company is not permitted to accept or renew deposits (whether secured or unsecured) which is repayable on demand or in less than six months. Further, the maximum period of acceptance of deposit cannot exceed thirty six months.

However, as an exception to this rule, for the purpose of meeting any of its short-term requirements of funds, a company is permitted to accept or renew deposits for repayment earlier than six months subject to the conditions that:

(i) such deposits shall not exceed ten per cent. of the aggregate of the paid-up share capital, free reserves and securities premium account of the company; and

(ii) such deposits are repayable only on or after three months from the date of such deposits or renewal.

In the given case of Shringaar Readymade Garments Limited, it wants to accept deposits of ₹ 50.00 lacs from its members for a tenure which is less than six months. It can do so if it justifies that the deposits are required for the purpose of meeting any of its short-term requirements of funds but in no case such deposits shall exceed 10% ten per cent of the aggregate of its paid-

up share capital, free reserves and securities premium account and further, such deposits shall be repayable only on or after three months from the date of such deposits.

(v) According to section 73 (1) of the Act, no company can accept or renew deposits from public unless it follows the manner provided under Chapter V of the Act *(contains provisions regarding acceptance of deposits by companies)* for acceptance or renewal of deposits from public. However, Proviso to Section 73 (1) states that such prohibition with respect to the acceptance or renewal of deposit from public, *inter-alia*, shall not apply to a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987.

In the given case, it is assumed that Diamond Housing Finance Limited is registered with the National Housing Bank and therefore the prohibition contained in section 73 (1) of the Act with respect to the acceptance renewal of deposit from public shall not apply to it. In other words, it being an exempted company, can accept deposits from the public from time to time without following the prescribed manner.

Question 2

Enumerate the amounts which when received by a company in the ordinary course of business are not to be considered as deposits.

Answer

According to Rule 2 (1) (c) (xii), following amounts if received by a company in the course of, or for the purposes of, the business of the company, shall not be considered as deposits:

(a) any amount received as an advance for the supply of goods or provision of services accounted for in any manner whatsoever to be appropriated within a period of three hundred and sixty five days from the date of acceptance of such advance:

However, in case any advance is subject matter of any legal proceedings before any court of law, the time limit of three hundred and sixty five days shall not apply.

(b) any amount received as advance in connection with consideration for an immovable property under an agreement or arrangement. However, such advance is required to be adjusted against such property in accordance with the terms of agreement or arrangement;

(c) any amount received as security deposit for the performance of the contract for supply of goods or provision of services;

(d) any amount received as advance under long term projects for supply of capital goods except those covered under item (b) above;

(e) any amount received as an advance towards consideration for providing future services in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;

(f) any amount received as an advance and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;

(g) any amount received as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications;

However, if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules.

Further, for the purposes of this sub-clause the amount shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

Question 3

ABC Limited having a net worth of ₹ 120 crores wants to accept deposit from its members. The directors of the company have approached you to advise them as to what special care has to be taken while accepting such deposit from the members in case their company falls within the category of an 'eligible company'.

Answer

According to section 76 (1) of the Act, an "eligible company" means a public company, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits.

However, an 'eligible company', which is accepting deposits within the limits specified under section 180 (1) (c), may accept deposits by means of an ordinary resolution.

According to Rule 4 (a), an 'eligible company' shall accept or renew any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members does not exceed ten per cent. of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.

ABC Limited is having a net worth of 120 crore rupees. Hence, it falls in the category of 'eligible company'.

Thus, ABC has to ensure that acceptance deposits from members together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members, in no case, exceeds 10% of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.

CHAPTER 6

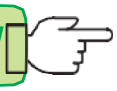
REGISTRATION OF CHARGES

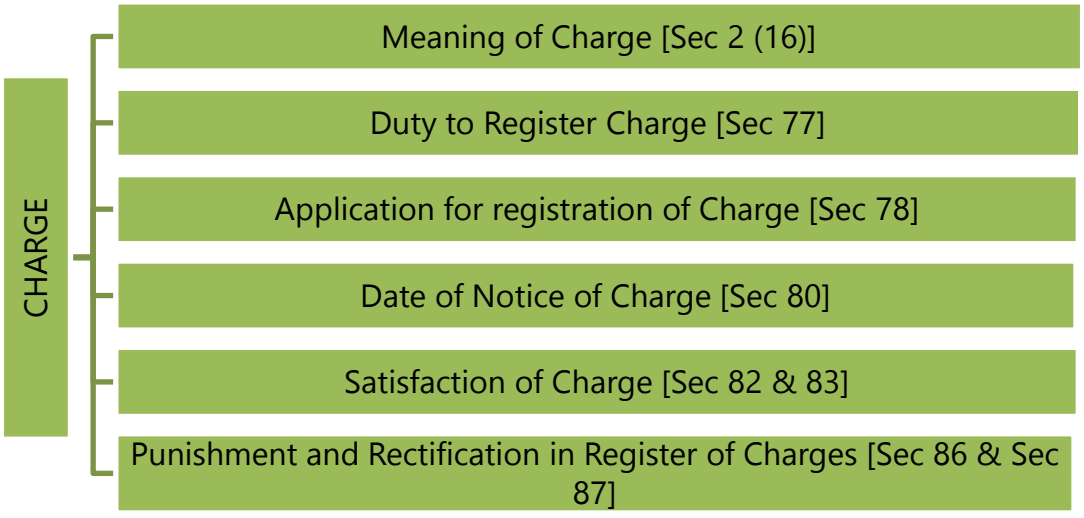
LEARNING OUTCOMES

At the end of this chapter, you will be able to:

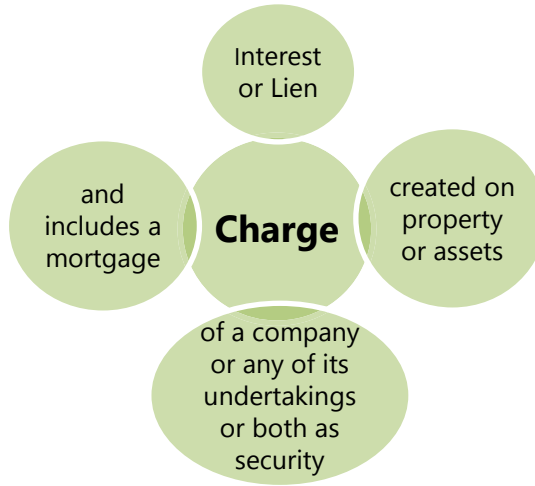
- Understand the meaning of Charge, Notice of Charge
- Know the steps to be followed for satisfaction of charge
- Know the penal provisions in case of default

CHAPTER OVERVIEW





1. INTRODUCTION



According to section 2(16) of the Companies Act, 2013 "charge" has been defined as an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

Thus, charge is:

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

Whenever a company obtains term loans or working capital loans from financial institutions or banks by offering its property or assets, etc. as security it is required to create a charge on such property or assets in favour of the lender. In other words, creation of charge is necessary in case of secured borrowings availed by a company. Even where secured debentures are issued, a charge on any specific movable or immovable property needs to be created in favour of debenture trustee.

Once the charge is registered with the Registrar of Companies, it becomes an information available in the public domain which can be used by a lender to his advantage. After the registration, apparently the company is precluded from offering the same assets again to borrow funds fraudulently from a different lender.

The law with respect to the registration of charges has been dealt in sections 77 to 87 of the Companies Act, 2013.

Types of Charge

A charge may be either fixed or floating.

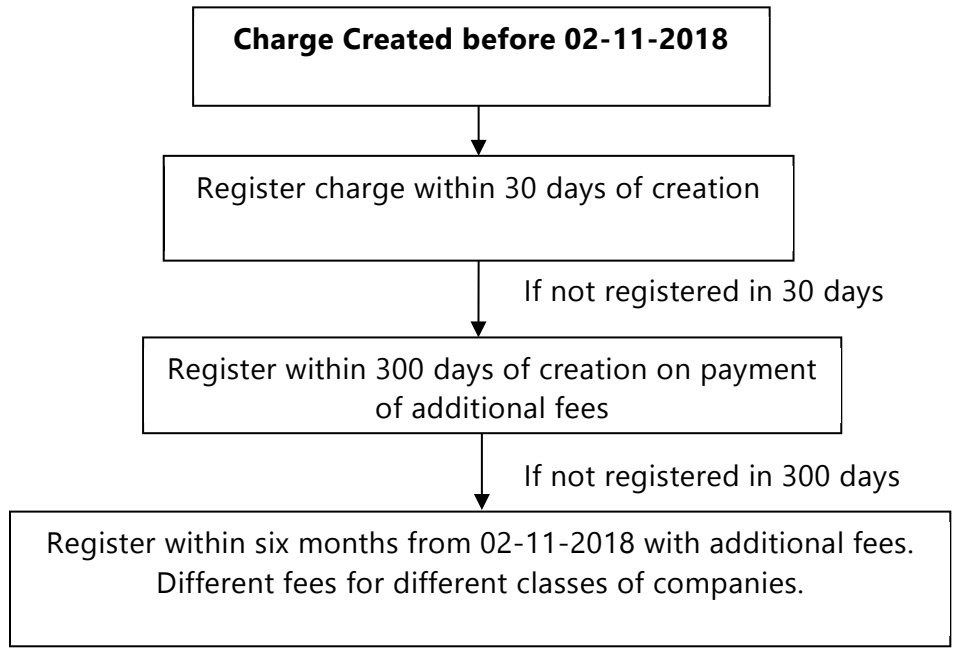
Fixed Charge: A 'fixed charge' is a charge which attaches specific assets of the borrowing company. These assets are of permanent nature like land and building, office premises, machinery installed by the company, etc. and are identified at the time of creation of charge. When a charge is created on such assets, the charge remains 'fixed' and the borrowing company is not permitted to sell such assets though it may use them. A fixed charge is created by way of mortgage or deposit of title deeds. Assets under fixed charge can be sold only with the permission of the charge-holder. A fixed charge is vacated when the money borrowed against the assets subject to fixed charge is repaid in full.

Floating Charge: A 'floating charge' is created on assets which are of fluctuating nature like raw material, stock-in-trade, debtors, etc. A floating charge is created by way of hypothecation or lien. The assets under floating charge keep on changing because the borrowing company is permitted to use them for producing final goods for sale *e.g.* in case of a company which manufactures leather goods, the raw material in the form of leather, which is subject matter of floating charge, shall be used to manufacture leather goods without seeking any permission from the lender. The raw material (*i.e.* leather) which was attached at the time of creation of 'floating charge' may not be the same after some time though floating charge continues and keeps on attaching the raw material which is currently in possession of the company. Thus, the company is free to deal with the assets which are under floating charge according to its own choice. In a way, it can be said that a floating charge is a present security which covers in its fold all such assets which are mentioned in the hypothecation deed for inclusion in the floating charge.

A floating charge remains dormant until it becomes fixed or crystallises. On crystallisation, the security (i.e. raw material, stock-in-trade, etc.) becomes fixed and is available for realization so that borrowed money is repaid. Crystallisation of floating charge may occur when the terms and conditions of floating charge are violated or the company ceases to continue its business or the company goes into liquidation or the creditors enforce the security covered by the floating charge, etc.

2. DUTY TO REGISTER CHARGES, ETC. [SECTION 77]

(1)



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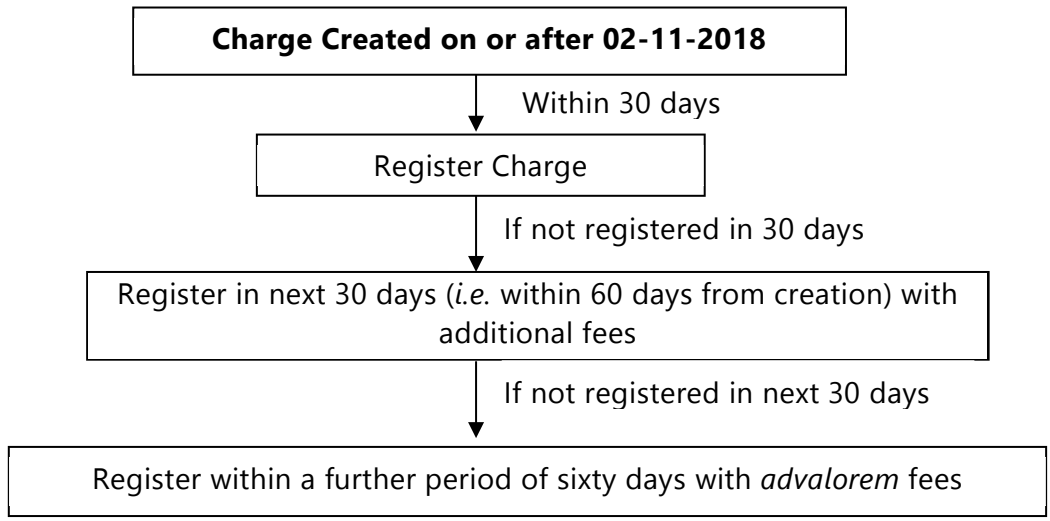

Section 77 of the Companies Act, 2013 contains provisions regarding registration of charges with the Registrar of Companies.

A. Registration of Charges

Registration by the company creating a charge: It shall be duty of the company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise and situated in or outside India, to register the particulars of the charge.

Thus, charge may be created within India or outside India. The subject-matter of the charge *i.e.* the property or assets or any of company's undertakings, whether tangible or non-tangible, may be situated within India or outside India. But in each case when charge is created it must be registered by the company.

In case a charge is created by deposit of title deeds (normally banks agree for this mode of charge instead of proper mortgage), it should also be registered by the borrowing company.[1]

Registration by the charge-holder: Section 78 (explained later) provides that in case the company creating a charge fails to register the charge within the prescribed period of 30 days, the person in whose favour the charge is created can get the charge registered.

Registration by the purchaser: Section 79 (explained later) covers another case of registration of charge where a company purchased some property in whose case a charge was already registered. In this case also, the company purchasing the property shall get the charge registered in its name in place of seller in the records of Registrar.

B. How to Register Charge[2]

For the purpose of registration of charge by the company, the particulars of charge in the prescribed form[3] together with a copy of the instrument, if any, creating the charge duly signed by the company and the charge holder, shall be filed with the Registrar within 30 days of creation of charge along with the prescribed fee.

C. Verification of Instrument of Charge[4]

A copy of every instrument creating (or modifying) any charge and required to be filed with the Registrar, shall be verified as follows:

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[1] As per Section 58 (f) of the Transfer of Property Act, 1882.

[2] As per Section 77 (1) and Rule 3 (1) of the Companies (Registration of Charges) Rules, 2014.

[3] As per Rule 3, Form CHG-1 or Form CHG-9 (in case of debentures) is to be filled.

[4] As per Rule 3 (4).

(a) *in case of property situated outside India:* where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either-

- under the seal, if any, of the company, or
- under the hand of any director or company secretary of the company, or an authorised officer of the charge holder, or
- under the hand of some person other than the company who is interested in the mortgage or charge;

(b) *in case of property situated in India (whether wholly or partly):* where the instrument or deed relates to the property situated in India (whether wholly or partly), the copy shall be verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

Thus, in case the instrument or deed relates solely to a property situated outside India, the copy may also be additionally verified by a certificate issued under the hand of some person other than the company who is interested in the mortgage or charge. This type of verification is not possible when the instrument or deed relates to the property situated in India, whether wholly or partly.

D. Extension of Time Limit

The original period within which a charge needs to be registered is 30 days from the date of creation of charge. The Companies (Amendment) Second Ordinance, 2019 (w.r.e.f. 02-11-2018) has amended the provisions relating to extension of time limit as under:

(i) Charges created before 02-11-2018 (i.e. before the commencement of the Companies (Amendment) Second Ordinance, 2019)[5]*:* In such cases, where charge was created before 02-11-2018 but was not registered within the original period of 30 days, the Registrar may, on an application by the company, allow such registration to be made within a period of **300 days** of such creation.

Further, if the registration is not made within the extended period of 300 days, it shall be made within six months from 02-11-2018 on payment of prescribed additional fees. It is provided that different fees may be prescribed for different classes of companies.

[5] As per Clause (a) of First Proviso and also Clause (a) of Second Proviso to Section 77 (1).

(ii) Charges created on or after 02-11-2018 (i.e. on or after the commencement of the Companies (Amendment) Second Ordinance, 2019)[6]*:* In such cases (i.e. charge was created on or after 02-11-2018 but the registration of charge not effected within the original period of 30 days), the Registrar may, on an application by the company, allow such registration to be made within a period of **60 days of such creation** (i.e. another 30 days are granted after the expiry of original 30 days), on payment of additional fees as prescribed.

According to another relaxation, if the registration is not made within the extended period as above, the company shall make an application and the Registrar is empowered to allow such registration to be made within a further period of **sixty days** after payment of prescribed *advalorem* fees[7].

Procedure for Extension of Time Limit*[8]*: For seeking extension of time, the company is required to make an application to the Registrar in the prescribed form[9]. It should be supported by a declaration from the company signed by its company secretary or a director that such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

The application so made must satisfy the Registrar that the company had sufficient cause for not filing the particulars and the instrument of charge, if any, within the original period of thirty days. Only then he will allow registration of charge within the extended period. Further, requisite additional fee or *advalorem fee*, as applicable, must also be paid.

E. Issue of Certificate of Registration[10]

If a charge is registered with the Registrar, a certificate of registration of such charge shall be issued in Form CHG-2 to the company and, as the case may be, to the person in whose favour the charge is created.

The certificate so issued by the Registrar shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made thereunder as to registration of creation of charge have been complied with.

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[6] As per Clause (b) of First Proviso and also Clause (b) of Second Proviso to Section 77 (1).
[7] *Advalorem* fees is charged according to the value of transaction.
[8] As per Rule 4.
[9] As per Rule 4 (2) Form CHG-1 or CHG-9 (in case of debentures) is to be used.
[10] As per Section 77 (2) and Rule 6 (1).

F. Subsequent Registration not to prejudice Rights of Charge-holder[11]

It is provided that any subsequent registration of a charge (*i.e.* registered within the extended period instead of original thirty days) shall not prejudice any right acquired in respect of any property before the charge is actually registered by the company.

In other words, rights of the lender or charge-holder shall not get affected and shall remain as they were before the actual registration (*i.e.* rights acquired from the date of creation of charge) even if the charge is actually registered within the extended period.

G. Section 77 not to apply to Certain Charges[12]

The application of Section 77 shall not be made to certain charges which are prescribed in consultation with the Reserve Bank of India.

H. Unregistered Charge not to be taken into account by the Liquidator/Creditor[13]

If a registrable charge though created but was not registered by a company and no certificate of registration of such charge was issued by the Registrar, it shall not be taken into account by the liquidator appointed under the Companies Act, 2013 or the Insolvency and Bankruptcy Code, 2016 or any other creditor.

However, not registering the charge shall not impact/negate any contract or obligation for the repayment of the money secured by the charge. Further, it may be noted that failure to register charge shall not absolve a company from its liability in respect of any offence under this Chapter.

3. APPLICATION FOR REGISTRATION OF CHARGE BY CHARGE-HOLDER [SECTION 78]

Section 78 of the Companies Act, 2013, empowers the holder of charge to get the charge registered in case the company creating the charge on its property fails to do so.

Accordingly, if a charge is created but the company primarily responsible for registering the charge fails to do so within the prescribed period of 30 days [as

[11] As per Third Proviso to Section 77 (1).
[12] As per Fourth Proviso to Section 77 (1). [inserted by the Companies (Amendment) Act, 2017, w.e.f. 07-05-2018.]
[13] As per Section 77 (3) and (4).

provided in section 77 (1)], the person in whose favour the charge is created (i.e. charge-holder) may apply to the Registrar for registration of the charge along with the instrument of charge within the prescribed time, form and manner.

On receipt of application from the charge-holder, the Registrar shall give a notice to the company and if no objection is received, allow such registration within a period of 14 days after giving notice to the company on payment of the prescribed fees.

However, the Registrar shall not allow such registration by the charge-holder, if the company itself registers the charge or shows sufficient cause why such charge should not be registered.

Recovery of fees: In case registration is effected on application made by the holder of charge, such person shall be entitled to recover from the company the amount of any fees or additional fees paid by him to the Registrar for the purpose of registration of charge.

4. SECTION 77 TO APPLY IN CERTAIN MATTERS [SECTION 79]

Section 79 of the Act covers two situations. One relates to acquisition of any property already subject to charge by a company. Other relates to modification in the terms and conditions or modification in the extent of any charge already registered. In both the cases another registration (in place of existing one) becomes necessary and the provisions contained in section 77 relating to registration of charge shall equally apply.

A. Company acquiring any Property subject to Charge [Section 79 (a)]

In case of a property where charge is already registered and if it is sold with the permission of the holder of charge, it shall be the duty of the company acquiring it to get the charge registered in accordance with Section 77. In other words, the earlier charge should get vacated and, in its place, new charge should get registered by the company which has acquired it.

B. Modification of Charge when there is Change in Terms and Conditions, etc. [Section 79 (b)]

Section 79 (b) requires any modification in charge (*i.e.* change in terms and conditions or change in extent of any charge, etc.) to be registered by the company in accordance with Section 77.

'Modification' includes variation in any of the terms and conditions of the agreement including change in rate of interest which may be by mutual agreement or by operation of law. Variation in extent or operation of any charge is also a kind of modification. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification.

Some **other examples** of 'modification' are as under:

1. where the charge is modified by varying any terms and conditions of the existing charge through an agreement;
2. where the modification is in pursuance of an agreement for enhancing or decreasing the limits;
3. where the modification is by ceding a *pari passu* charge;
4. where there is change in rate of interest (other than bank rate);
5. where there is change in repayment schedule of loan; (not applicable in case of working loans which are repayable on demand); and
6. where there is partial release of the charge on a particular asset or property.

C. Issue of Certificate of Modification

As per *Rule 6*, where the particulars of modification of charge is registered under section 79, the Registrar shall issue a certificate of modification of charge in Form CHG-3.

The certificate so issued by the Registrar shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made thereunder as to registration of modification of charge have been complied with.

5. DEEMED NOTICE OF CHARGE [SECTION 80]

Section 80 of the Companies Act, 2013 deals with the deemed notice of charge from the date of its registration. Accordingly, where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration.

This provision has cautionary effect. Thus, every person needs to be cautious or careful when he desires to acquire any asset or property of a company and must enquire whether such asset or property is subject to any charge by going through

the record of charges maintained at the office of Registrar of Companies before entering into the transaction. He shall be deemed to have notice of charge from the date of its registration. In case he enters into the transaction without making any enquiry and later on suffers loss because of charge, he cannot succeed against the company for incurring loss, for it shall be deemed that he had notice of charge.

For example, Vishnu Marketing Limited obtained a term loan of ₹ fifty lacs from Beta Commercial Bank Limited by creating a charge on one of its office buildings and the charge was duly registered. Later on, if the building is sold to Neeraj, he is deemed to have notice of such charge. In other words, it is presumed that Neeraj knew beforehand that the building was mortgaged to the bank for obtaining a loan. He cannot plead against such presumption by contending that he did not know about the charge if he suffers any loss at a later date because of the mortgage.

6. COMPANY TO REPORT SATISFACTION OF CHARGE [SECTION 82]

1. Intimation regarding Satisfaction of Charge

Section 82 of the Act of 2013, requires a company to give intimation of payment or satisfaction in full of any charge earlier registered, to the Registrar in the prescribed form[14]. The intimation needs to be given within a period of 30 days from the date of such payment or satisfaction.[15]

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[14] As per Rule 8, Form CHG-4 is to be used.

[15] (1) In case of a *specified IFSC public company*, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed (*vide Notification No. GSR 8 (E), dated 04-01-2017).*

(2) In case of a *specified IFSC private company*, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed (*vide Notification No. GSR 9 (E), dated 04-01-2017).*

Extended period of intimation: Proviso to Section 82 (1)[16] extends the period of intimation from thirty days to three hundred days. Accordingly, it is provided that the Registrar may, on an application by the company or the charge holder, allow such intimation of payment or satisfaction to be made within a period of **three hundred days** of such payment or satisfaction on payment of prescribed additional fees[17].

2. Notice to the Holder of Charge by the Registrar[18]

On receipt of intimation, the Registrar shall cause a notice to be sent to the holder of the charge calling upon him to show cause within such time as specified in the notice but not exceeding 14 days, as to why payment or satisfaction in full should not be recorded.

If no cause is shown by the charge-holder, the Registrar shall order entering of a memorandum of satisfaction in the register of charges kept by him and accordingly, he shall inform the company of having done so.

However, no notice is required to be sent, in case the intimation to the Registrar in this regard is in the specified form[19] and signed by the holder of charge.

If any cause is shown by the charge-holder, the Registrar shall record a note to that effect in the register of charges and inform the company.

3. No Effect of Section 82 on the Powers of the Registrar

According to sub-section (4), Section 82 shall not be deemed to affect the powers of the Registrar to make an entry in the register of charges under section 83 or otherwise than on receipt of an intimation from the company *i.e.* even if no intimation is received by him from the company.

4. Issue of Certificate

As per Rule 8 (2), in case the Registrar enters a memorandum of satisfaction of charge in full, he shall issue a certificate of registration of satisfaction of charge in Form No. CHG-5.

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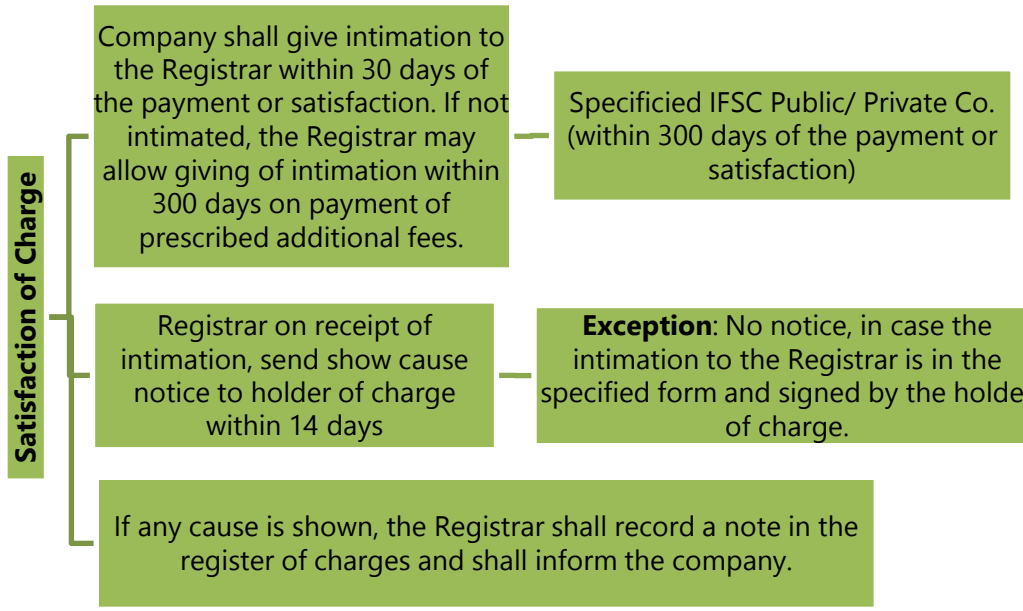
[16] Proviso inserted *vide* the Companies (Amendment) Act, 2017.

[17] Rule 8 (1) has been substituted *vide* the Companies (Registration of Charges), Amendment Rules, 2018 (w.e.f. 05-07-2018) to provide for giving of intimation within three hundred days instead of thirty days.

[18] As per Section 82 (2).

[19] As per Rule 8, Form CHG-4 is required to be filled for this purpose.



7. POWER OF REGISTRAR TO MAKE ENTRIES OF SATISFACTION AND RELEASE IN ABSENCE OF INTIMATION FROM COMPANY [SECTION 83]

Section 83 of the Act of 2013 empowers the Registrar to make entries with respect to the satisfaction and release of charges even if no intimation has been received by him from the company.

Accordingly, with respect to any registered charge if an evidence is shown to the satisfaction of Registrar that the debt secured by charge has been paid or satisfied in whole or in part or that the part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking, then he may enter in the register of charges a memorandum of satisfaction that:

- the debt has been satisfied in whole or in part; or
- the part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking.

This power can be exercised by the Registrar despite the fact that no intimation has been received by him from the company.

Information to affected parties: The Registrar shall inform the affected parties within 30 days of making the entry in the register of charges.

Issue of Certificate: As per Rule 8 (2), in case the Registrar enters a memorandum of satisfaction of charge in full, he shall issue a certificate of registration of satisfaction of charge in Form No. CHG-5.

8. INTIMATION OF APPOINTMENT OF RECEIVER OR MANAGER [SECTION 84]

Section 84 of the Act of 2013 is about the appointment of a receiver or manager and of giving intimation thereof to the company and the Registrar.

Accordingly,

- if any person obtains an order for the appointment of a receiver or a person to manage the property which is subject to a charge, or
- if any person appoints such receiver or person under any power contained in any instrument,

he shall give notice of such appointment to the company and the Registrar along with a copy of the order or instrument within 30 days from the passing of the order or making of the appointment.

In turn, the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

On ceasing to hold such appointment[20], the person appointed as above shall give a notice to that effect to the company and the Registrar. In turn, the Registrar shall register such notice.

9. PUNISHMENT FOR CONTRAVENTION [SECTION 86]

(i) According to section 86 (1) of the Act of 2013, if a company contravenes any of the provisions relating to the registration of charges or modification or satisfaction of charges, the punishment shall be as under:

[20] As per Rule 9, the notice of appointment or cessation shall be filed with the Registrar in Form No. CHG-6.

- **the company** shall be punishable with minimum fine of ₹ one lakh and maximum fine of ₹ ten lakhs; and
- **every defaulting officer** of the company shall be punishable with imprisonment maximum up to six months or with minimum fine of ₹ twenty-five thousand and maximum of ₹ one lakh, or with both.

(ii) With the insertion of sub-section (2)[21], section 447 relating to 'punishment for fraud' also becomes applicable in certain cases. Accordingly, if any person wilfully furnishes:

- any false or incorrect information; or
- knowingly suppresses any material information;

which is required to be registered under section 77, he shall be liable for action under section 447.

10. RECTIFICATION BY CENTRAL GOVERNMENT IN REGISTER OF CHARGES [SECTION 87]

Rectification in Register of Charges

Section 87[22] of the Act of 2013 and Rule 12[23] empowers the Central Government[24] to order rectification of Register of Charges in the following cases of default:

(i) when there was omission in giving intimation to the Registrar with respect to payment or satisfaction of charge within the specified time;

(ii) when there was omission or mis-statement of any particulars in any filing previously made to the Registrar. Such filing may relate to any charge or any modification of charge or with respect to any memorandum of satisfaction or other entry made under Section 82 (*Company to report satisfaction of charge*) or Section 83 (*Power of Registrar to make entries of satisfaction and release*).

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[21] Sub-section (2) of section 86 inserted vide the Companies (Amendment) Second Ordinance, 2019 w.e.f. 02-11-2018.

[22] As substituted by the Companies (Amendment) Second Ordinance, 2019 w.r.e.f. 02-11-2018.

[23] As substituted by the Companies (Registration of Charges) Amendment Rules, 2019 w.e.f. 30-04-2019

[24] *Vide* Notification No. S.O. 4090 (E), dated 19-12-2016, powers of the Central Government with respect to Section 87 stand delegated to the Regional Directors.

Before directing that the 'time for giving the intimation of payment or satisfaction shall be extended' or the 'omission or mis-statement shall be rectified', the Central Government needs to be satisfied that such default was accidental or due to inadvertence or because of some other sufficient cause or it did not prejudice the position of creditors or shareholders.

The application in Form CHG-8 shall be filed by the company or any interested person and order of rectification shall be made by the Central Government on such terms and conditions as it deems just and expedient.

"According to Rule 12 of *the Companies (Registration of Charges) Rules, 2014:*

The Central Government may on an application filed in Form No. CHG-8 in accordance with section 87-

(a) direct rectification of the omission or misstatement of any particulars, in any filing, previously recorded with the Registrar with respect to any charge or modification thereof, or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,

(b) direct extension of time for satisfaction of charge, if such filing is not made within a period of three hundred days from the date of such payment or satisfaction."

SUMMARY

- "Charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.
- A charge created by a company is required to be registered with Registrar within 30 days of its creation.
- In case a charge was created **before 02-11-2018** but was not registered within 30 days, the Registrar may, on an application by the company, allow registration of charge within 300 days of such creation. In case registration is not made within the extended period, it shall be made within six months from 02-11-2018 on payment of prescribed additional fees. Different fees may be prescribed for different classes of companies.
- In case a charge was created **on or after 02-11-2018** but was not registered within 30 days, the Registrar may, on an application by the company, allow registration of charge within **60 days** of such creation on payment of prescribed additional fees. If the registration is not made within the extended

period, the Registrar may, on an application, allow such registration to be made within a further period of **sixty days** after payment of prescribed *advalorem* fees.

- If a company fails to register the charge, the charge-holder can make an application for registration of charge and can also recover the amount of any fees or additional fees paid by him from the company.
- Modification in the terms and conditions, etc. of charge also requires registration of charge afresh. On recording the particulars of modification of charge, the Registrar shall issue a certificate of modification of charge.
- Any person acquiring a property which is subject to charge shall be deemed to have notice of the charge from the date of such registration.
- The particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in/MCA21) shall be deemed to be the register of charges maintained by the Registrar.
- Every company is required to keep at its registered office a **register of charges** in the prescribed form and manner.
- The company shall give intimation to Registrar of payment or satisfaction in full of any charge within a period of 30 days from the date of such payment or satisfaction. If no intimation is given within 30 days, the Registrar may allow such intimation to be made within 300 days of such payment or satisfaction on payment of prescribed additional fees.
- On receipt of intimation, the registrar shall issue a notice to the holder of charge calling upon him to show cause within such time not exceeding 14 days as to why payment or satisfaction in full should not be recorded as intimated to the Registrar. If no cause is shown, the Registrar shall order recording of memorandum of satisfaction.
- In case intimation of payment or satisfaction in full of charge is in prescribed form and signed by the holder of charge no notice as mentioned above shall be sent.
- In case, the company fails to send intimation of satisfaction of charge to the Registrar, the Registrar may enter in the register of charges memorandum of satisfaction on receipt of evidence to his satisfaction.
- Where Registrar enters a memorandum of satisfaction of charge in full, he shall issue a certificate of registration of satisfaction of charge.

- If a company contravenes any provision relating to the registration of charges or modification or satisfaction of charges, the company and every defaulting officer is punishable.
- The Central Government is empowered to order rectification of Register of Charges in certain cases of default.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. The instrument creating a charge or modification thereon shall be preserved for a period of _____ years from the date of satisfaction of charge by the company.

   (a) 5

   (b) 7

   (c) 8

   (d) 15

2. On receipt of intimation of satisfaction of charge, the registrar issues a notice to the holder calling upon him to show cause within such time not exceeding _____ days as to why payment or satisfaction in full should not be recorded as intimated to the Registrar:

   (a) 14

   (b) 21

   (c) 30

   (d) 300

3. The Register of Charges and instrument of charges maintained by the company shall be open for inspection during _____.

   (a) working hours

   (b) business hours

   (c) at all times

   (d) 9 A.M. to 5 P.M.

4. Any person acquiring property (on which charge is registered under section 77) shall be deemed to have notice of the charge from:

(a) end of 30 days

(b) date of application for charge

(c) date acquiring the property

(d) date of such registration

5. An interest or lien created on the property or assets of a company or any of its undertakings or both as security is known as:

(a) Debt

(b) Charge

(c) Liability

(d) Hypothecation

6. If a charge is created on or after 02-11-2018 but the registration is not made within the original period of 30 days and also not made within next 30 days after the expiry of original 30 days, then the Registrar is empowered to allow such registration to be made within a further period of _____

(a) 30 days

(b) 45 days

(c) 60 days

(d) 90 days

Answer to MCQs

1. (c) **2.** (a) **3.** (b) **4.** (d) **5.** (b) **6.** (c)

Question and Answer

Question 1

How will a copy of an instrument evidencing creation of charge and required to be filed with the Registrar be verified?

Answer

A copy of every instrument evidencing any creation or modification of charge and required to be filed with the Registrar shall be verified as follows:

(a) *in case property is situated outside India:* where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal, if any, of the company, or under the

hand of any director or company secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge;

(b) *in case property is situated in India (whether wholly or partly):* where the instrument or deed relates to the property situated in India (whether wholly or partly), the copy shall be verified by a certificate issued under the hand of any director or company secretary of the company or an authorised officer of the charge holder.

Question 2

Briefly explain the provisions enforced by the Companies (Amendment) Second Ordinance, 2019 when a charge created before 02-11-2018 is not registered within the prescribed period of thirty days as provided in Section 77 (1).

Answer

As per Section 77 (1) of the Companies Act, 2013 every company creating a charge:

a. within or outside India,

b. on its property or assets or any of its undertakings,

c. whether tangible or otherwise, and

d. situated in or outside India,

is required to register the particulars of the charge with the Registrar within thirty days of its creation.

In case the charge was created before 02-11-2018 and it was not registered within the prescribed period of thirty of its creation, clause (a) of the first Proviso to Section 77 (1) states that the Registrar may, on an application by the company, allow such registration to be made within a period of **300 days** of such creation.

According to clause (a) of the Second Proviso to Section 77 (1), if the registration is not made within the extended period of 300 days, it shall be made within six months from 02-11-2018 on payment of prescribed additional fees. It is provided that different fees may be prescribed for different classes of companies.

Note: The Companies (Amendment) Second Ordinance, 2019 stand enforced w.r.e.f. 02-11-2018.

Question 3

Define the term "charge" and also explain what is the punishment for default with respect to registration of charge as per the provisions of the Companies Act, 2013.

Answer

The term charge has been defined in section 2 (16) of the Companies Act, 2013 as 'an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage'.

Punishment for contravention – According to section 86 of the Companies Act, 2013, if a company makes any default with respect to the registration of charges covered under Chapter VI, a penalty shall be levied, ranging from ₹ 1 lakh to ₹ 10 lakhs.

Every defaulting officer is punishable with imprisonment maximum up to six months or with minimum of ₹ twenty-five thousand and maximum of ₹ one lakh, or with both.

Further, if any person wilfully furnishes any false or incorrect information or knowingly suppresses any material information which is required to be registered under section 77, he shall be liable for action under section 447 (punishment for fraud).

Question 4

Renuka Soaps and Detergents Limited realised on 2nd May, 2019 that particulars of charge created on 12th March, 2019 in favour of a Bank were not registered with the Registrar of Companies. What procedure should the company follow to get the charge registered? Would the procedure be different if the company realised its mistake of not registering the charge on 7th June, 2019 instead of 2nd May, 2019? Explain with reference to the relevant provisions of the Companies Act, 2013.

Answer

The charge in the present case was created after 02-11-2018 (*i.e.* the date of commencement of the Companies (Amendment) Second Ordinance, 2019) to which another set of provisions is applicable. These provisions are different from a case where the charge was created before 02-11-2018.

Initially, the prescribed particulars of the charge together with the instrument, if any, by which the charge is created or evidenced, or a copy thereof, duly verified by a certificate, are to be filed with the Registrar within 30 days of its creation.

[Section 77 (1)]. In this case particulars of charge were not filed within the prescribed period of 30 days.

However, the Registrar is empowered under clause (b) of first proviso to section 77 (1) to extend the period of 30 days by another 30 days (*i.e.* sixty days from the date of creation) on payment of prescribed additional fee. Taking advantage of this provision, Renuka Soaps and Detergents Limited should immediately file the particulars of charge with the Registrar after satisfying him through making an application that it had sufficient cause for not filing the particulars of charge within 30 days of its creation.

If the company realises its mistake of not registering the charge on 7th June, 2019 instead of 2nd May, 2019, it shall be noted that a period of sixty days has already expired from the date of creation of charge. However, Clause (b) of Second Proviso to Section 77 (1) provides another opportunity for registration of charge by granting a further period of sixty days but the company is required to pay *advalorem* fees. Since first sixty days from creation of charge were expired on 11th May, 2019, Renuka Soaps and Detergents Limited can still get the charge registered within a further period of sixty days from 11th May, 2019 after paying the prescribed *advalorem* fees. The company is required to make an application to the Registrar in this respect giving sufficient cause for non-registration of charge.

Question 5

Mr. Antriksh purchased a commercial property in Delhi belonging to NRT Limited after entering into an agreement with the company. At the time of registration, Mr. Antriksh comes to know that the title deed of the company is not free and the company expresses its inability to get the title deed transferred in his name contending that he ought to have the knowledge of charge created on the property of the company. Explain, whether the contention of NRT Limited is correct?

Answer

According to section 80 of the Companies Act, 2013, where any charge on any property or assets of a company or any of its undertakings is registered under section 77 of the Companies Act, 2013, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have **notice of the charge** from the date of such registration.

Thus, Section 80 clarifies that if any person acquires a property, assets or undertaking in respect of which a charge is already registered, it would be deemed that he has complete knowledge of charge from the date of its registration. Mr. Antriksh, therefore, was ought to have been careful while purchasing property and

should have noticed beforehand that NRT Limited had already created a charge on the property.

In view of above, the contention of NRT Limited is correct.

Question 6

Explain the provisions of the Companies Act, 2013 relating to Rectification by Central Government in Register of Charges.

Answer

Section 87 of the Act of 2013 and Rule 12 empowers the Central Government to order rectification of Register of Charges in the following cases of default:

(i) when there was omission in giving intimation to the Registrar with respect to payment or satisfaction of charge within the specified time;

(ii) when there was omission or mis-statement of any particulars in any filing previously made to the Registrar. Such filing may relate to any charge or any modification of charge or with respect to any memorandum of satisfaction or other entry made under Section 82 (*Company to report satisfaction of charge*) or Section 83 (*Power of Registrar to make entries of satisfaction and release*).

Before directing that the 'time for giving the intimation of payment or satisfaction shall be extended' or the 'omission or mis-statement shall be rectified', the Central Government needs to be satisfied that such default was accidental or due to inadvertence or because of some other sufficient cause or it did not prejudice the position of creditors or shareholders.

The application in Form CHG-8 shall be filed by the company or any interested person and order of rectification shall be made by the Central Government on such terms and conditions as it deems just and expedient.

Question 7

What are the powers of Registrar to make entries of satisfaction and release of charges in the absence of any intimation from the company. Discuss this matter in the light of provisions of the Companies Act, 2013.

Answer

Section 83 of the Act of 2013 empowers the Registrar to make entries with respect to the satisfaction and release of charges even if no intimation has been received by him from the company.

Accordingly, with respect to any registered charge if an evidence is shown to the

satisfaction of Registrar that the debt secured by charge has been paid or satisfied in whole or in part or that the part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking, then he may enter in the register of charges a memorandum of satisfaction that:

- the debt has been satisfied in whole or in part; or
- the part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking.

This power can be exercised by the Registrar despite the fact that no intimation has been received by him from the company.

Information to affected parties: The Registrar shall inform the affected parties within 30 days of making the entry in the register of charges.

Issue of Certificate: As per Rule 8 (2), in case the Registrar enters a memorandum of satisfaction of charge in full, he shall issue a certificate of registration of satisfaction of charge in Form No. CHG-5.

CHAPTER 7

MANAGEMENT & ADMINISTRATION

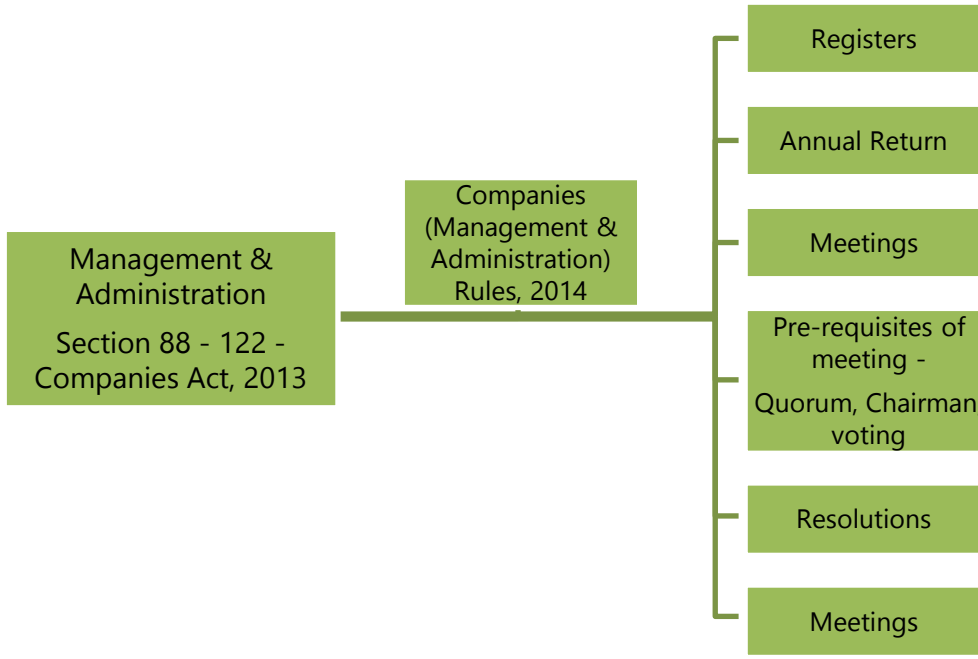
LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

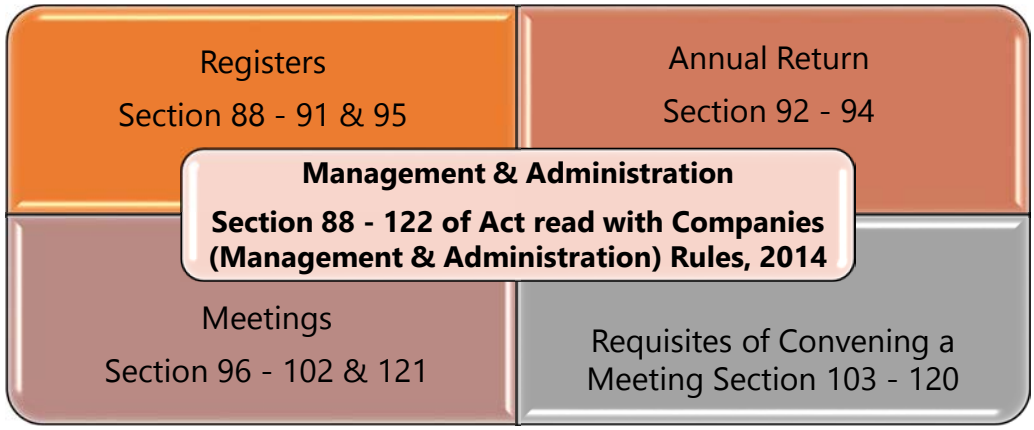
- State the meaning, need and importance of management & administration of company.
- Learn about the Maintenance of registers and other documentation required to be kept by a Company.
- Know about meeting for conduct of the business.
- Explain the requirements for convening of a valid meeting.

1. CHAPTER OVERVIEW & INTRODUCTION

A company is an artificial legal entity distinct from its members, thus, the affairs of the company are practically done by the Board of Directors. The Board of Directors in carrying out the day-to-day affairs of the company has to perform the role within their limited powers and the powers, which are granted to them. Certain powers can be exercised by the board of their own and some with the consent of the company at the general meeting. The shareholders as owners of the company ratify the actions of the board at the meetings of the company. The meetings of the shareholders serve as the focal point for the shareholders to converge and give their decisions on the actions taken by the directors.



To begin with, let us understand the structure of this Chapter of Companies Act, 2013 which deals with the provisions related to Management & Administration of Company. It runs from Section 88 to 122 and is divided under the following headings–

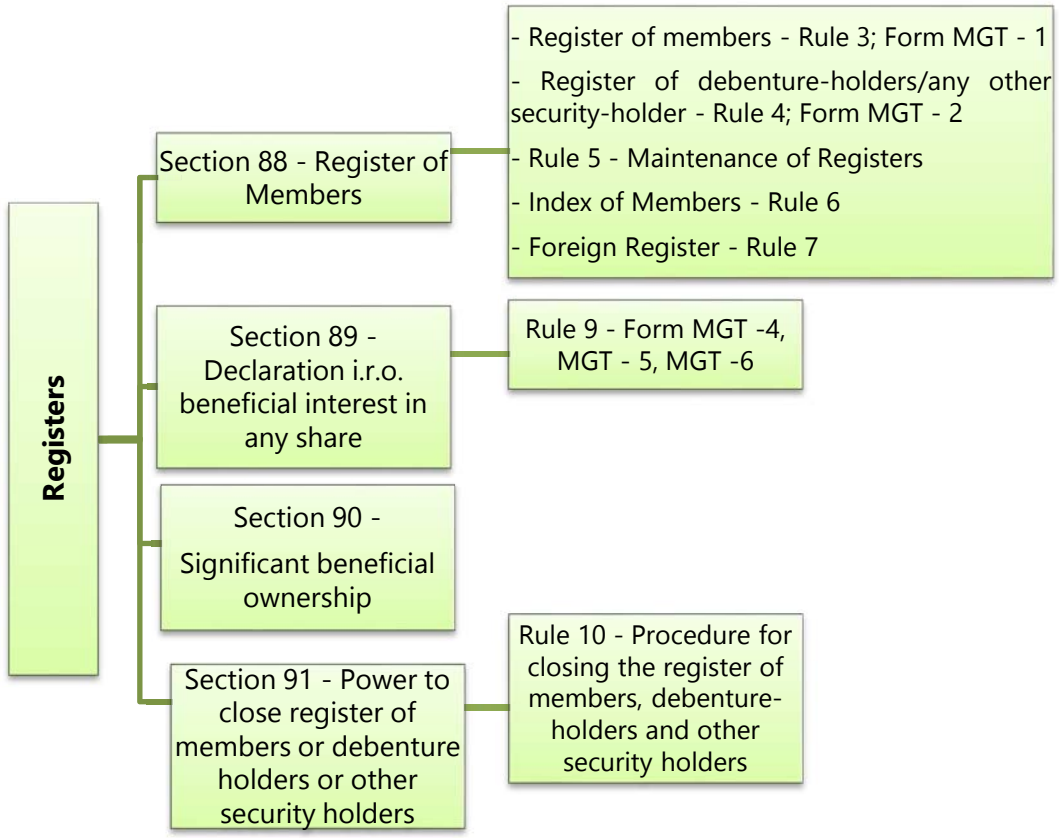


Thus, to initiate, it is imperative that we streamline the understanding of this chapter so as to link it with the essential concepts along with their procedures which can be found in the respective rules, *i.e. Companies (Management & Administration) Rules, 2014*.

This Chapter applies to all the companies, public and private and has special provisions applicable to One Person Company, which are detailed out in section 122 of the Act and is discussed later in the Chapter.

2. REGISTERS

The provisions relating to maintaining the various registers as per the Companies Act, 2013 are contained in Sections 88 – 91. Along with these provisions, the *Companies (Management & Administration) Rules, 2014* are also applicable to the maintenance of registers by a Company. Relevant provisions related to maintenance of register is as follows:



Section 88 – Register of members, etc.

Section 88(1) of the Companies Act, 2013 seeks to provide that every company shall keep and maintain the register of members, register of debenture-holders and register of any other security holders.

- **Maintenance of Register of members:** Section 88(1)(a) requires a register of members to be maintained and that the holding of **each class** of equity and preference shares by each **member residing in or outside India** will have to be shown **separately** in the register of members. The form and manner in which these registers are to be maintained, is contained in Rule 3 of the Companies (Management & Administration) Rules, 2014; whereas Rule 5 provides for the maintenance of the register of members.
- **Time period for entries in register:** As per Rule 5, entries have to be made in the Register within **7 days** of the date of approval by the Board or Committee thereof by approving the allotment or transfer as the case may be.
- **Place where register shall be maintained:** Rule 5 also states that the registers shall be maintained at the **registered office** of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than 1/10th of the total members entered in the register of members reside.
- **Other informations also to be referred in register:** Any order passed by the authority attaching the shares or relating to dividends is also required to be referred in the register of members. Hypothecation and pledge of shares is also required to be entered in the register of members as per Rule 5(7) and 5(8).
- **Particular in register:** Rule 3 prescribes that every company **limited by shares**, shall, from the date of its registration, **maintain a register of its members** in Form MGT – 1. In case of a company not limited by shares, the register shall contain the following particulars, in respect of each member–
  - Name of the member, address (registered office address in case the member is a body corporate); email address; Permanent Account Number or Corporate Identity Number ('CIN'); Nationality; in case member is a minor – name of his guardian and the date of birth of the member, name and address of the nominee;

- Date of becoming the member;
- Date of cessation;
- Amount of guarantee, if any;
- Any other interest, if any; and
- Instructions, if any, given by the member with regard to sending of notices, etc.

♦ **Maintenance of register of debenture holders:** Section 88(1)(b) of the Act refers to the form and manner of maintenance of **Register of debenture-holders**, which corresponds to Rule 4 which states that every company which issues or allots debentures or any other security shall maintain a separate register for debenture holder or security holder in Form– MGT–2.

♦ **Updation of rewards of members:** Rule 5 also states that the changes relating to the status of the member should be effectively captured and updated accordingly in the relevant register. If any change occur in the status of a member or debenture-holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or due to any other reason, entries shall be made in the respective registers.

♦ **Index of names:** Section 88(2) mentions that every register maintained under section 88(1) shall include an index of names included therein. The relevant rule here is, Rule 6 of the *Companies (Management & Administration) Rules, 2014* which state that the maintenance of index is not necessary where the number of members is less than 50. It also states that the company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in such Register.

♦ **Register index of beneficial owner to be maintained of a depository:** Section 88(3) is basically an enabling provision, which sets out that the register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

To understand the term 'depository' here, let us go back to the times when shares used to be held in physical form by the shareholders and the evidence that a particular person was a shareholder in a particular company in which he/she had invested, could be proved only by the fact that the said person had the share certificates of the company. With the advent of time, the companies dematerialised

their shares by converting them into electronic form and thus, now-a-days if you wish to invest in the shares of a company, you can do so by opening a Demat account and so the shares get transferred to you. In this situation, you are the beneficial owner of the shares of the company in which you have invested. The physical shares are still issued by the Company and transferred to intermediary institutions (like NSDL and CDSL in India) who store and secure the shares for the company and the investor and maintains an account for their securities. These intermediaries are known as Depository, who work like a bank. So practically, the company issues the shares to you when you invest in the securities of the issuing company, but what you get is the electronic copy of the share certificate. The physical share certificate is handled by the Depository, although you are the beneficial owner of the securities. Whenever any transfer of shares take place, the Depository's function is to transfer the ownership of shares from one investor's account to another investor account.

Foreign Register – Section 88(4) read with Rule 7:

- **Maintenance of foreign register:** The most important part of section 88 is its sub-clause (4) since it deals with Foreign Register. Section 88(4) read with Rule 7 entitles a company to maintain a foreign register of members, debenture-holders or other security holders or beneficial owners, showing the holding of persons residing outside India.
- **Compliances:** The compliances with respect to maintenance of foreign register are as follows–
  - A company which has share capital or which has issued debentures or any other security may, if so authorised by its articles, keep in any country outside India, a part of the register of members or as the case may be, of debenture holders or of any other security holders or of beneficial owners, resident in that country.
  - The company shall, within 30 days from the date of the opening of any foreign register, file with the Registrar of Companies ('RoC') notice of the situation of the office in the prescribed from Form No. MGT – 3 along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within 30 days from the date of such change or discontinuance, as the case may be, file notice with the RoC of such change or discontinuance.

- A foreign register shall be deemed to be part of the company's register ('principal register') of members or of debenture-holders or of any other security holders or beneficial owners, as the case may be.
- The foreign register shall be maintained in the same format as the principal register.
- A foreign register shall be open to inspection and may be closed, and extracts may be taken therefrom and copies thereof may be required, in the same manner, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept.
- If a foreign register is kept by a company in any country outside India, the decision of the appropriate competent authority in regard to the rectification of the register shall be binding.
- Entries in the foreign register maintained under section 88(4) shall be made after the Board of Directors or its duly constituted committee approved the allotment or transfer of shares, debentures or any other securities, as the case may be.
- The company shall –
  - ❖ Transmit to its registered office in India, a copy of every entry in any foreign register within 15 days after the entry is made; and
  - ❖ Keep at such office a duplicate register for all the purposes of this Act, be deemed to part of the principal register.
  - ❖ Subject to the provisions of section 88 and the rules made thereunder, with respect to duplicate registers, the shares or as the case may be, debentures or any other security, registered in any other security, registered in any foreign register shall be distinguished from the shares or as the case may be, debentures or any other security, registered in the principal register and in every other foreign register; and no transaction with respect to any shares or as the case may be, debentures or any security, registered, be registered in any other register.
- Every such duplicate register shall, for the purposes of this Act, be deemed to be a part of the principal register.

- Subject to the provisions of section 88 and the rules made thereunder, with respect to duplicate registers, the shares or as the case may be, debentures or any other security, registered in any foreign register shall be distinguished from the shares or as the case may be, debentures or any other security, registered in the principal register and in every other foreign register; and no transaction with respect to any shares or as the case may be, debentures or any other security, registered in a foreign register shall, during the continuance of that registration, be registered, be registered in any other register.
- The company may discontinue the keeping of any foreign register, and thereupon all entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

♦ **Penalty on failure to maintain register:** Section 88(5) deals with the penalty for contravention of the provisions of section 88, i.e. failure to maintain registers in accordance with the provisions of Section 88(1) and 88(2) of the Act. It states that the company and every officer of the company who is in default shall be punishable with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 3,00,000 and where the failure is a continuing one, with a further fine which may extend to ₹ 1,000 per day.

♦ **Nature of offence:** The offence under this section is a compoundable offence under section 441 of the Act.

♦ **Details of Nominations in the register:** It is important to note here that Form MGT – 1 and MGT – 2 require details of nomination as referred to in section 72 of the Act, *read with Rule 19 of the Companies (Share Capital and Debentures)* Rules, 2014 to be entered in the Register of members and register of debenture-holders or other security holders as the case may be.

Example 1

Mr. Zoey purchased the shares of Luxy Hairstyles Private Limited, at market price, in the name of his daughter, Mila, who is 4 years old. Mr. Joe, the Director of the Company, has approached you to advise him on the updation of said change in the register of members, since Mila, being a minor is incompetent to contract in her capacity.

Answer: Since, the minors are not competent to enter into any contract, thus their names cannot be entered in the register of members. Therefore, Mr. Joe is advised that while filing MGT – 1 and MGT – 2, the names of the minor can only be entered

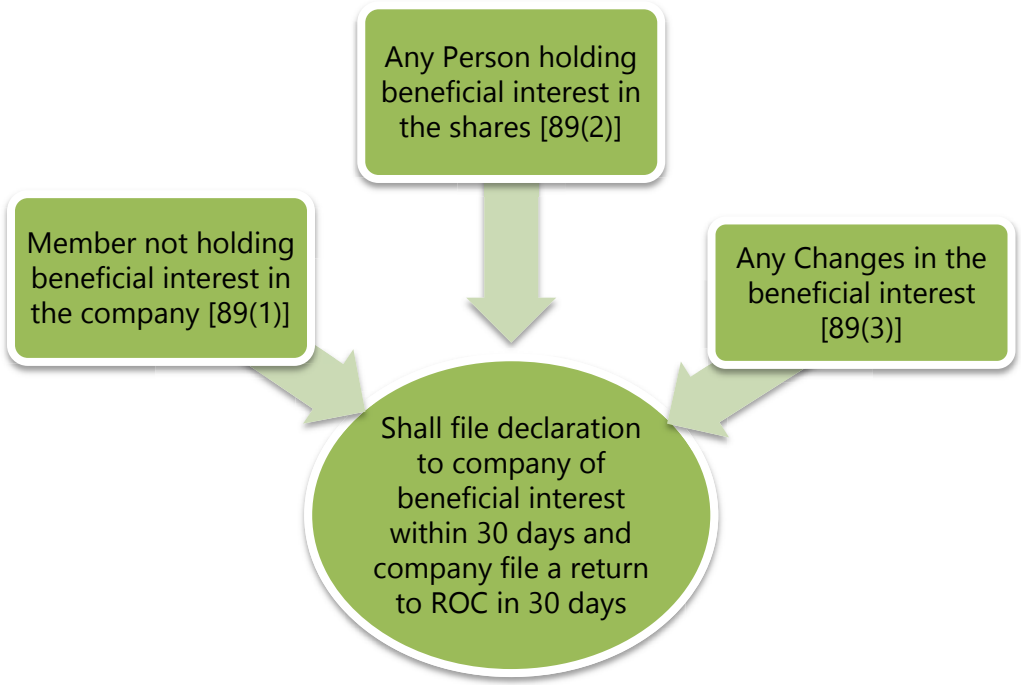
only if the details of the guardian are present. Thus, Zoey's name shall appear in the register of members of Luxy Hairstyles Private Limited since Mila is a minor.

Example 2

Mrs. And Mr. Taneja, recently got married and jointly purchased the shares of New Hopes India Private Limited on 14th August 2016. Mr. Taneja intimated the company that only the name of his wife should appear in the records of the company, for the shares purchased by them. The secretary of the company is not sure whether this is possible, given that the shares are held in the names of both the persons.

Answer: Joint holders of shares may request the company to enter their names on the register in a certain order, or execute transfers to have their holding split, with the result that part of the holding is entered showing the name of one holder and part showing the name of another. However, the condition of Mr. Taneja that only the name of his wife should appear in the register as a member cannot be catered to, although the names can be entered in the order such that the name of his wife appears first. The reason for this is that the articles of most companies provide that, in the case of exclusion of the other joint holders, and for this purpose, seniority shall be determined by the order in which the names stand in the register of members.

Section 89 – Declaration in respect of beneficial interest in any share-



- This section seeks to provide that a declaration is to be given to the company by any person who is a member but not holding the beneficial interest in such shares.
- Further the person holding beneficial interest shall declare the nature of his interest and other particulars on those shares to the company.
- Any changes in the beneficial interest is also to be declared.
- [1]The section also provides that the company shall make note of all the above incidents, as and when they occur and intimate the same to RoC within the time and manner as prescribed in Rule 9 of the Companies *(Management & Administration)* Rules, 2014.
- Rule 9 prescribes the procedure to be followed in case of declaration in respect of beneficial interest in any shares –
  - A person whose name is entered in the register of members of a company as the holder of shares in that company but who does not hold the beneficial interest such share, shall file with the company, a declaration to that effect in Form MGT – 4, within 30 days from the date on which his name is entered in the register of members of such company. Any change in the beneficial interest of the same shall be intimated to the company within 30 days in Form MGT – 4.
  - Every person holding and exempted from furnishing declaration or acquiring a beneficial interest in shares of a company not registered in his name, shall file with the company, a declaration disclosing such interest in Form MGT – 5, within 30 days after acquiring such beneficial interest in the shares of the company.
  - Where any declaration is received by the company under section 89, the company shall make note of such declaration in the register of members and shall file, within a period of 30 days from the date of receipt of declaration by it, a return in Form MGT – 6 with the RoC in respect of such declaration with the required fee.
  - Provided that nothing contained in this rule shall apply in relation to a trust which is created, to set up a Mutual Fund or Venture Capital Fund

[1] In case of an unlisted public company and private company which is licensed to operate from the IFSC, in section 89(6) for the word "30 days" read as "60 days".

or such other fund as may be approved by the Securities and Exchange Board of India.

- Where any declaration under this section is made to a company, the company shall make a note of such declaration in the register concerned and shall file, within thirty days from the date of receipt of declaration by it, a return in the prescribed form with the Registrar in respect of such declaration with such fees or additional fees as may be prescribed. [Section 89(6)]
- No right in relation to any share in respect of which a declaration is required to be made under this section but not made by the beneficial owner, shall be enforceable by him or by any person claiming through him.
- Nothing in this section shall be deemed to prejudice the obligation of a company to pay dividend to its members under this Act and the said obligation shall, on such payment, stand discharged.
- For the purposes of this section and section 90, beneficial interest in a share includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to—

  (i) exercise or cause to be exercised any or all of the rights attached to such share; or

  (ii) receive or participate in any dividend or other distribution in respect of such share. [Section 89(10)]

Penalty for default under section 89(5) & 89(7) –

Two kinds of penal provisions are included under section 89 –

- **Related to persons required to make a declaration:** Section 89(5) applies to those who are required to make a declaration, but fail to do so. The penalty for their failure, without any reasonable explanation, is fine which extends upto ₹ 50,000 and additionally ₹ 1,000 per day during which the failure continues.
- **Related to company:** Section 89(7) refers to the company which fails to comply with the provisions of section 89, makes punishable the company and every defaulting officer with a fine which shall not be less than ₹ 500 but which may go up to ₹ 1,000 with further fine of ₹ 1,000 per day during which the failure continues.

Exemption to Government Company- In case of Government company - Section 89 shall not apply - *Notification dated 5th June, 2015*.

The above mentioned exemption shall be applicable to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar- *Notification dated 13th June, 2017*.

Example

Ms. Emma gifted the shares purchased by her of the Company Bio-Optics Limited, to her sister Cathy. Emma had purchased these shares on the occasion of her birthday in February 2017. However, neither Emma nor Cathy were aware that they had to intimate about the transaction of transfer of such shares as a gift, to the company. Discuss the same in light of the provisions of section 89 of the Act.

Answer: The provisions of the section 89 of the Act, dealing with declaration of beneficial interest in shares by a person to the company does not apply in a civil suit where the title of the shares is in a dispute. *Khajamiya Miransaheb Mujahid v. Peerapasha Miransaheb Mujahid (1987) (Kar.)*. Where the shares are gifted away, they become the property of the donee. Hence, the provisions relating to declaration of beneficial interest are not applicable.

SECTION 90– REGISTER OF SIGNIFICANT BENEFICIAL OWNERS IN A COMPANY

(1) Every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than twenty-five per cent. or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (*27*) of section 2, over the company (herein referred to as "significant beneficial owner"), shall make a declaration to the company, specifying the nature of his interest and other particulars, in such manner and within such period of acquisition of the beneficial interest or rights and any change thereof, as may be prescribed:

Provided that the Central Government may prescribe a class or classes of persons who shall not be required to make declaration under this sub-section.

(2) Every company shall maintain a register of the interest declared by individuals under sub-section (1) and changes therein which shall include the name of individual, his date of birth, address, details of ownership in the company and such other details as may be prescribed.

(3) The register maintained under sub-section (*2*) shall be open to inspection by any member of the company on payment of such fees as may be prescribed.

(4) Every company shall file a return of significant beneficial owners of the company and changes therein with the Registrar containing names, addresses and other details as may be prescribed within such time, in such form and manner as may be prescribed.

(5) A company shall give notice, in the prescribed manner, to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe—

(a) to be a significant beneficial owner of the company;

(b) to be having knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or

(c) to have been a significant beneficial owner of the company at any time during the three years immediately preceding the date on which the notice is issued,

and who is not registered as a significant beneficial owner with the company as required under this section.

(6) The information required by the notice under sub-section (5) shall be given by the concerned person within a period not exceeding thirty days of the date of the notice.

(7) The company shall,—

(a) where that person fails to give the company the information required by the notice within the time specified therein; or

(b) where the information given is not satisfactory,

apply to the Tribunal within a period of fifteen days of the expiry of the period specified in the notice, for an order directing that the shares in question be subject to restrictions with regard to transfer of interest, suspension of all rights attached to the shares and such other matters as may be prescribed.

(8) On any application made under sub-section (7), the Tribunal may, after giving an opportunity of being heard to the parties concerned, make such order restricting the rights attached with the shares within a period of sixty days of receipt of application or such other period as may be prescribed.

(9) The company or the person aggrieved by the order of the Tribunal may make an application to the Tribunal for relaxation or lifting of the restrictions

placed under sub-section (8), within a period of one year from the date of such order:

Provided that if no such application has been filed within a period of one year from the date of the order under sub-section (8), such shares shall be transferred, without any restrictions, to the authority constituted under sub-section (5) of section 125, in such manner as may be prescribed.

(10) If any person fails to make a declaration as required under sub-section (1), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees or with both and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

(11) If a company, required to maintain register under sub-section (2) and file the information under sub-section (4), fails to do so or denies inspection as provided therein, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than ten lakh rupees but which may extend to fifty lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

(12) If any person wilfully furnishes any false or incorrect information or suppresses any material information of which he is aware in the declaration made under this section, he shall be liable to action under section 447.

Exemption to Government Company- In case of Government company - Section 90 shall not apply - *Notification dated 5th June, 2015*.

The above mentioned exemption shall be applicable to a government company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar- *Notification dated 13th June, 2017*.

SECTION 91 – POWER TO CLOSE REGISTER OF MEMBERS OR DEBENTURE-HOLDERS OR OTHER SECURITY HOLDERS:

- The said section is divided into two parts – sub-section (1) deals with the time limits for which the register of members is allowed to be closed and sub-section (2) mentions the penalty for contravention of the provisions of sub-section (1).

- The section seeks to provide that a company may close the register of members, debenture-holders and other security holders by giving minimum **7 days' notice** or such lesser period as specified by Securities Exchange Board of India ('SEBI').
- Section 91(1) further states that the registers may be closed for any period not exceeding 30 days at any one time and for an aggregate period of 45 days in one year.
- Section 91(2) sets out that if the registers is closed without giving the notice as prescribed in sub-section (1), or after giving a shorter notice than that so provided, or for a continuous period or an aggregate period in excess of the limits specified in that sub-section, the company and every officer of the company who is in default shall be liable to a penalty of ₹ 5,000 per day subject to a maximum of ₹ 1,00,000 during which the register is kept closed. However, the offence is a compoundable offence under section 441 of the Companies Act, 2013.
- It is important to note here that the **private companies** have been **exempted from issuing public notice** in newspapers, provided it issues 7 days' notice to its members before effecting closure of the registers.
- Rule 10 of the *Companies (Management & Administration) Rules, 2014* lists down the procedure to be followed for closing the register of members/ debenture-holders/ other security holders –
    - A company closing the register of members or the register of debenture holders or the register of other security holders shall give at least seven days previous notice and in such manner, as may be specified by Securities and Exchange Board of India, if such company is a listed company or intends to get its securities listed, by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company. [Sub rule (1)]
    - The provisions contained in sub-rule (1) shall not be applicable to a private company provided that the notice has been served on all

members of the private company not less than seven days prior to closure of the register of members or debenture holders or other security holders.

3. ANNUAL RETURN [SECTION 92-94]

The provisions of preparation and filing of annual return of a company are contained in section 92 of the Companies Act, 2013.

The section is particularly important from the compliance point of view, since this is an annual compliance and essentially captures all the important events that have taken place in the company during the financial year. Every company is required to file with the RoC, the annual return as prescribed in section 92, in Form MGT– 7 as per Rule 11(1) of the *Companies (Management & Administration) Rules, 2014*.

The particulars contained in an annual return, to be filed by every company are as follows–

1. Its registered office, principal business activities, particulars of its holding, subsidiary and associate companies.

2. Its shares, debentures and other securities and shareholding pattern

3. Its indebtedness

4. Its members and debenture-holders along with the changes therein since the close of the previous financial year

5. Its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year.

6. Meetings of members or a class thereof, Board and its various committees along with attendance details.

*7. Remuneration of directors and key managerial personnel

8. Penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment.

9. Matters relating to certification of compliances, disclosures.

10. Details in respect of shares held by or on behalf of the Foreign Institutional Investors including their names, addresses, countries of incorporation, registration and percentage of shareholding held by them.

- The afore-mentioned annual return has to be signed by a director of the company and the company secretary; and in case, there is no company secretary, by a company secretary in practice. However, in relation to [2]One Person Company and small company, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.
- Sub section 2 of section 92 read with Rule 11(2) of the *Companies (Management & Administration) Rules, 2014*, provides that the annual return, filed by a listed company or a company having paid-up share capital of ₹ 10 crore or more; or a turnover of ₹ 50 crore or more, shall be certified by a Company Secretary in practice and the certificate shall be in Form MGT – 8. It must state that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Act.
- [3]The extract of annual return shall be attached with the Board's Report in Form MGT – 9, as per section 92(3) read with rule 12(1).
- A copy of annual return shall be filed with the RoC within **60 days** from the date on which the Annual General Meeting ('AGM') is held or where **no annual general meeting** is held in any year within **60 days from the date on which the annual general meeting should have been held**, along with the **reasons** for not holding the AGM.

*"**In case of Private Company** - Clause(g) of Sub-Section (1) of Section 92 shall apply to private companies namely:-

"(g) "aggregate amount of remuneration drawn by directors;". - *Notification Dated 13th June, 2017*"

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[2] In case of Private Company - proviso to sub-section (1) of Section 92 for the proviso the following proviso shall be substituted, namely:-
"Provided that in relation to One Person Company, small company and private company (if such private company is a start-up), the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.".
The above exceptions/ modifications/ adaptations shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with Registrar. *Notification Dated 13th June, 2017*

[3] In case of Specified IFSC Public Company and Specified IFSC Private Company - Sub-section (3) of section 92 shall not apply. - *Notification Date 4th January, 2017*

Signing of annual return and certification in case of listed companies

- Section 92(2) provides for certification of the annual return by a company secretary in practice.
- As per *Rule 11 of the Companies (Management & Administration) Rules, 2014,* every company shall prepare its annual return in Form MGT – 7 and in respect of the specified listed companies as mentioned above, the annual return shall be certified in by a company secretary in practice and the certificate will be in Form MGT – 8.
- In this context, a company secretary in practice who signs the annual return cannot certify the same. Although there is no specific provision prohibiting this, it will not be a proper compliance for the same professional to sign as well as certify the document.[4]

Penalty for contravention–

- Section 92(5) of the Act specifies that if any company fails to file its annual return under sub-section (4), before the expiry of the period specified therein, such company and its every officer who is in default shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with further penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of five lakh rupees.
- If a company secretary in practice, certifies the annual return otherwise than in accordance with this section and the rules made thereunder, he shall be punishable with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5,00,000.
- Rule 14 of the *Companies (Management & Administration) Rules, 2014* relates to inspection of annual returns; whereas Rule 15 deals with the preservation of annual return. As per Rule 15(3), copies of annual return along with the copy of certificates and the documents required to be annexed thereto shall be preserved for a period of 8 years from the date of filing of the annual return.

Example

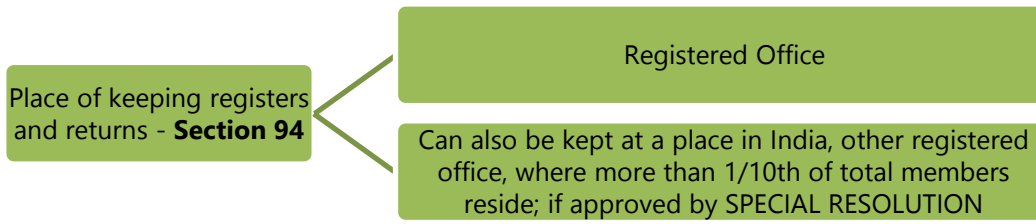
Big Fox Private Limited called it's Annual General Meeting on 30th September, 2018 for laying down the financial statement for approval of its shareholders' for the financial year ended 31st March 2018. However, due to want of quorum, the meeting could not take place and was cancelled. The company has not file the annual financial

[4] Page 1599 of Ramaiya's Chapter VII- Management & Administration

statements, or the annual return for the year ending March 2018, with the RoC till date. The director is of the view that since the annual general meeting did not take place, the period of 60 days for filing of annual return is not applicable and thus, there is no contravention of section 92. Discuss.

Answer: The director is incorrect in holding that there no contravention of the provisions of the Companies Act, 2013. Section 92 states that every company has to file an annual return with the RoC in Form MGT – 7 within 60 days of date on which annual general meeting was held or the date when it must have been held. In the above case, the annual general meeting of Big Fox Private Limited should have been held by 30th September 2018, but it did not take place. Thus, the company has contravened the provisions of section 92 of the Companies Act, 2013 and shall be liable for a penalty as specified in Section 92(5) of the Act.

[5]Section 94 – Place of keeping and inspection of registers, returns, etc.



Extract of Section 94(1)

"The registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company:

Provided that such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company:

Provided further that the period for which the registers, returns and records are required to be kept shall be such as may be prescribed."

- The registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or

[5] Section 93 of the Companies Act, 2013 has been omitted by the Companies (Amendment) Act, 2017 -Amendment Effective from 13th June 2018

beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as prescribed in Rule 14(1).

- As per Rule 14(1), the registers and indices maintained pursuant to section 88 and copies of returns prepared pursuant to section 92, shall be open for inspection during business hours, at such reasonable time on every working day as the board may decide, by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified in the articles of association of the company but not exceeding fifty rupees for each inspection.

  Explanation.- For the purposes of this sub-rule, reasonable time of not less than two hours on every working day shall be considered by the company.

- According to Section 94(3) read with Rule 14(2), any member, debenture-holder or security holder or beneficial owner can take the extracts during any business without payment of any fee or can also get copies thereof with payment of fee not exceeding ` 10 for each page. Such copies or entries or return shall be supplied within 7 days of deposit of fee.

Provided that such particulars of the register or index or return as may be prescribed shall not be available for inspection under sub-section (*2*) or for taking extracts or copies under this sub-section.

Preservation of register of members etc. and annual return–

- **Preservation of register of members:** Rule 15 of the *Companies (Management & Administration) Rules, 2014* states that the **register of members** along with the index shall be preserved **permanently** and shall be kept in the custody of company preservation of register of members secretary of the company or any other person authorised by the Board for such purpose; and

- **Preservation of register of debenture holders/ other security holders:** The register of debenture-holder or any other security holder along with the index shall be preserved for a period of 8 years from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.

- **Copies of documents filled with ROC to be preserved:** Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of 8 years from the date of filing with the RoC.

- **Preservation of foreign register:** shall be preserved permanently, unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture-holder or any other security holder shall be preserved for a period of 8 years from the date of redemption of debenture or securities.

Penalty for refusing the inspection or making any extract or copy required –

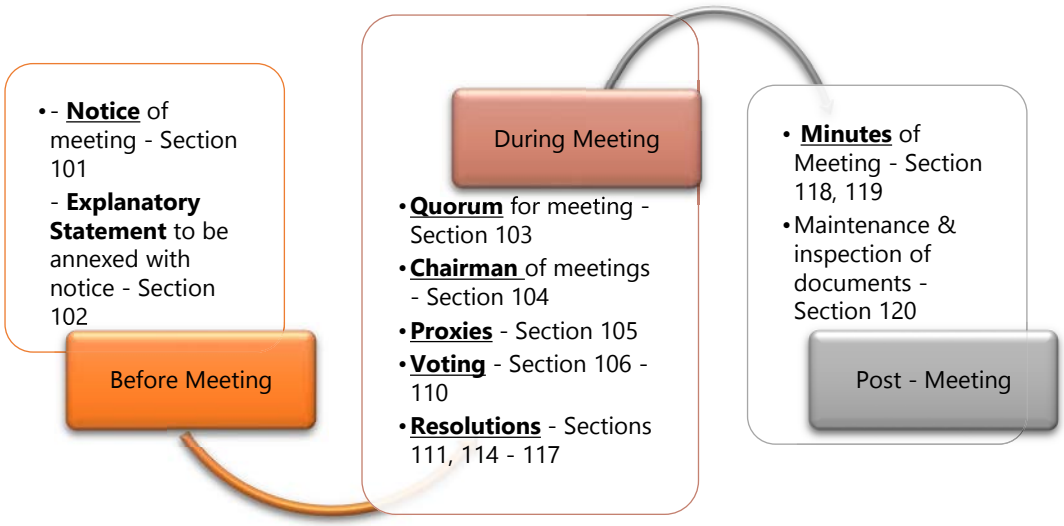
- If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default, shall be liable for each such default, to a penalty of ₹ 1,000 for every day subject to a maximum of ₹ 1,00,000 during which the refusal or default continues.
- The Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it. [Section 94(5)]

Section 95 – Registers, etc. to be evidence–

The section simply seeks to provide that the registers, indices and copies of annual return shall be prima facie evidence of any matter directed or authorised to be inserted therein by or under this Act.

4. PRE-REQUISITES OF A MEETING

Before we move on to our next concept of types of meetings and the procedure to convene them, as per the Companies Act, 2013, let us take a turn and swot the terms which are important to know for convening the meeting.



Let us discuss each of these concepts one-by-one in the following sections. But first, it's important to know the very basics of the meeting, so that it helps us in the better understanding of these terms as well. So, first of all, the most common term that are going to be used while discussing the following terms is, 'General Meeting'. Now, it is very important to note here that the term general meeting is used to describe a meeting of members of shareholders, as per the provisions of the Act; whereas there exist other types of meetings as well, viz. Board Meetings, i.e. meetings of the board of directors and class meetings, i.e. meetings of special class of persons, like, creditors, preference shareholders, etc. The pre-requisites of the meetings that we are going to discuss below are, in general applicable to all kinds of meetings, although the time limits may differ and there might be a specific mention of a certain type of meeting in that section.

Also, this part is divided into three chunks, i.e. how to properly 'call' a meeting; how to properly 'convene' a meeting and how to make sure that the post-meeting formalities and compliances are completed as per the legal provisions of the law. So, let's check with the provisions in details–

SECTION 101: NOTICE OF A MEETING[6]

Section 101 of the Companies Act, 2013 states the length of notice for calling a meeting. It states that in order to properly call a general meeting the notice should be sent at least ***21 clear days'***[7] before the meeting, to all the members, legal representative of any deceased member or the assignee of insolvent members, the auditors and directors, in writing or electronic mode or other prescribed mode.

Mode of sending the notice:

As per *Rule 18 of the Companies (Management & Administration) Rules, 2014*, sending of notices through electronic mode has been statutorily recognized by the Act.

- The said rule mentions that a notice may be sent through e-mail as a–
  - Text; or

[6] In case of Specified IFSC Public Company - Section 101 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Dated 4th January, 2017*

[7] In case of section 8 company, in clause (1) of Sub-section (1) of Section 101 for the words "21 days", the words "14 days" shall be substituted. *Notification dated 5th June, 2015*.
The above mentioned exception shall be applicable to a section 8 company which has not committed a default in filing of its financial statements under section 137 or annual return under section 92 with the Registrar. *Notification dated 13th June, 2017.*

- As an attachment to e-mail; or
- As a notification providing electronic link; or
- Uniform Resource Locator for accessing such notice.

♦ The e-mail shall be addressed to the person entitled to receive such e-mail as per the records of the company as provided by the depository. Also, the company shall provide an advance opportunity at least once in a financial year, to the member to register his e-mail address and the changes therein and such request may be made by only those members who have not got their email id recorded or to update a fresh email id and not from the members whose email ids are already registered.

♦ The notice shall be placed simultaneously on the website of the Company, if any, and on the website as may be notified by Central Government.

Length of serving the notice – 21 clear days:

Note that, the section mentions that the notice shall be sent 21 clear days' before the date of meeting. It's quite obvious to question as to what the term 'clear days' means. 21 clear days mean that the date on which notice is served and the date of meeting are excluded for sending the notice. A company cannot curtail by its articles of association the requirement of 21 clear days.

Who is entitled to receive the notice of the general meeting? (Section 101(3))

The notice of every meeting of the company shall be given to—

(a) every member of the company, legal representative of any deceased member or the assignee of an insolvent member;

(b) the auditor or auditors of the company; and

(c) every director of the company.

Example 1

Mr. Abeer filed a complaint against the company, Elixir Private Limited since it did not serve the notice to him for attending the annual general meeting. The company, in turn, provided the proof that they had sent the notice, by way of an email to Mr. Abeer, inviting him to attend the annual general meeting of the company. Abeer alleges that he never received the email. State whether the company is liable as guilty for contravening the provisions of section 101 of the Companies Act, 2013 read with rules.

Answer: As per Rule 18(3) of the Companies (Management & Administration) Rules, 2014, the company's obligation shall be satisfied when it transmits the e-mail and the company shall not be held responsible for a failure in transmission beyond its control. Also, if the member entitled to receive the notice fails to provide or update relevant e-mail address to the company, or to the depository participant as the case may be, the company shall not be in default for not delivering notice via e-mail.

Meetings held at shorter notice–

Generally, general meetings need to be called by giving at least a notice of 21 clear days.

However, a general meeting may be called after giving shorter notice than that specified in this sub-section if consent, in writing or by electronic mode, is accorded thereto—

(i) in the case of an annual general meeting, by not less than **ninty-five per cent**. of the members **entitled to vote thereat**; and

(ii) in the case of **any other general meeting**, by members of the company—

  (a) holding, if the **company has a share capital**, majority in number of members entitled to vote and who represent not less than ninety-five per cent. of such part of the **paid-up share capital** of the company as **gives a right to vote at the meeting**; or

(b) having, if the company has **no share capital**, not less than ninty-five per cent. of the **total voting power** exercisable at that meeting:

Provided further that where any member of a company is entitled to vote only on some resolution or resolutions to be moved at a meeting and not on the others, those members shall be taken into account for the purposes of this sub section in respect of the former resolution or resolutions and not in respect of the latter.

Contents of the Notice – Section 101(2):

A valid notice must state the day, date, hour of the meeting and place of the meeting and shall contain a statement of business to be transacted in that meeting. It must be issued on the authority of the Board of Directors under the name of an authorised official.

Omission to send notice – Section 101(4):

Section 101(4) states that any accidental omission to give notice to, or non-receipt of such notice to any member or other person who is entitled to such notice for any meeting shall not invalidate the proceedings of the meeting.

This essentially means, that the omission must not be designed or deliberate. Failure to send notice to a member, under a belief that it will not reach him at the address mentioned in the register of members is deliberate and not accidental, even if the belief is based on a mistaken impression.

The onus is on the company to prove that the omission was not deliberate.

Applicability of section 101 to Private companies- Section 101 shall apply, unless otherwise specified in respective sections or the articles of the company provide otherwise. *Notification dated 5th June, 2015*.

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar. *Notification dated 13th June 2017*.

*EXPLANATORY STATEMENT TO BE ANNEXED TO NOTICE (SECTION 102)[8]

Section 102 of the Companies Act, 2013 mentions that where any **special business** is to be transacted at the company's general meeting, then an 'Explanatory

[8] In case of Specified IFSC Public Company - Section 102 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Date 4th January, 2017*.

Statement' should be annexed to the notice calling such general meeting, which must specify,

(a) the nature of concern or interest, financial or otherwise, if any, in respect of each items of—

  (i) every director and the manager, if any;

  (ii) every other key managerial personnel; and

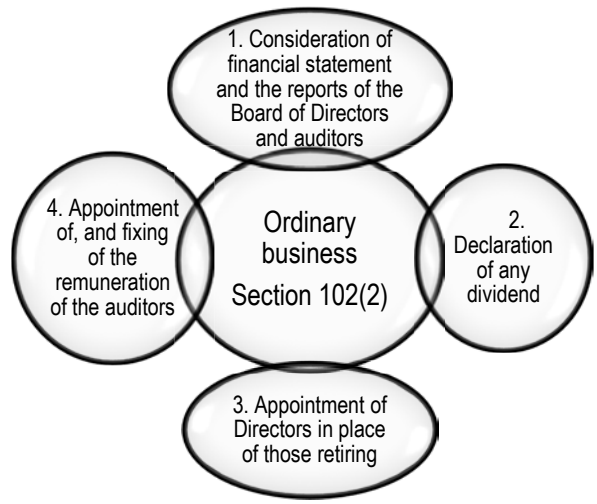
  (iii) relatives of the persons mentioned in sub-clauses (i) and (ii);

(b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

For the purposes of understanding what special business means, let us understand the types of businesses that are transacted at the general meetings. Companies Act, 2013 sets out the two types of businesses transacted in general meetings, which are –

- Ordinary business; and
- Special business.

Ordinary business are the following business which are transacted at the annual general meeting of the company–



- In simple words, at the annual general, all the other businesses except the ones stated above are special business. At extra-ordinary general meeting, every business transacted is a special business.

- Proviso to section 102(2) sets out that where an item of special business which is to be transacted at a meeting of the company relates to or affects any other company, then the extent of shareholding interest in that other company of every promoter, director, manager, and of every key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than 2% of the paid-up share capital of that company, shall also be set out in the statement.
- In case any item of business refers to any document which is to be considered at the meeting, then the time and place where such document can be inspected should also be specified in the explanatory statement.
- An important clause in section 102 of the Act states that in case of non-disclosure or insufficient disclosure in any statement made by promoter, director, manager or other key managerial personnel which results into any benefit for themselves or their relatives, then the same profit derived shall have to be compensated by him.

Extract of Sub section (4) of Section 102

"Where as a result of the non-disclosure or insufficient disclosure in any statement referred to in sub-section (1), being made by a promoter, director, manager, if any, or other key managerial personnel, any benefit which accrues to such promoter, director, manager or other key managerial personnel or their relatives, either directly or indirectly, the promoter, director, manager or other key managerial personnel, as the case may be, shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him."

Penalty for contravention of the provisions of this section–

Without prejudice to the provisions of sub-section (4), if any default is made in complying with the provisions of this section, every promoter, director, manager or other key managerial personnel of the company who is in default shall be liable to a penalty of fifty thousand rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is higher.

Applicability of section 102 to Private companies- Section 102 shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise. *Notification dated 5th June, 2015.*

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar. *Notification dated 13th June 2017.*

Ratification of appointment of Statutory Auditor–

- An important point while understanding the concept of ordinary business is the fact that where section 102 states that appointment of auditors is an ordinary business. Let us understand this effectively and link this with section 139(1) of the Company Act, 2013 which states that –
- "Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting."
- The proviso to section 139(1) states that the company shall place the matter relating to such appointment for ratification by members at every annual general meeting.
- Thus, as per the above provisions, companies are required to ratify the appointment of statutory auditors who were appointed in the last AGM for a period of 5 years. Therefore, an Ordinary Resolution is to be passed for ratification to continue as a Statutory Auditor of the Company.
- The ratification of Statutory Auditor at every subsequent AGM is neither appointment nor re-appointment, since the appointment has already been made in the first AGM for the next 5 years. Therefore, the ratification of continuation will be ordinary business.

QUORUM FOR MEETINGS [SECTION 103]9

The said section of the Companies Act, 2013 states that unless the articles of the company provide for a larger number, the quorum for the meeting shall be as follows–

[9] In case of Specified IFSC Public Company - Section 103 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Date 4th January, 2017.*

Public Company -	Private Company -
If number of members is not more than 1000, quorum shall be 5 members personally present	Quorum - 2 members personally present
if the number of members is more than 1000 but upto 5000, then the quorum shall be 15 members personally present	
If the number of members exceed 5000, then quorum shall be 30 members personally present.	

- The term 'members personally present' as mentioned above refers to the members entitled to vote in respect of the items of business on the agenda of the meeting.

Adjourned Meeting due to want of Quorum–

If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company—

(a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine; or

(b) the meeting, if called by requisitionists under section 100, shall stand cancelled:

Provided that in case of an adjourned meeting or of a change of day, time or place of meeting under clause (a), the company shall give not less than three days notice to the members either individually or by publishing an advertisement in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated.

- Where quorum is not present in the adjourned meeting also within half an hour, then the members present shall form the quorum.

Applicability of section 103 to Private companies- Section 103 shall apply to a private company unless otherwise specified in respective sections or the articles of the company provide otherwise. *Notification dated 5th June, 2015.*

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar. *Notification dated 13th June 2017.*

Example 1

There are 54 members of Dicey Private Limited. The company held its annual general meeting on 1st July 2019 at 2.00 p.m. and 28 members were present till 2.45 p.m. The Chairman of the meeting proceeded to initiate the meeting and passed the resolutions as discussed in the meeting. Comment whether the meeting took place as per the provisions of Companies Act, 2013.

Answer: As per the provisions of Section 103 of the Companies Act, 2013, the quorum for a Private Limited Company shall be two members personally present. Thus, the quorum for the annual general meeting of Dicey Private Limited was complied with and the company is not in contravention with any of the provisions of the Companies Act, 2013.

Example 2

Abbey Limited has 2300 members and the annual general meeting of the company is to be held on 23rd February 2019 at 10.30 a.m. On the day of the meeting, 18 members were personally present by 11.00 a.m. and the Chairman proceeded to initiate the chronicles of the meeting. There were 5 special businesses to be discussed at the said meeting and by 2.30 p.m. Agenda 1 to 3 had been discussed and appropriate resolutions were passed. However, due to some emergency, 4 of the members had to leave around 3 p.m. The Chairman granted them the permission and proceeded to discuss Agenda 4 & 5 and accordingly passed resolution as per the consent of the remaining members. Comment whether the meeting is a properly convened meeting as per the provisions of section 103 of the Companies Act, 2013.

Answer: In the above case, while the appropriate quorum was present at the time when the meeting started as per section 103 of the Companies Act, 2013, the quorum was not present at the time of deciding Agenda 4 & 5. It has been held that where at the time of transacting business, the number of members is less than the quorum fixed for the meeting, the business cannot be transacted and shall be a nullity.

CHAIRMAN OF MEETING [SECTION 104][10]

Election of chairman by members: Section 104 of the Companies Act, 2013 seeks to provide that unless the articles of association of the Company otherwise provide, the members, personally present, shall elect among themselves to be the Chairman by show of hands.

Demand of poll: The section further provides that if a poll is demanded on the election of the Chairman, the Chairman elected by show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of poll, and such other elected person shall be the Chairman for rest of the meeting.

Powers of chairman: A very basic thing that comes to anyone's mind when hearing the word, Chairman, is, are we talking about the Chairman of the Company? Or is he just a Chairman of the meeting? Yes, that's right. Section 104 talks about the Chairman of the meeting, the one who manages the meetings and ensures that the required decorum of the meeting is maintained at all times, till the meeting is concluded and post that, executes the minutes of the meeting. The Chairman has *prima facie* authority to decide all questions which arise at a meeting and which require decision at the time.in order to fulfil his duty properly, he must observe strict impartiality, even though he must be personally strongly opposed to any matter.

Right to cast casting vote: The Chairman has a casting vote in Board Meetings and general meetings, if specifically empowered by the articles of the Company. A casting vote means that in event of the equality of vote on a particular business being transacted at the meeting, the Chairman of the meeting shall have a right to cast a second vote. If there is no provision in the articles for a casting vote, an ordinary resolution on which there is equality of votes is deemed to be dropped.

Exemption to Private Company- In case of private company - Section 104 shall apply, unless otherwise specified in respective sections or the articles of the company provide otherwise. - *Notification dated 5th June, 2015*.

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar. *Notification dated 13th June 2017*.

[10] In case of Specified IFSC Public Company - Section 104 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Date 4th January, 2017*.

5. Proxies [Section 105][11]

The section provides following laws related to proxy:

- Section 105 of the Companies Act, 2013 deals with the provisions of proxy for meetings. Sub-section (1) provides that any member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.

  However, a proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll.

  Applicability of the sub-section (1) - Unless the articles of a company otherwise provide, this sub-section shall not apply to a company not having a share capital. CG may also prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.

- A person appointed as proxy shall act on behalf of such member or number of members not exceeding fifty and holding in aggregate not more than 10 per cent of the total share capital of the company carrying voting rights. However, a member who is holding more than 10 per cent of the total share capital of the Company carrying voting rights, may appoint a single person as a proxy and such person shall not act as a proxy for any other person or shareholder.

- As per Rule 19(3) of the Companies (Management & Administration) Rules, 2014, the appointment of proxy shall be in the Form MGT – 11.

- As a compliance requirement, in every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, there shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member. [Sub- section (2)]

- Section 105(4) of the Act provides that a proxy received 48 hours before the meeting will be valid even if the articles provide for a longer period.

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[11] In case of Specified IFSC Public Company - Section 105 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Date 4th January, 2017.*

- Rule 20 of the Companies (Management & Administration) Rules, 2014 is applicable to listed companies. According to Rule – 20(4)(iii), the notice of the meeting shall clearly state that the members who have cast their vote by remote e-voting prior to the meeting may also attend the meeting but shall not be entitled to cast their vote again.
- Section 105(8) provides for inspection of proxies during the meeting and 24 hours before the meeting before its commencement, and the inspection is to be given only during business hours. At least 3 days' notice in writing is required to be given to the company for conducting the inspection.
- Penalty for default–
  - If default is made in complying with sub-section (2), every officer of the company who is in default shall be liable to penalty of five thousand rupees.
  - If for the purpose of any meeting of a company, invitations to appoint as proxy a person or one of a number of persons specified in the invitations are issued at the company's expense to any member entitled to have a notice of the meeting sent to him and to vote thereat by proxy, every officer of the company who knowingly issues the invitations as aforesaid or willfully authorises or permits their issue shall be punishable with fine which may extend to one lakh rupees.
  - For refusing the inspection to members at any time during the business hours, the company and every officer who is in default, shall be punishable with fine upto ₹ 10,000 and where the contravention is a continuing one, with a further fine upto ₹ 1,000 per day of default.
  - Offences under this section are compoundable under section 441 of the Act.
- Rule 19 of the *Companies (Management & Administration) Rules, 2014* provides as under–
  - Restriction on the maximum number of members (50) and shareholding (10 percent) that a proxy holder can represent.
  - Only a member can be a proxy holder in a company registered under section 8 of the Companies Act, 2013.

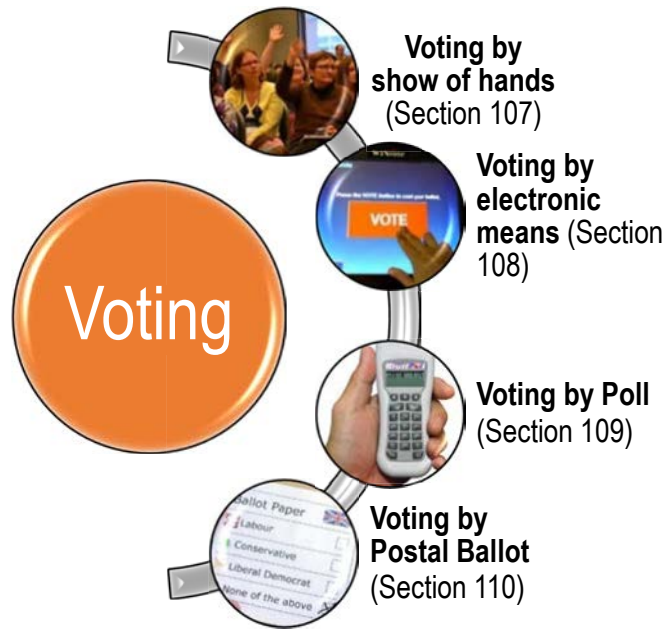
Exemption to Private Company- In case of private company - Section 105 shall apply, unless otherwise specified in respective sections or the articles of the company provide otherwise. *Notification dated 5th June, 2015.*

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar. *Notification dated 13th June 2017*.

6. VOTING [SECTION 106-109]

Ever pondered as to why is voting important in the meetings? The meeting takes places with an agenda or say, the decisions to be taken by the company's members which are crucial for the working of the company. So, the meeting takes place to discuss and decide upon the topics which are important – thus this decision requires consensus of the members attending the meeting. This consensus is reached through voting. As per the Companies Act, 2013, the voting in a meeting can take place in the following ways–

- Voting by show of hands – (section 107);
- Voting by electronic means – (section 108);
- Voting by demand of poll – (section 109);
- Voting by Postal Ballot – (section 110).



The right to vote is a personal right of a shareholder and he may use it as he likes it. He may split its vote for and against the resolution. The Act also prescribes the

restriction on voting rights under section 106 so as to enable that the shareholders or members who are liable to pay upon calls of the shares are restricted to vote on important decisions at the meetings, if the articles of the company provide so. Let us discuss each of these provisions in detail.

RESTRICTION ON VOTING RIGHTS [SECTION – 106][12]

The **section overrules the whole of the Companies Act, 2013** and provides that the articles of association of a company may provide that no member shall exercise any voting right in respect of any share registered in his name on which any amount is due from him on calls or any other sums payable to the company, or in regard to which the company has exercised the right of lien. [Sub section (1)]

Section – 106 (2) also suggests that a company shall not prohibit any member from exercising his voting rights on any other ground except the grounds mentioned in (1).

On a poll taken at a meeting of a company, a member entitled to more than one vote, or his proxy, where allowed, or other person entitled to vote for him, as the case may be, need not, if he votes, use all his votes or cast in the same way all the votes he uses. [Sub section (3)]

Also, such member can't sign a requisition for an extraordinary general meeting.

Exemption to Private Company- In case of private company - Section 106 shall apply, unless otherwise specified in respective sections or the articles of the company provide otherwise. - *Notification dated 5th June, 2015.*

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar. *Notification dated 13th June 2017.*

Note: Where the articles of the company do not contain any provision restricting the exercise of voting right of member, a member cannot be prevented from voting, even though, calls or other sum payable by him have not been paid or the company has exercised any right of lien over his shares. But, where the articles contain any such provision, and the shares forfeited for non-payment of calls have been re-allotted, the new allottee being liable for the balance remained unpaid on the

[12] In case of Specified IFSC Public Company - Section 106 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Date 4th January, 2017.*

shares will not be entitled to vote so long as any calls presently payable on the shares remain unpaid.

Example 1

What happens in case of voting by joint shareholders? Suppose that Mr. & Mrs. Iyer are joint shareholders of Goal Private Limited and they hold 500 shares of the company. Regarding a particular special business being transacted at the extra-ordinary general meeting of the company, Mr. Iyer is in the favour of the decision, whereas Mrs. Iyer is against the resolution. Decide how should the vote be casted in case of this situation?

Join shareholders must concur in voting unless the articles provide to the contrary.

The voting in case of joint shareholders is done in the order of seniority, which is determined on the basis of the order in which their names appear in the register of members/ shareholders. The joint-holders have a right to instruct the company as to the order in which their names are to appear in the register.

Example 2

Consider a situation where directors are also the shareholders of the company.

Directors, who are also the shareholders of the company, stand in a fiduciary relationship with the company in their capacity as directors. However, a director should vote as a common shareholder would vote in a general meeting, and need not be influenced by the fact of his being a director.

VOTING BY SHOW OF HANDS [SECTION 107][13]

- The general meaning set out by this section of the Companies Act, 2013 is that unless the voting is demanded by way of poll or by electronic means, the voting should be by way of show of hands in the first instance.
- Also, section 107(2) states that the declaration by the Chairman of the meeting in the minutes books shall be the conclusive evidence that the resolution is passed.

[13] In case of Specified IFSC Public Company - Section 107 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Date 4th January, 2017.*

Extract of the Act,

"(1) At any general meeting, a resolution put to the vote of the meeting shall, unless a poll is demanded under section 109 or the voting is carried out electronically, be decided on a show of hands.

(2) A declaration by the Chairman of the meeting of the passing of a resolution or otherwise by show of hands under sub-section (1) and an entry to that effect in the books containing the minutes of the meeting of the company shall be conclusive evidence of the fact of passing of such resolution or otherwise."

Exemption to Private Company- In case of private company - Section 107 shall apply, unless otherwise specified in respective sections or the articles of the company provide otherwise. - *Notification dated 5th June, 2015*.

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar. *Notification dated 13th June 2017*.

Example

Can an insolvent shareholder vote at the meeting by show of hands?

Yes. Notwithstanding that he has no longer any beneficial interest in the shares and the dividends are payable only to his trustee in bankruptcy, an insolvent shareholder so long as he remains in the register of the company as a member, is entitled to exercise his votes which are attributed to his status as member.

VOTING THROUGH ELECTRONIC MEANS [SECTION 108]

This is a new mode of voting in meetings which has been introduced in the Companies Act, 2013 and provides that a member in the prescribed class of companies may exercise his right to vote by electronic means.

Rule 20 of the Companies (Management & Administration) Rules, 2014 provides a detailed procedure for electronic voting, which states as follows –

"Voting through electronic means" shall apply in respect of the general meetings for which notices are issued on or after the date of commencement of this rule.

Companies providing its members to exercise right to vote by electronic means: Every company which has listed its equity shares on a recognised stock exchange and every company having not less than one thousand members shall provide to its members facility to exercise their right to vote on resolutions proposed to be considered at a general meeting by electronic means:

Provided that a Nidhi, or an enterprise or institutional investor referred to in Chapter XB or Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 is not required to provide the facility to vote by electronic means:

Explanation**:** For the purpose of this sub-rule, "Nidhi" means a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

Exercise of right by a member: A member may exercise his right to vote through voting by electronic means on resolutions and the company shall pass such resolutions in accordance with the provisions of this rule.

Procedure: A company which provides the facility to its members to exercise voting by electronic means shall comply with the following procedure, namely:-

(i) **Notice of meeting:** The notice of the meeting shall be sent to all the members, directors and auditors of the company either-

(a) by registered post or speed post; or

(b) through electronic means, namely, registered e-mail ID of the recipient; or

(c) by courier service;

(ii) **Notice to be hosted on website:** the notice shall also be placed on the website, if any, of the company and of the agency forthwith after it is sent to the members;

(iii) **Notice containing the particular:** the notice of the meeting shall clearly state -

(a) that the company is providing facility for voting by electronic means and the business may be transacted through such voting;

(b) that the facility for voting, either through electronic voting system or ballot or polling paper shall also be made available at the meeting and members attending the meeting who have not already cast their vote by remote e-voting shall be able to exercise their right at the meeting;

(c) that the members who have cast their vote by remote c-voting prior to the meeting may also attend the meeting but shall not been titled to cast their vote again;

(iv) the notice shall:

(a) indicate the process and manner for voting by electronic means;

(b) indicate the time schedule including the time period during which the votes may be cast by remote e-voting;

(c) provide the details about the login ID;

(d) specify the process and manner for generating or receiving the password and for casting of vote in a secure manner.

(v) Publication of notice: the company shall cause a public notice by way of an **advertisement** to be published, immediately on completion of dispatch of notices for the meeting under clause (i) of sub-rule (4) but at least twenty-one days before the date of general meeting, at least once in a vernacular **newspaper** in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having country-wide circulation, and specifying in the said advertisement, inter alia, the following matters, namely:-

(a) statement that the business may be transacted through voting by electronic means;

(b) the date and time of commencement of remote e-voting;

(c) the date and time of end of remote e-voting;

(d) cut-off date;

(e) the manner in which persons who have acquired shares and become members of the company after the dispatch of notice may obtain the login JD and password;

(f) the statement that-

(A) remote e-voting shall not be allowed beyond the said date and time;

(B) the manner in which the company shall provide for voting by members present at the meeting; and

(C) a member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again in the meeting; and

(D) a person whose name is recorded in the register of members or in the register of beneficial owners maintained by the depositories as on the cut-off date only shall be entitled to avail the facility of remote e-voting as well as voting in the general meeting;

(g) website address of the company, if any, and of the agency where notice of the meeting is displayed; and

(h) name, designation, address, email id and phone number of the person responsible to address the grievances connected with facility for voting by electronic means:

Provided that the public notice shall be placed on the website of the company, if any, and of the agency;

(vi) **Time for opening of e-voting:** the facility for remote e-voting shall remain open for **not less than three days** and shall close at **5.00 p.m.** on the **date preceding the date of the general meeting**;

(vii) **Option for remote e-voting:** During the period when facility for remote e-voting is provided, the members of the company, holding shares either in physical form or in dematerialized form, as on the cut-off date, may opt for remote e-voting:

Provided that once the vote on a resolution is cast by the member, he shall not be allowed to change it subsequently or cast the vote again:

Provided further that a member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again;

(viii) At the end of the remote e-voting period, **the facility shall forthwith be blocked**:

Provided that if a company opts to provide the same electronic voting system as used during remote e-voting during the general meeting, the said facility shall be in operation till all the resolutions are considered and voted upon in the meeting and may be used for voting only by the members attending the meeting and who have not exercised their right to vote through remote e-voting.

(ix) **Appointment of scrutinizer:** The Board of Directors shall appoint one or more scrutinizer, who may be Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an Advocate, or any other person who is not in employment of the company and is a person

of repute who, in the opinion of the Board can scrutinize the voting and remote e-voting process in a fair and transparent manner:

Provided that the scrutinizer so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the electronic voting system;

(x) **Function of scrutinizer:** the scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority;

(xi) **Role of Chairman:** The Chairman shall, at the general meeting, at the end of discussion on the resolutions on which voting is to be held, allow voting, as provided in clauses (a) to (h) of sub-rule (1) of rule 21, as applicable, with the assistance of scrutinizer, by use of ballot or polling paper or by using an electronic voting system for all those members who are present at the general meeting but have not cast their votes by availing the remote e-voting facility.

(xii) **Counting of votes:** The scrutinizer shall, immediately after the conclusion of voting at the general meeting, first count the votes cast at the meeting, thereafter unblock the votes cast through remote e-voting in the presence of at least two witnesses not in the employment of the company and make, not later than three days of conclusion of the meeting, a consolidated scrutinizer's report of the total votes cast in favour or against, if any, to the Chairman or a person authorized by him in writing who shall countersign the same:

Provided that the Chairman or a person authorized by him in writing shall declare the result of the voting forthwith;

Explanation: It is hereby clarified that the manner in which members have cast their votes, that is, affirming or negating the resolution, shall remain secret and not available to the Chairman, Scrutiniser or any other person till the votes are cast in the meeting.

(xiii) **Access to details:** For the purpose of ensuring that members who have cast their votes through remote e-voting do not vote again at the general meeting, the scrutiniser shall have access, after the closure of period for remote e-voting and before the start of general meeting, to details relating to members, such as their names, folios, number of shares held and such other information that the scrutiniser may require, who have cast votes through remote e-voting but not the manner in which they have cast their votes:

(xiv) Maintenance of Register: The scrutiniser shall maintain a register either manually or electronically to record the assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the members, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights;

(xv) Safe Custody of register: The register and all other papers relating to voting by electronic means shall remain in the safe custody of the scrutiniser until the Chairman considers, approves and signs the minutes and thereafter, the scrutiniser shall hand over the register and other related papers to the company.

(xvi) Result on websites: The results declared along with the report of the scrutiniser shall be placed on the website of the company, if any, and on the website of the agency immediately after the result is declared by the Chairman:

Provided that in case of companies whose equity shares are listed on a recognised stock exchange, the company shall, simultaneously, forward the results to the concerned stock exchange or exchanges where its equity shares are listed and such stock exchange or exchanges shall place the results on its or their website.

(xvii) Passing of date of resolution: Subject to receipt of requisite number of votes, the resolution shall be deemed to be passed on the date of the relevant general meeting.

Explanation: For the purposes of this clause, the requisite number of votes shall be the votes required to pass the resolution as the 'ordinary resolution' or the 'special resolution', as the case may be, under section 114 of the Act.

(xviii) Resolution not to be withdrawn: a resolution proposed to be considered through voting by electronic means shall not be withdrawn.

DEMAND FOR POLL [SECTION 109][14]

The section discusses four things –

- Who can demand poll at the meeting;

[14] In case of Specified IFSC Public Company - Section 109 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. *Notification Date 4th January, 2017*

- What should be the time for taking the poll;
- Appointment of Scrutinizer for poll; and
- Manner of taking poll and result thereof.

♦ Section 109 provides that before or on declaration of result of the voting on any resolution by a show of hands, the Chairman of the meeting on his own, or on demand made by the 'specified' members order for a poll.

Members who can demand for poll –

- In case of a company having a **share capital**, by the members present in person or proxy, where allowed, and having not less than **1/10th of the total voting power** or **holding shares** on which an aggregate sum of **not less than ₹ 5,00,000** or such **higher** amount has been prescribed has been paid – up.
- In the case of **any other company**, by any member or members present in person or by proxy, where allowed, and having **not less than 1/10th of the total voting power**.

♦ The section further provides that the demand for poll may be withdrawn by the persons who made the demand, at any time.

♦ A poll demanded for adjournment of the meeting or appointment of Chairman of the meeting shall be taken forthwith.

♦ A poll demanded on any question other than adjournment of the meeting or appointment of Chairman shall be taken at such time, not being later than **48 hours** from the time when the demand was made, as the Chairman of the meeting may direct.

♦ Where a poll is to be taken, the Chairman of the meeting shall appoint a scrutinizer for observing the poll process and votes given on poll and to report thereon.

♦ The results of the poll shall be deemed to be the decision of the meeting on the resolution.

♦ The Chairman shall regulate the manner in which the poll shall be taken at the meeting and appoint such number of scrutinizers as may be necessary. Rule 21 lays down the manner in which the poll process shall be scrutinized.

♦ The duties of a scrutinizer shall be as follows–

- To ensure proper conduct of the polling process;

- To maintain proper records of the poll;
- To submit a report to the Chairman of the meeting which shall contain the details of votes cast in the favour and against the resolution; and
- To ensure that the compliance of the provisions of section 109 and Rule 21.
- The scrutinizer shall give a report to the Chairman in Form MGT -13 as per Rule 21 of the *Companies (Management & Administration) Rules, 2014*.
- The procedure describing the manner in which the Chairman shall get the poll process scrutinized in Rule 21 is as follows –
- The Chairman of the meeting shall ensure that –
    - ❖ The Scrutinizers are provided with the Register of Members, specimen signatures of the members, Attendance Register and Register of Proxies.
    - ❖ The Scrutinizers are provided with all the documents received by the Company pursuant to sections 105, 112 and section 113.
    - ❖ The Scrutinizers shall arrange for Polling papers and distribute them to the members and proxies present at the meeting; in case of joint shareholders, the polling paper shall be given to the first named holder or in his absence to the joint holder attending the meeting as appearing in the chronological order in the folio and the Polling paper shall be in Form No. MGT.12.
    - ❖ The Scrutinizers shall keep a record of the polling papers received in response to poll, by initialling it.
    - ❖ The Scrutinizers shall lock and seal an empty polling box in the presence of the members and proxies.
    - ❖ The Scrutinizers shall open the Polling box in the presence of two persons as witnesses after the voting process is over.
    - ❖ In case of ambiguity about the validity of a proxy, the Scrutinizers shall decide the validity in consultation with the Chairman.
    - ❖ The Scrutinizers shall ensure that if a member who has appointed a proxy has voted in person, the proxy's vote shall be disregarded.

- ❖ The Scrutinizers shall count the votes cast on poll and prepare a report thereon addressed to the Chairman.
- ❖ Where voting is conducted by electronic means under the provisions of section 108 and rules made thereunder, the company shall provide all the necessary support, technical and otherwise, to the Scrutinizers in orderly conduct of the voting and counting the result thereof.
- ❖ The Scrutinizers' report shall state total votes cast, valid votes, votes in favour and against the resolution including the details of invalid polling papers and votes comprised therein.
- ❖ The Scrutinizers shall submit the Report to the Chairman who shall counter-sign the same.
- ❖ The Chairman shall declare the result of Voting on poll. The result may either be announced by him or a person authorized by him in writing.

- The scrutinizers appointed for the poll, shall submit a report to the Chairman of the meeting in Form No. MGT.13 and the report shall be signed by the scrutinizer and, in case there is more than one scrutinizer by all the scrutinizer, and the same shall be submitted by them to the Chairman of the meeting within seven days from the date the poll is taken.

Applicability of section 109 to Private companies- Section 109 shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise. *Notification dated 5th June, 2015*.

This exception shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 of the Act, with the Registrar. *Notification dated 13th June 2017*.

POSTAL BALLOT [SECTION 110]

Shareholders who are unable to attend the meetings, there should a requirement which will enable them to vote by postal ballot for key decisions[15].

Extract of the Act

"(1) Notwithstanding anything contained in this Act, a company—

[15] Page 1765 of Chapter VII of Ramaiya's Companies Act, 2013.

(a) shall, in respect of such items of business as the Central Government may, by notification, declare to be transacted only by means of postal ballot; and

(b) may, in respect of any item of business, other than ordinary business and any business in respect of which directors or auditors have a right to be heard at any meeting, transact by means of postal ballot.

In such manner as may be prescribed, instead of transacting such business at a general meeting.

Provided that any item of business required to be transacted by means of postal ballot under clause (a), may be transacted at a general meeting by a company which is required to provide the facility to members to vote by electronic means under section 108, in the manner provided in that section.

(2) If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf."

- The section seeks to provide that the Central Government may declare items of business that can be transacted only by postal ballot and also in respect of any item of business, other than ordinary business and any business in respect of which directors or auditors have a right to be heard at any meeting.
- Only those assents/ dissents are to be considered which have been sent by the members within 30 days as prescribed in Rule 22. Sub-section (2) of Section 110 makes a deeming provision that if a resolution is assented by requisite majority of shareholders by means of postal ballot, it shall be deemed to have been passed at a general meeting convened in that behalf.
- Manner in which postal ballot shall be conducted is prescribed in Rule 22 of the *Companies (Management & Administration) Rules, 2014*. The same is described as follows–
  - Where a company is required or decides to pass any resolution by way of postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor and requesting them to send their assent or dissent in writing on a postal ballot because postal ballot means voting by post or through electronic means within a period of thirty days from the date of dispatch of the notice.
  - The notice shall be sent either
    (a) by Registered Post or speed post, or

(b) through electronic means like registered e-mail id or

(c) through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days.

- An advertisement shall be published at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, about having dispatched the ballot papers and specifying therein, *inter alia*, the following matters, namely:-

  (a) a statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;

  (b) the date of completion of dispatch of notices;

  (c) the date of commencement of voting;

  (d) the date of end of voting;

  (e) the statement that any postal ballot received from the member beyond the said date will not be valid and voting whether by post or by electronic means shall not be allowed beyond the said date;

  (f) a statement to the effect that members, who have not received postal ballot forms may apply to the company and obtain a duplicate thereof; and

  (g) contact details of the person responsible to address the grievances connected with the voting by postal ballot including voting by electronic means.

- The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.

- The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting process in a fair and transparent manner.

- The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.
- Postal ballot received back from the shareholders shall be kept in the **safe custody of the scrutinizer** and after the receipt of assent or dissent of the shareholder in writing on a postal ballot, **no person shall deface or destroy the ballot paper** or **declare the identity of the shareholder**.
- The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof;
- The scrutinizer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the shareholder, number of shares held by them, nominal value of such shares, whether the shares have differential voting rights, if any, details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.
- The postal ballot and all other papers relating to postal ballot including voting by electronic means, shall be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall return the ballot papers and other related papers or register to the company who shall **preserve such ballot papers** and other related papers or register safely.
- The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received.
- The results shall be declared by placing it, **along with the scrutinizer's report, on the website of the company**.
- The provisions of rule 20 regarding voting by electronic means shall apply, as far as applicable, *mutatis mutandis* to this rule in respect of the voting by electronic means.
- pursuant to clause (a) of sub-section (1) of section 110, the following items of business shall be transacted only by means of voting through a postal ballot—

  (a) **alteration of the objects clause** of the memorandum and in the case of the company in existence immediately before the

commencement of the Act, alteration of the main objects of the memorandum;

(b) **alteration of articles of association** in relation to insertion or removal of provisions which, under **sub-section (68) of section 2**, are required to be included in the articles of a company in order to constitute it a private company;

(c) **change in place of registered office outside the local limits** of any city, town or village as specified in sub-section (5) of section 12;

(d) **change in objects** for which a company has **raised money** from public through prospectus and still has any unutilized amount out of the money so raised under sub-section (8) of section 13;

(e) **issue of shares with differential rights** as to voting or dividend or otherwise under sub-clause (ii) of clause (a) of section 43;

(f) **variation in the rights** attached to a class of shares or debentures or other securities as specified under section 48;

(g) **buy-back of shares** by a company under sub-section (1) of section 68;

(h) **election of a director** under section **151** of the Act;

(i) **sale** of the **whole** or substantially the whole of an **undertaking** of a company as specified under sub-clause (a) of sub-section (1) of section 180;

(j) **giving loans** or **extending guarantee** or **providing security** in excess of the limit specified under sub-section (3) of section **186**:

Provided that any aforesaid items of business under this sub-rule, required to be transacted by means of postal ballot, **may be transacted at a general meeting** by a company which is required to provide the facility to members to vote by electronic means under section 108, in the manner provided in that section

Provided further that **One Person Companies** and other companies having members upto **two hundred** are **not required to transact any business through postal ballot.**

Example

How does the counting happen at the time of postal ballot?

It is important to know here that, a member who is voting by way of postal ballot, has votes in proportion to his share in the paid-up share capital of the company. And in this regard, he need not use all his votes not does he need to use all his votes in the same way. Therefore, 4 types of ballots may be received from the shareholders–

(i) Ballots which contain assents;

(ii) Ballots which contain dissents;

(iii) Ballots wherein the member has voted partially assenting, partially dissenting or using not all his shares in any particular way; and

(iv) Invalid ballots (due to absence/ mismatch of signature, overwriting, etc)

7. CIRCULATION OF MEMBER'S RESOLUTIONS [SECTION 111]

Circulation of members' resolution and statements: Students should carefully note the circumstances in which the members can make use of the administrative machinery of a company for introducing resolutions for consideration at next annual general meeting or for circulation of statements in regard to any resolution to be proposed at an extraordinary general meeting or business to be dealt with at any general meeting. Such circumstances are stated below:

(1) **Notice to members:** As per section 111 of the Companies Act, 2013, a company shall, on requisition in writing of such number of members, as required in section 100(Calling of EGM), give notice to members of any resolution which may properly be moved and is intended to be moved at a meeting; and circulate to members any statement with respect to the matters referred to in proposed resolution or business to be dealt with at that meeting.

(2) **Exemption from serving notice:** A company shall not be bound under this section to give notice of any resolution or to circulate any statement, unless-

(a) a copy of the requisition signed by the requisitionists (or two or more copies which, between them, contain the signatures of all the

requisitionists) is deposited at the registered office of the company,- (i) in the case of a requisition requiring notice of a resolution, not less than six weeks before the meeting; (ii) in the case of any other requisition, not less than two weeks before the meeting; and

(b) there is deposited or tendered with the requisition, a sum reasonably sufficient to meet the company's expenses in giving effect thereto.

Where however, after a copy of a requisition requiring notice of a resolution has been deposited at the registered office of the company, an annual general meeting is called on a date within six weeks after the copy has been deposited, the copy, although not deposited within the time required by this subsection, shall be deemed to have been properly deposited for the purposes thereof.

(3) **Exception from circulation of any statement:** The company shall not be bound to circulate any statement, if on the application either on behalf of the company or of any other person who claims to be aggrieved, then the [16]Central Government, by order, declares that the rights conferred are being abused to secure needless publicity for defamatory matter.

(4) **Order to bear the cost:** An order made may also direct that the cost incurred by the company shall be paid to the company by the requisitionists, notwithstanding that they are not parties to the application.

(5) **Default in contravention of the provision:** If any default is made in complying with the provisions of this section, the company and every officer of the company who is in default shall be liable to a penalty of twenty-five thousand rupees.

8. REPRESENTATION OF THE PRESIDENT & GOVERNORS IN MEETING OF COMPANIES TO WHICH THEY ARE MEMBER [SECTION 112]

Section 112 of the Companies Act, 2013 provides that the President of India or the Governor of a State, if he is a member of a company, may appoint such person as he thinks fit to act as his representative at any meeting and such other person shall

[16] The Power of the Central Government has been delegated to Regional Director. *MCA Notification 4090 (E) dated 19th December, 2016.*

be entitled to exercise the same rights and powers including the right to vote to proxy and postal ballot, as the President or, as the case may be, the Governor could exercise as a member of the company.

9. REPRESENTATIONS OF CORPORATIONS MEETING OF COMPANIES AND CREDITORS [SECTION 113]

Section 113 of the Companies Act, 2013 seeks to provide that where a body corporate is member or creditor of the company, they may authorize a person to act as its representative in the meeting of the company. The provision is as under-

(1) **Appointment of representative by a body corporate:** A body corporate, whether a company within the meaning of this Act or not, may-

(a) **if it is a member of company-**by resolution of its Board of Directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of the company, or at any meeting of any class of members of the company;

(b) **if it is a creditor, including a holder of debentures,** of a company-, by resolution of its directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of any creditors of the company held in pursuance of this Act or of any rules made thereunder, or in pursuance of the provisions contained in any debenture or trust deed, as the case may be.

(2) **Powers and rights of an authorised person:** A person authorised by resolution as above, shall be entitled to exercise the same rights and powers, including the right to vote by proxy and by postal ballot, on behalf of the body corporate which he represents as that body could exercise if it were an individual member, creditor or holder of debentures of the company.

10. RESOLUTIONS [SECTION 114–117]

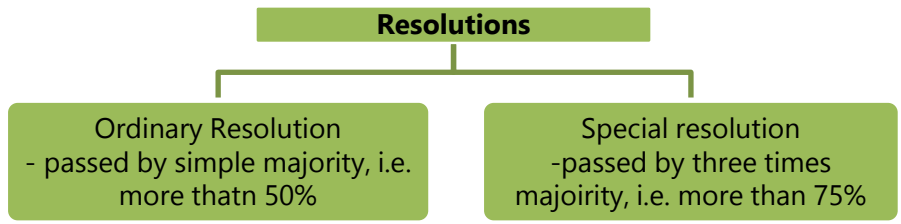
In lay man's language, a resolution is the formal decision of an organization while transacting a business at a meeting. A motion which has obtained the necessary majority vote in favour becomes a resolution. So, in effect there is a difference between the two–Motion and Resolution.

Difference between Motion & Resolution—

- Most matters come before a meeting by way of a motion recommending that the meeting may express approval or disapproval or take certain action or order something to be done.
- A motion is a proposal, and a resolution is the adoption of a motion duly made and seconded. But every motion need not be followed by a resolution, as where a motion is made for the adjournment of the meeting.
- A motion whether it is passed for the closure of discussion or adjournment, etc. can be passed by an ordinary resolution unless there is a specific provisions in the articles.

As per the Companies Act, 2013, resolutions are of two types–

- Ordinary Resolutions – which are passed by simple majority; and
- Special Resolutions – which are passed by 75% majority.



SECTION 114–ORDINARY & SPECIAL RESOLUTION:

The section seeks to provide that a resolution shall be an ordinary resolution if the votes cast in the favour of the resolution exceeds the votes, if any, cast against the resolution by the members.

Ordinary Resolution—

Section 114(1) states that a resolution shall be ordinary resolution, if the notice required under this Act has been duly given and it is required to be passed by the votes cast, whether on a show of hands, or electronically or on a poll, as the case may be, in favour of the resolution, including the casting vote of the Chairman, if any, of the Chairman, by members, who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, exceed the votes, if any cast against the resolution by members, so entitled and voting.

Simply put, the votes cast in the favour of the resolution, by any mode of voting should exceed the votes cast against it.

Special Resolution—

As per Section 114(2) of the Act, a resolution shall be a special resolution, when–

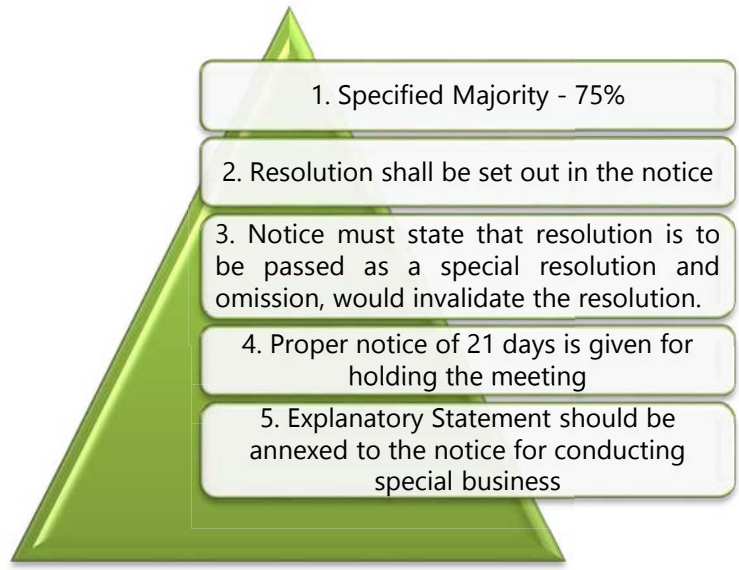
(a) The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members of the resolution;

(b) The notice required under this Act has been duly given; and

(c) The votes cast in favour of the resolution, whether on a show of hands, or electronically or on a poll, as the case may be, in favour of the resolution, including the casting vote of the Chairman, if any, of the Chairman, by members, who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, are required to be not less than 3 times the number of the votes, if any, cast against the resolution by members so entitled and voting.

In simple words, a resolution shall be a special resolution, when it is duly specified in the notice, calling the general meeting and votes cast in favour is 3 times the votes cast against the resolution.

Characteristics of Special Resolution—



Now, how will one know that a section of the Act requires the passing of an ordinary resolution or special resolution? Where it is provided that "*the company in general meeting may*" do some act, this means that an ordinary resolution is required to be passed. On the other hand, a special resolution is one which has been passed by a

majority of not less than 3/4ths of such members as, being entitled so to do, vote in person or by proxy at a general meeting of which notice specifying the intention to propose the resolution as a special resolution has been duly given.

Difference between Ordinary Business, Special Business and Ordinary Resolution & Special Resolution–

After studying the above concepts, it is quite common to get confused between the terms. Generally, the people think that a "special business" can only be transacted by means of a "special resolution", which is a misapprehension. A special resolution is required for transacting business only where it is specifically so required by the Act. All other business can be transacted by an ordinary resolution.

Example

In the annual general meeting of Black Mango Limited, the notice contained the agenda for 8 special businesses to be transacted. The Chairman decided to move all the resolutions at one time in order to save time of the members present at the meeting. Discuss whether two or more resolutions can be moved together as per the provisions of the Companies Act, 2013.

For the sake of avoiding confusion and mixing up, the resolutions are moved separately. However, there is nothing illegal if the Chairman of the meeting desires that two or more resolutions should be moved together, unless any member requires that each resolution should be put to vote separately or unless a poll is demanded in respect of any.

The only case where a resolution should be moved separately is the one which requires that as regards the appointment of directors at a general meeting of a public or private company, where two or more directors may not be appointed as directors by a single resolution.

Where notice has been given of several resolutions, each resolution must, be put separately. However, if the meeting unanimously adopts all the resolutions, this would not be material.

RESOLUTIONS REQUIRING SPECIAL NOTICE [SECTION 115]

Section 115 of the Companies Act, 2013 states that where any provision of this Act specifically requires or Articles of Association of a company so require that a special notice is required for passing any resolution, then the notice of the intention to move such resolution shall be given to the company by such number of members holding not less than 1% of the total voting power, or holding shares on which such aggregate sum not exceeding five lakh rupees, as may be prescribed, has been

paid-up. In such a case, the company shall give its members notice of the resolution in the manner as prescribed in *Rule 22 of the Companies (Management & Administration) Rules, 2014*.

As per section 115 of the Act, **special notice is required in the following cases** –

(a) To appoint as auditor a person other than a retiring auditor (Section 140 of the Act);

(b) To stand for directorship by a person other than retiring director 14 days' notice is required under section 160(1) of the Act;

(c) To remove a director under section 169(2) or to appoint a person to fill the vacancy caused by the dismissal of a director under section 169 at the same meeting.

Rule 23–Special Notice—

1. A special notice required to be given to the company shall be signed, either individually or collectively by such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than 5,00,000 rupees has been paid up on the date of the notice.

2. The afore-mentioned notice shall be sent by members to the company not earlier than 3 months but at least 14 days before the date of meeting at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.

3. The company shall immediately after receipt of the notice, give its members notice of the resolution at least seven days before the meeting, exclusive of the day of dispatch of notice and day of the meeting, in the same manner as it gives notice of any general meetings.

4. Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered office of the Company is situated and such notice shall also be posted on the website, if any, of the Company.

5. The notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.

RESOLUTIONS PASSED AT ADJOURNED MEETING [SECTION 116]

The section simply states that where a resolution is passed at an adjourned meeting of–

- A company; or
- The holder of any class of shares in a company; or
- The Board of Directors of a company,

And states that if a meeting is adjourned then the date of passing of the resolution shall be the date on which it is actually passed and not an earlier date.

Example

The extra-ordinary general meeting of the company, Purple Banana Private Limited was due to be held on 23rd September 2016. However, due to want of quorum, the meeting was adjourned to a later date on 1st October 2016 and two resolutions were passed on that date. Now, as per section 116 of the Companies Act, 2013, the said two resolutions shall be deemed to have been passed on the original date of meeting, i.e. 1st October 2016 and not on the earlier date.

RESOLUTIONS AND AGREEMENTS TO BE FILED [SECTION 117]

Section 117 of the Companies Act, 2013 talks about the resolutions and agreements which are to be filed with the Registrar of Companies, together with the explanatory statement, within 30 days of its passing.

Extract of Act [Section 117(1)][17]& [18]

"A copy of every resolution or any agreement, in respect of matters specified in sub-section (3) together with the explanatory statement under section 102, if any, annexed to the notice calling the meeting in which the resolution is proposed, shall be filed with the Registrar within thirty days of the passing or making thereof in such manner and with such fees as may be prescribed:

Provided that the copy of every resolution which has the effect of altering the articles and the copy of every agreement referred to in sub-section (3) shall be embodied in or annexed to every copy of the articles issued after passing of the resolution or making of the agreement."

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[17] In case of Specified IFSC Public Company - Sub-section (1) of section 117, for the words "thirty days" read as "sixty days". *Notification Dated 4th January, 2017*.

[18] In case of Specified IFSC Private Company - Sub-section (1) of section 117, for the words "thirty days" read as "sixty days". *Notification Dated 4th January, 2017*

Section 117(3) states that the following resolutions and agreements shall be filed with the RoC in Form MGT – 14 within 30 days of its passing –

- Special Resolutions
- Resolutions which have been agreed to by all the members of a company, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions;
- Any resolution of the Board of Directors of a company or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;
- Resolutions or agreements which have been agreed to by any class of members but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a specified majority or otherwise in some particular manner; and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members.
- Resolutions requiring a company to be wound up voluntarily passed in pursuance of section 59 of the Insolvency and Bankruptcy Code, 2016.
- [19] & [20]Resolutions passed in pursuance of sub-section (3) of section 179.

  Provided that no person shall be entitled under section 399 to inspect or obtain copies of such resolutions;

  Provided further that nothing contained in this clause shall apply to a banking company in respect of a resolution passed to grant loans, or give guarantee or provide security in respect of loans under clause (f) of sub-section (3) of section 179 in the ordinary course of its business; and
- any other resolution or agreement as may be prescribed and placed in the public domain.

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[19] In case of private company - clause (g) of Sub-section 3 of Section 117 shall not apply. *Notification dated 5th June, 2015*.
The above mentioned exemption shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar- *Notification dated 13th June, 2017*.
[20] In case of Specified IFSC Public Company - Clause (g) of sub-section (3) of section 117 shall not apply. *Notification Dated 4th January, 2017*.

Penalty under the Act-

Section 117(2) sets out the penalty in case of failure to intimate RoC about the resolutions and agreements that are required to be filed within the time specified therein and states that such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of twenty-five lakh rupees and every officer of the company who is in default including liquidator of the company, if any, shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees.

11. MINUTES (SECTION 118)

Section 118 prescribes that Every company shall cause minutes of the proceedings of every general meeting of any class of shareholders or creditors, and every resolution passed by postal ballot and every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in such manner as may be prescribed and kept within 30 days of the conclusion of every such meeting concerned, or passing of resolution by postal ballot in books kept for that purpose with their pages consecutively numbered. [Sub section (1)][21] & [22]

- The minutes shall be prepared as prescribed in Rule 25 of the *Companies (Management and Administration) Rules, 2014*
- The minute book shall be consecutively numbered.

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[21] In case of Specified IFSC Public Company - In Sub-section (1) of section 118, the following proviso shall be inserted, namely:-
"Provided that in case of a Specified IFSC public company, the minutes of every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in the manner as may be prescribed under sub section (1) at or before the next Board or committee meeting, as the case may be and kept in books kept for that purpose.".- *Notification Date 4th January, 2017*

[22] In case of Specified IFSC Private Company - In Sub-section (1) of section 118, the following proviso shall be inserted, namely:-
"Provided that in case of a Specified IFSC private company, the minutes of every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in the manner as may be prescribed under sub section (1) at or before the next Board or committee meeting, as the case may be and kept in books kept for that purpose.".- *Notification Date 4th January, 2017*

- The minutes of each meeting shall contain a fair and correct summary of the proceedings that took place at the concerned meeting.
- All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.
- In the case of a Board Meeting or a meeting of a committee of the Board, the minutes shall also contain–
  - The names of the directors present at the meeting; and
  - In the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.
- Any of the following matter shall not be included in the minutes of the meeting, which in the opinion of the Chairman of the meeting–
  - Is or could reasonably be regarded as defamatory of any person; or
  - Is irrelevant or immaterial to the proceedings; or
  - Is detrimental to the interests of the company.
- The matter to be included or excluded in the minutes of the meetings shall be at the absolute discretion of the Chairman of the meeting.
- The minutes kept in accordance with the provisions shall serve as the evidence of the proceedings therein.
- Where the minutes have been kept in accordance with this section, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and the resolutions passed by postal ballot to have been duly passed and in particular, all appointments of directors, key managerial personnel, auditors or company secretary in practice, shall be deemed to be valid.
- No document, purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters requires by this section to be contained in the minutes of the proceedings of such meeting.
- Every company shall observe Secretarial Standards with respect to general and Board meetings, specified by the Institute of Company Secretaries of

India and approved as such by the Central Government.[23 & 24] [Sub section (10)]

- Penalty for contravention–
  - If any default is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of ₹ 25,000 and every officer of the company who is in default shall be liable to a penalty of ₹ 5,000.
  - If a person is found guilty of tampering with the minutes of the proceedings of the meeting, he shall be punishable with imprisonment for a term which may extend to 2 years and with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 1,00,000.

Rule 25 of the Companies (Management & Administration) Rules, 2014 prescribes the procedure for maintenance of minutes of proceedings of general meeting, meeting of Board of Directors and other meetings and resolutions passed by postal ballot as follows–

- A distinct minute book shall be maintained for each type of meeting namely:
  (i) general meetings of the members;
  (ii) meetings of the creditors
  (iii) meetings of the Board; and
  (iv) meetings of each of the committees of the Board.
- The minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting.
- In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

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[23] In case of Specified IFSC Public Company- Sub-section (10) of section 118 Shall not apply. - Notification Date 4th January, 2017.
[24] In case of Specified IFSC Private Company- Sub-section (10) of section 118 Shall not apply. - Notification Date 4th January, 2017

- Each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed –

  (i) in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;

  (ii) in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for the purpose;

  (iii) In case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

- The minute books of general meetings, shall be kept at the registered office of the company and shall be preserved permanently and kept in the custody of the company secretary or any director duly authorised by the board.

- The minute-books of the Board and committee meetings shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as Board may decide.

Exemption to Section 8 companies: In case of Section 8 company - section 118 shall not apply as a whole except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation - *Notification dated 5th June, 2015*.

The exceptions, modifications and adaptations, shall be applicable to a section 8 company which has not committed a default in filing its financial statements under 137 or Annual Return under section 92 with the Registrar. *Notification dated 13th June, 2017*.

12. INSPECTION OF MINUTE-BOOKS OF GENERAL MEETING [SECTION 119]

How shall the inspection take place?

As per section 119 of the Companies Act, 2013, the books containing the minutes of the proceedings of any general meeting of a company shall–

- Be kept at the registered office of the company; and
- Be open for inspection, during business hours, by any member, without charge, subject to such reasonable restrictions as specified in the articles of the company or as imposed in the general meeting. However, at least 2 hour in each business day shall be allowed for inspection [Sub – Section (1)].

Any member shall be entitled to be furnished, within seven working days after he has made a request in that behalf to the company, and on payment of such fees as may be prescribed, with a copy of any minutes referred [Sub – Section (2)].

What is the penalty for contravention of the provisions of the Act? [Sub section (3)]

If any inspection under sub – section (1), is refused by the company to the member, or if the copy of minute-book is not furnished within the time specified under sub – section (2), then the company shall be liable to a penalty of ₹ 25,000 and every officer of the company who is in default shall be liable to a penalty of ₹ 5,000 for each such refusal or default as the case may be.

Power of Tribunal [Sub – Section (4)]

In the case of any such refusal or default, the Tribunal may, without prejudice to any action being taken under sub-section (3), by order, direct an immediate inspection of the minute-books or direct that the copy required shall forthwith be sent to the person requiring it.

Rule 26–Copy of minute book of general meeting–

Any member shall be entitled to be furnished, within seven working days after he has made a request in that behalf to the company, with a copy of any minutes of any general meeting, on payment of such sum as may be specified in the articles of association of the company, but not exceeding a sum of ten rupees for each page or part of any page:

Provided that a member who has made a request for provision of soft copy in respect of minutes of any previous general meetings held during a period immediately preceding three financial years shall be entitled to be furnished, with the same free of cost.

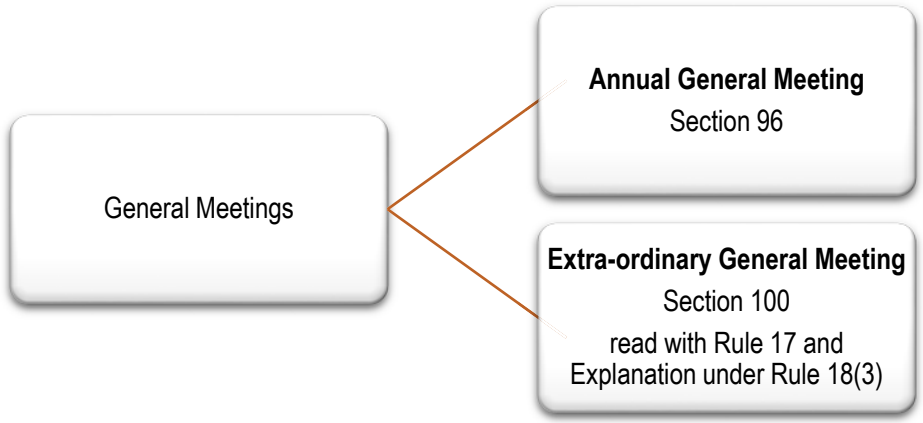
MAINTENANCE AND INSPECTION OF DOCUMENTS IN ELECTRONIC FORM [SECTION 120]

The said section seeks to provide that any document, record, register or minute, etc., required to be kept by a company or allowed to be inspected or copies given to any person by a company under this Act, may be kept or inspected or copies given, as the case may be, in electronic form in such form and manner as may be specified in *Rule 27, 28 and 29 of the Companies (Management and Administration) Rules, 2014*.

- *Rule 27 of the Companies (Management and Administration) Rules, 2014* talks about the maintenance and inspection of documents in electronic form. It states that every listed company or a company having at least 1000 shareholders, debenture-holders and other security holders, may maintain its records, as required to be maintained under the Act or rules made thereunder, in electronic form.
- *Rule 28* sets out the security of records maintained in electronic forms and mentions that the Managing Director, Company Secretary or any other director or officer of the company as the Board may decide shall be responsible for the maintenance and security of electronic records.
- *Rule 29* states that where a company maintains its records in electronic form, any duty imposed by the Act or rules made there under to make those records available for inspection or to provide copies of the whole or a part of those records, shall be construed as a duty to make the records available for inspection in electronic form or to provide copies of those records containing a clear reproduction of the whole or part thereof, as the case may be on payment of not exceeding 10 rupees per page.

13. MEETINGS

Now that we have understood the basic terms which are required to call, convene and conduct the meeting properly, let us discuss the provisions related to meetings given in the Companies Act, 2013. The Act describes two types of general meeting to be held in a company which are–



SECTION 96–ANNUAL GENERAL MEETING ('AGM')

- Section 96(1) of the Companies Act, 2013 states that every company, whether public or private, except One Person Company, shall hold an annual general meeting every year and that the gap between two AGMs shall not be more than 15 months.
- The company shall specify the meeting as such [i.e. as AGM] in the notices calling it.
- In case of the First AGM of a company, it shall be held within a period of 9 months from the date of closing of the 1st financial year (i.e. April to March next year).
- In any other case, AGM shall be held within a period of 6 months from the date of closing of its financial year.
- The section further states that where a company holds its first AGM as aforesaid, it shall not be necessary for the company to hold any AGM in the year of its incorporation.
- Moreover, the Registrar may grant an extension by 3 months, for holding the AGM to any company for special reasons, except in the case of first AGM of the company.

Example

1. Abbeys Private Limited closed its financial year on 31st March 2018. According to section 96(1) of the Act, the Company should hold its annual general meeting for the year 2017-18 by 30th September 2018 unless an extension is granted by RoC on special reasons.

2. Abbyrush Limited was incorporated on 11th December 2016. When should the company hold its AGM?

According to section 96(1), the company's financial year will close on 31st March 2017. The company may hold its first AGM by 31st December 2017, i.e. within 9 months of the close of its financial year, unless an extension of maximum 3 months is granted by RoC to hold the AGM.

- Section 96(2) states Every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate:
- Provided that annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance:

  Provided further that the Central Government may exempt any company from the provisions of this sub-section subject to such conditions as it may impose.
- Explanation—For the purposes of this sub-section, "National Holiday" means and includes a day declared as National Holiday by the Central Government.

Exemption to Section 8 companies:

In case of Section 8 company- In Sub-section (2) of Section 96 after the proviso and before the explanation the following proviso shall be inserted;

Provided further that the time, date and place of each annual general meeting are decided upon before-hand by the board of directors having regard to the directions, if any, given in this regard by the company in its general meeting. - *Notification dated 5th, June 2015.*

The above mentioned exception shall be applicable to a section 8 company which has not committed a default in filing of its financial statements under section 137 or annual return under section 92 with the Registrar. *Notification dated 13th June, 2017.*

Exemption to Government companies:

In case of Government company, section 96(2) shall be read as:

'Every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday and shall be held either at the registered office of the company or at such other place within the

city, town or village in which the registered office of the company is situate or such other place as the Central Government may approve in this behalf. *Notification dated 5th June, 2015 read with Notification Dated 13th June, 2017*

The above mentioned exception/ modification/ adaptation shall be applicable to Government company which has not committed a default in filing of its financial statements under section 137 or annual return under section 92 with the Registrar. *Notification dated 13th June, 2017'*.

- Further, section 97 mentions that the if any default is made in holding the AGM of the company under section 96, the Tribunal, i.e. National Company Law Tribunal ('NCLT' or 'the Tribunal'), may, on application of any member of the company, call or direct the calling of an AGM of the company and give such ancillary or consequential directions as the Tribunal thinks fit.
- Section 98 of the Act provides that if for any reason, it is impracticable to call a meeting of a company other than an AGM, the Tribunal shall have the power to order for calling the meeting either *suo motu* (on its own) or on the application of any director of the company or of any member of the company.

Extract of the Act

"SECTION 97: POWER OF TRIBUNAL TO CALL ANNUAL GENERAL MEETING

(1) If any default is made in holding the annual general meeting of a company under section 96, the Tribunal may, notwithstanding anything contained in this Act or the articles of the company, on the application of any member of the company, call, or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient:

Provided that such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(2) A general meeting held in pursuance of sub-section (1) shall, subject to any directions of the Tribunal, be deemed to be an annual general meeting of the company under this Act.

SECTION 98: POWER OF TRIBUNAL TO CALL MEETINGS OF MEMBERS, ETC

(1) If for any reason it is impracticable to call a meeting of a company, other than an annual general meeting, in any manner in which meetings of the company may be called, or to hold or conduct the meeting of the company in the manner prescribed by this Act or the articles of the company, the Tribunal

may, either suomotu or on the application of any director or member of the company who would be entitled to vote at the meeting,—

(a) order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and

(b) give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company:

Provided that such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(2) Any meeting called, held and conducted in accordance with any order made under sub-section (1) shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted."

Punishment for default in complying with the provisions of section 96 to 98–

Section 99 lists out the punishment for contravention of section 96 to 98, i.e. default in holding a meeting of the company as AGM or on the directions issued by the Tribunal. It states that the company and every officer of the company who is in default, shall be punishable with fine which may extend to ₹ 1,00,000 and in the case of a continuing default, with a further fine which may extend to ₹ 5,000 for every day during which the default continues.

SECTION 121: REPORT ON ANNUAL GENERAL MEETING

This section is applicable to listed public companies and states that they shall prepare a report in the Form MGT – 15 as prescribed in Rule 31 of the *Companies (Management and Administration) Rules, 2014,* on each AGM including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of this Act and the rules made thereunder.

- The company shall file with the Registrar a copy of the report referred to in sub-section (1) within 30 days of the conclusion of the annual general meeting with such fees as may be prescribed, or with such additional fees as may be prescribed.
- If the company fails to file the report under sub-section (2) before the expiry of the period specified therein, such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure

continues, subject to a maximum of five lakh rupees and every officer of the company who is in default shall be liable to a penalty which shall not be less than twenty-five thousand rupees and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of one lakh rupees.

SECTION 100: EXTRA-ORDINARY GENERAL MEETINGS

Who can call an EGM?

[25] & [26]1. **The Board** may, whenever it deems fit, call an extraordinary general meeting of the company.

Provided that an extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India;

2. **The Board shall on the requisition** of –

(a) In the case of company having a share capital, such number of members who hold, on the date of receipt of requisition, at least 1/10th of such paid-up capital of the company as on that date carries the right of voting;

(b) In the case of company not having a share capital, such number of members who hold, on the date of receipt of requisition, at least 1/10th of total voting power of all the members having on the said date a right to vote.

Call an EGM of the company within the period specified in sub-section (4).*Other provisions related to calling of meeting by requisitionists*

1. The requisition shall set out the matters for the consideration of which the meeting is to be called and shall be signed by the requisitionists and sent to the registered office of the company.

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[25] In case of Specified IFSC Private Company - In sub-section (1) of section 100, the following proviso shall be inserted, namely:-
"Provided that in case of a Specified IFSC private company, the Board may subject to the consent of all the shareholders, convene its extraordinary general meeting at any place within or outside India.".- *Notification Dated 4th January, 2017*.

[26]In case of Specified IFSC Public Company- In sub-section (1), the following proviso shall be inserted, namely:- "Provided that in case of a Specified IFSC public company, the Board may subject to the consent of all the shareholders, convene its extraordinary general meeting at any place within or outside India.". *Notification Dated 4th January, 2017*.

2. If the Board does not, within twenty-one days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than forty-five days from the date of receipt of such requisition, the meeting may be called and held by the requisitonists themselves within a period of three months from the date of the requisition. [Sub section (4)]

3. A meeting under sub-section (4) by the requisitionists shall be called and held in the same manner in which the meeting is called and held by the Board.

4. Any reasonable expenses incurred by the requisitionists in calling a meeting under sub-section (4) shall be reimbursed to the requisitionists by the company and the sums so paid shall be deducted from any fee or other remuneration under section 197 payable to such of the directors who were in default in calling the meeting.

Rule 17 of the *Companies (Management and Administration) Rules, 2014*.

Calling of Extraordinary general meeting by requistionists.

(1) The members may requisition convening of an extraordinary general meeting in accordance with sub-section (4) of section 100, by providing such requisition in writing or through electronic mode at least clear twenty-one days prior to the proposed date of such extraordinary general meeting.

(2) The notice shall specify the place, date, day and hour of the meeting and shall contain the business to be transacted at the meeting.-

Explanation.- For the purposes of this sub-rule, it is here by clarified that requistionists should convene meeting at Registered office or in the same city or town where Registered office is situated and such meeting should be convened on any day except national holiday.

(3) If the resolution is to be proposed as a special resolution, the notice shall be given as required by sub-section (2) of section 114.

(4) The notice shall be signed by all the requistionists or by a requistionists duly authorised in writing by all other requistionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.

(5) No explanatory statement as required under section 102 need be annexed to the notice of an extraordinary general meeting convened by the requistionists and the requistionists may disclose the reasons for the resolution(s) which they propose to move at the meeting.

(6) The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within three days on which the requistionists deposit with the Company a valid requisition for calling an extraordinary general meeting.

(7) Where the meeting is not convened, the requistionists shall have a right to receive list of members together with their registered address and number of shares held and the company concerned is bound to give a list of members together with their registered address made as on twenty first day from the date of receipt of valid requisition together with such changes, if any, before the expiry of the forty-five days from the date of receipt of a valid requisition.

(8) The notice of the meeting shall be given by speed post or registered post or through electronic mode. Any accidental omission to give notice to, or the non-receipt of such notice by, any member shall not invalidate the proceedings of the meeting.

Example

1. The Board of directors of Illusions Private Limited, a company registered in New Delhi, has decided to call an extra-ordinary general meeting in Madrid, Spain on 2nd October 2018. Discuss whether the general meeting can be convened on the said date.

   No, the meeting cannot be convened in the manner as stated in the facts of the question. As per *Rule 17(2) of the Companies (Management and Administration) Rules, 2014*, the requisitionists should hold the meeting in the registered office of the company or in the same city or town in which the registered office is situated and it should be a working day.

2. The members of the Blumove Peacocks Private Limited, holding 1/10th voting power of the company, requisitioned a meeting on 14th August, 2018 to the Board of Directors. However, the directors did not pay any heed to such a requisition and did not call an extra-ordinary meeting. Discuss the consequences of the contravention of the same in accordance with the Companies Act, 2013.

   Where the Board, after the receipt of the requisition, does not within 21 days call for a meeting within 45 days of the date of requisition, then the requisitionists may themselves call and convene the meeting.

14. APPLICABILITY OF THIS CHAPTER TO ONE PERSON COMPANY [SECTION 122]

(1) The section states that the provisions of section 98 and section 100 to 111 shall not apply to One Person Company.

(2) The ordinary businesses as mentioned under section 102(2)(a), which a company is required to transact at an AGM, shall be transacted in the case of One Person Company, as provided in Sub-section (3).

(3) For the purposes of section 114, any business which is required to be transacted at an annual general meeting or other general meeting of a company by means of an ordinary or special resolution, it shall be sufficient if, in case of One Person Company, the resolution is communicated by the member to the company and entered in the minutes-book required to be maintained under section 118 and signed and dated by the member and such date shall be deemed to be the date of the meeting for all the purposes under this Act.

(4) Notwithstanding anything in this Act, where there is only one director on the Board of Director of a One Person Company, any business which is required to be transacted at the meeting of the Board of Directors of a company, it shall be sufficient if, in case of such One Person Company, the resolution by such director is entered in the minutes book required to be maintained under section 118 and signed and dated by such director and such date shall be deemed to be the date of the meeting of the Board of Directors for all the purposes under this Act.

SUMMARY

- The Chapter discusses about the registers and returns to be kept and maintained by the company as per the provisions of the Companies Act, 2013 and the types of meetings to be held in accordance with the Act. It also discusses the terms relevant to properly convene and conduct the meetings.
- Section 89 states that a person holding beneficial interest in the shares of the company shall intimate the company about the fact in Form MGT–4/5, as applicable, and thereafter the company shall intimate the RoC about the interest of member within 30 days in Form MGT–6.

- Section 91 deals with the time limits within which the registers of the company is allowed to be closed and also mentions the penalty for contravention of the same. It states that the registers may be closed for a maximum of 30 days at a time and 45 days in aggregate in a year.
- Section 92 of the Act provides that the company is required to file an annual return in Form MGT – 7 to RoC after the conclusion of AGM and specifies the content to be included in the annual return.
- The annual return should be signed by a Practising Company Secretary and in specific cases, it should be certified by the Company Secretary in MGT - 8.
- Section 94 describes that the registers and returns and other documents of the company shall be kept at the registered office of company. However, they can also be kept at any other place where more than $1/10^{th}$ of the total members reside but the same should be approved by way of a special resolution.
- The Act prescribes two types of general meetings that are held within the company – Annual General Meeting as mentioned in section 96 and Extra-Ordinary General Meeting as per section 100.
- Section 96 discusses about the annual general meeting to be held in a company every year and prescribes that the AGM shall be held within 6 months from the date of the closing of the financial year and that the gap between two AGM shall not exceed 15 months.
- The AGM shall be held within the business hours and on a working day, i.e. other than National Holidays.
- Listed public companies shall file a report on AGM with the RoC in MGT–15 within 30 days of the AGM.
- Section 100 prescribes the provisions for holding the EGM and states that either the board of directors, or a requisition made to Board by a specific number of members, are authorised to call an EGM.
- Further the chapter discusses about the notice to be sent to members and others for calling the meeting and sets out the length of the notice.
- Also, the Act describes the Chairman to be appointed for the meetings and the proxies to be appointed by the member of the meeting.
- Section 121 of the Act requires a listed public company to issue a report on the AGM to be filed with the RoC within 30 days of the conclusion of the AGM.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Which one of the following required ordinary resolution?

   (a) to change the name of the company

   (b) to alter the articles of association

   (c) to reduce the share capital

   (d) to declare dividends.

2. A resolution shall be a special resolution when the votes cast in favour of the resolution by members are not less than _____the number of votes, if any, cast against the resolution.

   (a) Twice

   (b) Three times

   (c) One third

   (d) One fourth

3. Register of members, debenture holders, other security holders or copies of return may also be kept at any other place in India in which more than _____ of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company and the Registrar has been given a copy of the proposed special resolution in advance.

   (a) one-half

   (b) one-eight

   (c) one-tenth

   (d) one-third

4. The Registrar may grant an extension by _____, for holding the Annual General Meeting to any company for special reasons (except in the case of first AGM of the company).

   (a) 1 Month

   (b) 2 Months

   (c) 3 Months

(d) 6 Months

5. Every listed company shall file with the Registrar a copy of the report on each annual general meeting within _____ of the conclusion of the annual general meeting.

(a) 7 days

(b) 30 days

(c) 3 months

(d) 90 days

Answer to MCQs

1. (d) **2.** (b) **3.** (c) **4.** (c) **5.** (b)

QUESTION AND ANSWER

Question 1

In a General meeting of Alpha Limited, the chairman directed to exclude certain matters detrimental to the interest of the company from the minutes, Mukesh, a shareholder contended that the minutes of the meeting must contain fair and correct summary of the proceedings thereat. Decide, whether the contention of Mukesh is maintainable under the provisions of the Companies Act, 2013?

Answer

Under Section 118 (5) of the Companies Act, 2013, there shall not be included in the Minutes of a meeting, any matter which, in the opinion of the Chairman of the meeting:

(i) is or could reasonably be regarded as defamatory of any person;

(ii) is irrelevant or immaterial to the proceeding; or

(iii) is detrimental to the interests of the company;

Further, under section 118(6) the chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the Minutes on the grounds specified in sub-section (5) above.

Hence, in view of the above, the contention of Mukesh, a shareholder of Alpha Limited is not valid because the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes for aforesaid reasons.

Question 2

A General Meeting was scheduled to be held on 15th April, 2018 at 3.00 P.M. As per the notice the members who are unable to attend a meeting in person can appoint a proxy and the proxy forms duly filled should be sent to the company so as to reach at least 48 hours before the meeting. Mr. X, a member of the company appoints Mr. Y as his proxy and the proxy form dated 10-04-2018 was deposited by Mr. Y with the company at its registered Office on 11-04-2018. Similarly, another member Mr. W also gives two separate proxies to two individuals named Mr. M and Mr. N. In the case of Mr. M, the proxy dated 12-04-2018 was deposited with the company on the same day and the proxy form in favour of Mr. N was deposited on 14-04-2018. All the proxies viz., Y, M and N were present before the meeting.

According to the provisions of the Companies Act, 2013, who would be the persons allowed to represent at proxies for members X and W respectively?

Answer

A Proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote thereat on his behalf and in his absence. As per the provisions of Section 105 of the Companies Act, 2013, every shareholder who is entitled to attend and vote has a statutory right to appoint another person as his proxy. It is not necessary that the proxy be a member of the company. Further, any provision in the articles of association of the company requiring instrument of proxy to be lodged with the company more than 48 hours before a meeting shall have effect as if 48 hours had been specified therein. The members have a right to revoke the proxy's authority by voting himself before the proxy has voted but once the proxy has voted the member cannot retract his authority.

Where two proxy instruments by the same shareholder are lodged of in such a manner that one is lodged before and the other after the expiry of the date fixed for lodging proxies, the former will be counted.

Thus, in case of member X, the proxy Y will be permitted to vote on his behalf as form for appointing proxy was submitted within the permitted time.

However, in the case of Member W, the proxy M (and not Proxy N) will be permitted to vote as the proxy authorizing N to vote was deposited in less than 48 hours before the meeting.

Question 3

M. H. Company Limited served a notice of general meeting upon its shareholders. The notice stated that the issue of sweat equity shares would be considered at such

meeting. Mr. 'A', a shareholder of the M. H. Company Limited complains that the issue of sweat equity shares was not specified fully in the notice. Is the notice issued by M. H. Company Limited regarding issue of sweat equity shares valid according to the provisions of the Companies Act, 2013? Explain in detail.

Answer

Under section 102 (2) (b) of the Companies Act, 2013, in the case of any meeting other than an Annual General Meeting, all business transacted thereat shall be deemed to be special business.

Further under section 102 (1) a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting:

(a) the nature of concern or interest, financial or otherwise, if any, in respect of each items, of every director and the manager, if any or every other key managerial personnel and relatives of such persons; and

(b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Thus, the objection of the member is valid since the complete details about the issue of sweat equity should be sent with the notice. The notice is, therefore, not a valid notice under Section 102 of the Companies Act, 2013.

Question 4

M/s. Tulip Ltd. maintains its Register of Members at its registered office in Mumbai. A group of members residing in Kolkata want to keep the register of members at Kolkata.

(i) Explain with provisions of Companies Act, 2013, whether the company can keep the Registers and Returns at Kolkata.

(ii) Does Mr. Rich, holding 400 shares of total worth ₹ 4000 only, has the right to inspect the Register of Members?

Answer

(i) Maintenance of the Register of Members etc.: As per section 94(1) of the Companies Act, 2013, the registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company:

Provided that such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company.

So, Tulip Ltd. can also keep the registers and returns at Kolkata after compliance with the above provisions, provided more than one-tenth of the total number of members entered in the register of members reside in Kolkata.

(ii) As per section 94(2) of the Companies Act, the registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be prescribed.

Accordingly, a director Mr. Rich, who is a shareholder of the company, has a right to inspect the Register of Members during business hours without payment of any fees, as per the provisions of this section.

Question 5

Examine the validity of the following with reference to the relevant provisions of the Companies Act, 2013:

The Board of Directors of Shrey Ltd. called an extraordinary general meeting upon the requisition of members. However, the meeting was adjourned on the ground that the quorum was not present at the meeting. Advise the company.

Answer

According to section 100 (2) of the Companies Act 2013, the Board of directors must convene a general meeting upon requisition by the stipulated minimum number of members.

As per Section 103 (2) (b) of the Companies Act, 2013, if the quorum is not present within half an hour from the appointed time for holding a meeting of the company, the meeting, if called on the requisition of members, shall stand cancelled. Therefore, the meeting stands cancelled and the stand taken by the Board of Directors to adjourn it, is not proper.

Question 6

Zorab Limited served a notice of General Meeting upon its members. The notice stated that a resolution to increase the share capital of the Company would be considered at such meeting. A shareholder complained that the amount of the proposed increase was not specified in the notice. Is the notice valid?

Answer

Under section 102(2)(b) in the case of any meeting other than an AGM, all business transacted thereat shall be deemed to be special business.

Further under section 102 (1), a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting, namely:—

(a) the nature of concern or interest, financial or otherwise, if any, in respect of each items, of:

  (i) every director and the manager, if any;

  (ii) every other key managerial personnel; and

  (iii) relatives of the persons mentioned in sub-clauses (i) and (ii);

(b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 102 of the Companies Act, 2013.

Question 7

Examine the validity of the following decisions of the Board of Directors with reference of the provisions of the Companies Act, 2013.

(i) In an Annual General Meeting of a company having share capital, 80 members present in person or by proxy holding more than 1/10th of the total voting power, demanded for poll. The chairman of the meeting rejected the request on the ground that only the members present in person can demand for poll.

(ii) In an annual general meeting, during the process of poll, the members who earlier demanded for poll want to withdraw it. The chairman of the meeting

rejected the request on the ground that once poll started, it cannot be withdrawn.

Answer

Section 109 of the Companies Act, 2013 provides for the demand of poll before or on the declaration of the result of the voting on any resolution on show of hands. Accordingly, law says that:-

Before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting on his own motion, and shall be ordered to be taken by him on a demand made in that behalf:-

(a) In the case a company having a share capital, by the members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power or holding shares on which an aggregate sum of not less than five lakh rupees or such higher amount as may be prescribed has been paid-up; and

(b) in the case of any other company, by any member or members present in person or by proxy, where allowed, and having not less than one tenth of the total voting power.

Withdrawal of the demand: The demand for a poll may be withdrawn at any time by the persons who made the demand.

Hence, on the basis on the above provisions of the Companies Act, 2013:

(i) The chairman cannot reject the demand for poll subject to provision in the articles of company.

(ii) The chairman cannot reject the request of the members for withdrawing the demand of the Poll.

Question 8

Sirhj, a shareholder, gives a notice for inspecting proxies, five days before the meeting is scheduled and approaches the company two days before the scheduled meeting for inspecting the same. What is the legal position relating to his actions (as per the provisions of the Companies Act, 2013)?

Answer

Under section 105 (8) of the Companies Act, 2013 every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, shall be

entitled during the period beginning twenty-four hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at any time during the business hours of the company, provided not less than three days' notice in writing of the intention so to inspect is given to the company.

In the given case, Sirhj has given proper notice.

However, such inspection can be undertaken only during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting. So, Sirhj can undertake the inspection only during the above mentioned period and not two days prior to the meeting.

Question 9

Miraj Limited held its Annual General Meeting on September 15, 2018. The meeting was presided over by Mr. Venkat, the Chairman of the Company's Board of Directors. On September 17, 2018, Mr. Venkat, the Chairman, without signing the minutes of the meeting, left India to look after his father who fell sick in London. Referring to the provisions of the Companies Act, 2013, examine the manner in which the minutes of the above meeting are to be signed in the absence of Mr. Venkat and by whom.

Answer

Section 118 of the Companies Act, 2013 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of shareholders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. Minutes kept shall be evidence of the proceedings recorded in a meeting.

By virtue of Rule 25 of the Companies (Management and Administration) Rules 2014 read with section 118 of the Companies Act, 2013 each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by, in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Therefore, the minutes of the meeting referred to in the case given above can be signed in the absence of Mr Venkat, by any director who is authorized by the Board.

Question 10

Infotech Ltd. was incorporated on 1.4.2016. No General Meeting of the company has been held till 30.4.2018. Discuss the provisions of the Companies Act, 2013 regarding the time limit for holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting.

Answer

According to Section 96 of the Companies Act, 2013, every company shall be required to hold its first annual general meeting within a period of 9 months from the date of closing of its first financial year.

The first financial year of Infotech Ltd is for the period 1st April 2016 to 31st March 2017, the first annual general meeting (AGM) of the company should be held on or before 31st December, 2017.

The section further provides that the Registrar may, for any special reason, extend the time within which any annual general meeting, other than the first annual general meeting, shall be held, by a period not exceeding three months.

Thus, the first AGM of Infotech should have been held on or before 31st December, 2017. Further, the Registrar does not have the power to grant extension to time limit

Question 11

The Articles of Association of DJA Ltd. require the personal presence of 7 members to constitute quorum of General Meetings. The company has 965 members as on the date of meeting. The following persons were present in the extra-ordinary meeting to consider the appointment of Managing Director:

(i) A, the representative of Governor of Uttar Pradesh.

(ii) B and C, shareholders of preference shares,

(iii) D, representing Y Ltd. and Z Ltd.

(iv) E, F, G and H as proxies of shareholders.

Can it be said that the quorum was present in the meeting?

Answer

According to section 103 of the Companies Act, 2013, unless the articles of the company provide for a larger number in case of a public company, five members

personally present if the number of members as on the date of meeting is not more than one thousand, shall be the quorum.

In this case the quorum for holding a general meeting is 7 members to be personally present (higher of 5 or 7). For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Further the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as his representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. B & C have to be excluded for the purpose of quorum because they represent the preference shares and since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and therefore, they shall not have voting rights. D will have two votes for the purpose of quorum as he represents two companies 'Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

Thus, it can be said that the requirements of quorum has not been met and it shall not constitute a valid quorum for the meeting.

CHAPTER 8

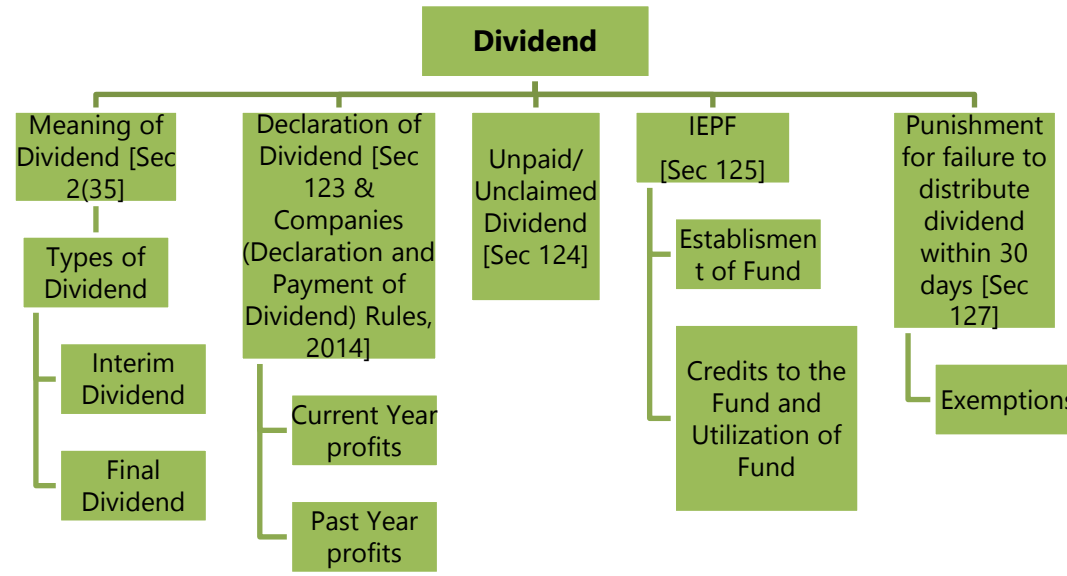
DECLARATION AND PAYMENT OF DIVIDEND

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Understand the mechanism of declaration and paying dividend and the underlying legal provisions.
- Know about the formalities which need to be fulfilled before declaring dividend in absence of profits.
- Know when the dividend will be transferred to the Investor Education and Protection Fund (IEPF).
- Analyse the consequences for failure to distribute dividend.

CHAPTER OVERVIEW



1. MEANING OF DIVIDEND

Definition

Section 2(35) of the Companies Act, 2013, while defining the term dividend simply states that "dividend" includes any interim dividend.

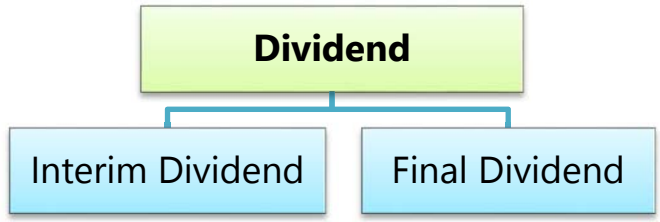
As we may understand, this definition only enlarges the scope of the term 'dividend' by including 'interim dividend' in its fold.

A dividend is a part of distributable profits whose payment is made by a company to its shareholders. In simple words, it is usually a distribution of profits *i.e.* a portion of profits earned and allocated as payable to the shareholders whenever declared.

A dividend is allocated as a fixed amount, say ₹ 5 per share or expressed as a certain percentage of face value of share, with shareholders receiving a dividend in proportion to their shareholding.

2. TYPES OF DIVIDEND

I. Dividend payable on the basis of Time (When declared)



Interim Dividend

Section 123 (3) and also section 123 (4) contain provisions regarding interim dividend. Following points are noteworthy:

- Interim dividend is declared by the Board of Directors.
- It can be declared during any financial year.
- Further, it can be declared at any time during the period from closure of the financial year till holding of the Annual General Meeting (AGM).
- The declaration of interim dividend is done out of profits before the final passing of the accounts and therefore, effectively, interim dividend is said to be declared and paid between two AGMs.
- The sources for declaring interim dividend include:
  - Surplus in the profit and loss account; or
  - Profits of the financial year in which such dividend is sought to be declared; or
  - Profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend.
- Declaration of interim dividend is regularized at the ensuing AGM by the members.
- If the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

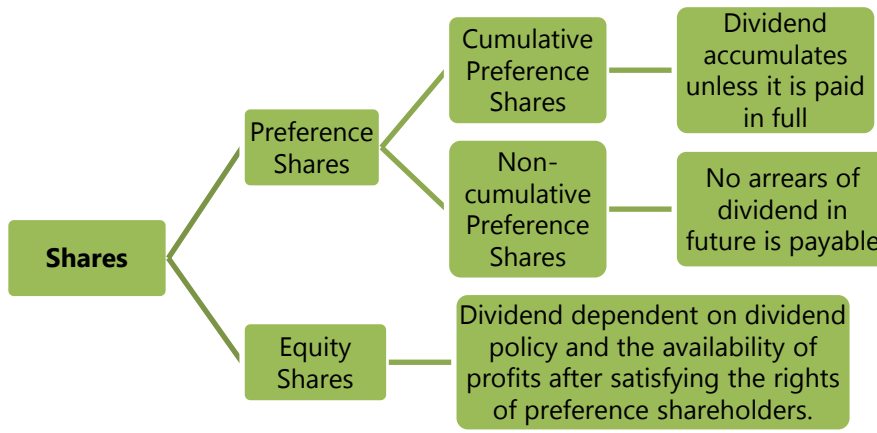
For example, if a company declared dividend at the rate of 16% during the immediately preceding three financial years, then in case the company incurs loss in the current financial year, it is permitted to declare interim dividend at a rate which is not higher than 16%.

- The amount of the dividend, including interim dividend, shall be deposited in a separate account maintained with a scheduled bank within five days from the date of declaration.
- All provisions which are applicable to the payment of dividend shall also apply in case of interim dividend.

Final Dividend

- When the dividend is declared at the Annual General Meeting of the company, it is known as 'final dividend'.
- The rate at which dividend needs to be declared and paid shall be recommended by the Board of Directors in the Directors' Report[1]. However, such rate (or a lower rate) is required to be approved by the members at the Annual General Meeting by passing an ordinary resolution since declaration of dividend is an ordinary business[2].
- The rate of dividend recommended by the Board cannot be increased by the members.

II. Dividend payable on the basis of Nature of Shares



[1] As per Section 134 (3) (k).

[2] As per section 102 (2) declaration of any dividend at the AGM is an ordinary business requiring ordinary resolution.

Shares can be classified into two categories *i.e.* preference shares and equity shares. The manner of payment of dividend is dependent upon the nature of shares.

(i) Preference Shares: According to Section 43 of the Companies Act, 2013, shareholders holding preference shares are assured of a preferential dividend at a fixed rate during the life of the company.

Dividend is generally cumulative in nature and need not be paid every year in case of deficiency of profits.

Types of Preference Shares on the basis of payment of dividend

Classification of preference shares on the basis of payment of dividend is as follows:

(a) ***Cumulative Preference Shares:*** A cumulative preference share is one that carries the right to a fixed amount of dividend or dividend at a fixed rate. Such a dividend gets accumulated and its arrears are payable from the profits earned in the later years if the profits of current year are insufficient for payment of dividend. Until and unless dividend on cumulative preference shares is paid in full, including arrears, if any, no dividend is payable on equity shares.

(b) ***Non-cumulative Preference Shares:*** A non-cumulative preference share carries with it the right to a fixed amount of dividend. In case no dividend is declared in a year due to any reason, the right to receive such dividend for that year expires. It implies that holder of such a share is not entitled to arrears of dividend in future.

(ii) Equity Shares: Equity shares are those shares, which are not preference shares. It means that they do not enjoy any preferential rights in the matter of payment of dividend or repayment of capital. The rate of dividend on equity shares is recommended by the Board of Directors and may vary from year to year. Rate of dividend depends upon the dividend policy and the availability of profits after satisfying the rights of preference shareholders.

3. PROVISIONS REGARDING DECLARATION AND PAYMENT OF DIVIDEND

A. Sources for Declaration of Dividend

According to Section 123 (1), the dividend for any financial year shall be declared or paid from the following sources:

(a) **Profits of the current financial year-** Profits arrived at after providing for depreciation in accordance with Schedule II[3].

(b) **Profits of any previous financial year or years-** Profits of any previous financial year(s) arrived at after providing for depreciation in accordance with Schedule II and remaining undistributed *i.e.* credit balance in profit and loss account and free reserves. It is to be noted that only free reserves[4] and no other reserves are to be used for declaration or payment of dividend[5].

(c) Both (a) and (b).

Note 1: Before declaration of any dividend, carried over previous losses and depreciation not provided in previous year or years are required to be set off against profit of the company for the current year[6].

Note 2: In computing profits any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded[7].

Note 3: Capital profits are not same as distributable profits because they are not earned in the normal course of business; and therefore, normally not available for distribution as dividend.

(d) **Provision of money by the Government-** Money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

B. Transfer to Reserves

As per First Proviso to Section 123 (1), it is not mandatory for a company to transfer a particular percentage of its profits to reserves before the declaration of any

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[3] As per Section 123 (2).

[4] Section 2 (43) defines the term 'free reserves' to mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. However, following items shall not be treated as free reserves:

(a) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise; or

(b) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

[5] As per Third Proviso to Section 123 (1).

[6] As per Fourth Proviso to Section 123 (1).

[7] As per Proviso to Section 123 (1) (a).

dividend in any financial year. Thus, a company may, as per its discretion, transfer any appropriate percentage of its profits to reserves before the declaration of dividend.

Example 1: For the current year, Alma Watches Limited proposes to transfer more than 10% of its profits to the reserves before declaration of dividend at the rate of 12%. Is the company allowed to do so?

Answer: The amount to be transferred to reserves out of profits for any financial year before the declaration of dividend has been left at the discretion of the company. Therefore, Alma Watches Limited is free to transfer any part of its profits to reserves as it may deem fit.

Example 2: Brix Shipyards Limited has earned a profit of ₹ 1,000 crores for the financial year 2018-19. It has proposed a dividend @ 8.75%. However, it does not intend to transfer any amount to the reserves out of the profits earned. Can the company do so?

Answer: The amount to be transferred to reserves out of profits for any financial year has been left at the discretion of the company. The company is free to transfer any part of its profits to reserves as it may deem fit or even it may not transfer any profits to reserve if it is deemed appropriate before the declaration of dividend. Thus, Brix Shipyards Limited is justified in its action if it does not transfer any amount of profits to the reserves.

C. Declaration of Dividend when there is Inadequacy or Absence of Profits

As per Second Proviso to Section 123 (1), in the event of inadequacy or absence of profits in any financial year, a company may declare dividend out of the accumulated profits of previous years which have been transferred to the free reserves. However, such declaration shall be subject to the following conditions[8]:

(a) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by the company in the immediately preceding three years.

[8] As per Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014. It may be noted that the conditions prescribed by Rule 3 are not applicable to a Government company in which the entire paid up share capital is held by the Central Government, or by any Stale Government or Governments or by the Central Government and one or more State Governments (*vide Notification No. 463 (E), dated 05-06-2015).*

Rate of Dividend ≤ $(RD_1 + RD_2 + RD_3)/3$

Where, RD_1, RD_2, RD_3 are rates at which dividend was declared by the company in the immediately preceding three years.

However, **this condition shall not apply** if the company has not declared any dividend in each of the three preceding financial year.

(b) The total amount to be drawn from such accumulated profits shall not exceed 10% of its paid-up share capital and free reserves as appearing in the latest audited financial statement. In other words:

Total amount that can be drawn from accumulated profits ≤ *10% of (paid up share capital + free reserves)*

(c) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared and only thereafter, any dividend in respect of equity shares shall be declared.

(d) The balance of reserves after such withdrawal shall not fall below 15% of its paid-up share capital as appearing in the latest audited financial statement.

Example: Shipra Sugar Mills Limited has been regularly declaring dividend at the rate of 20% on its equity shares for the past 3 years. However, the company has not made adequate profits during the current year ending on 31st March, 2019, but it has got adequate free reserves which can be utilized for maintaining the rate of dividend at 20%.

Advise the company as to how it should proceed in the matter if it wants to declare dividend at the rate of 20% for the year 2018-19, as per the provisions of the Companies Act, 2013.

Answer: In the given case, Shipra Sugar Mills Limited has not made adequate profits during the current year ending on 31st March, 2019, but it still wants to declare dividend at 20%. This can be done out of accumulated profits. Hence, the company can declare a dividend at the rate of 20% subject to the following:

- The total amount to be drawn from free reserves shall not exceed 10% of its paid-up share capital and free reserves as per the latest audited financial statement.

- The amount so drawn shall first be utilised to set off the losses incurred in the current financial year and only thereafter, dividend at 20% shall be declared.
- After such withdrawal from free reserves, the residual reserves shall not fall below 15% of its paid-up share capital as per the latest audited financial statement.

The *modus operandi* will be to get the desired dividend recommended by the Board of Directors and put up the same for the approval of the members at the ensuing Annual General Meeting as the authority to declare dividend lies with the members of the company.

D. Depositing of Amount of Dividend

In terms of section 123(4), the amount of the dividend (including interim dividend), shall be deposited in a separate account maintained with a scheduled bank. This is to be done **within 5 days** from the date of declaration of dividend[9].

E. Payment of Dividend

Section 123(5) contains provisions regarding payment of dividend. These are stated as under:

(a) Dividend shall be payable only to the registered shareholder or to his order or to his banker.

In case a shareholder informs the company to pay dividend to a particular banker and if the payment is so made by the company, then it shall be deemed to be made to the shareholder himself.

A purchaser of shares whose name is not registered in the Register of Members cannot claim payment of dividend to him though he might have made full payment to the seller of shares. In such a case if the instrument of transfer of shares has been delivered to the company but the company is yet to register the transfer and further the registered shareholder has not authorised the company to pay dividend to the transferee, then the dividend in relation to such shares shall be transferred to the Unpaid Dividend Account. Details in this respect are given later in the Chapter.

[9] In terms of *Notification No. 463 (E), dated 05-06-2015*, this requirement shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments or by one or more Government Company.

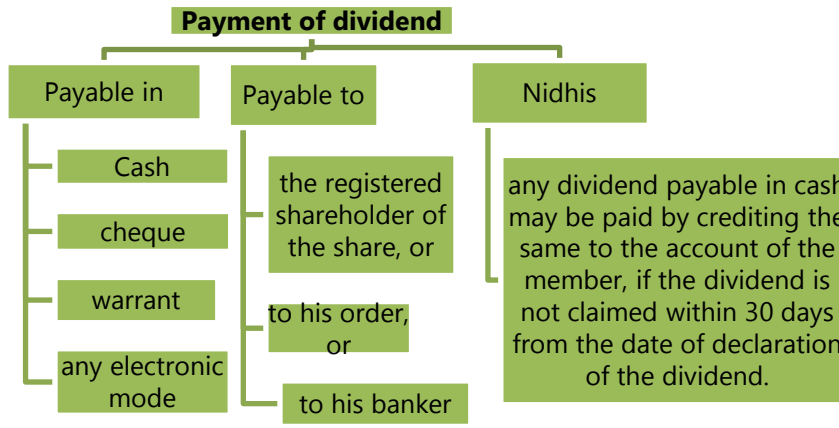
Note: In terms of Section 51, a company may, if so authorised by its articles, pay dividend in proportion to the amount paid-up on each share. Suppose, some of the shareholders have paid only ₹ 5 (face value ₹ 10) on each share held by them. In case of declaration of dividend at the rate of ₹ 5 per share, the company, if authorised by its articles, shall be justified in paying dividend of ₹ 2.50 per such share which is partly paid.

(b) Dividends are payable in cash and not in kind. Dividends that are payable to the shareholders in cash may also be paid by cheque or dividend warrant or through any electronic mode.

Section 127 requires that the declared dividend must be paid to the entitled shareholders within the prescribed time limit of thirty days from the date of declaration of dividend. In case dividend is paid by issuing dividend warrants, such warrants must be posted at the registered addresses within the prescribed time. Once posted, it is immaterial whether the same are received within thirty days by the shareholders or not.

Note: First Proviso to Section 123 (5) states that sub-section (5) shall not be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

(c) *Applicability of Section 123 (5) to Nidhis:* In terms of *Notification No. GSR 465 (E), dated 05-06-2015*, this sub-section shall apply to the Nidhis, subject to the modification that any dividend payable in cash may be paid by crediting the same to the account of the member, if the dividend is not claimed within 30 days from the date of declaration of the dividend.



Example: The Board of Directors of Som Mechanical Toys Limited proposed a dividend at 12% on equity shares for the financial year 2018-19. The same was approved at the Annual General Meeting of the company held on 25th June, 2019.

Mr. Nitin Jha was holding 1,000 equity shares as on 31st March, 2019, but the same were transferred by him to Mr. Raj, whose name was registered on 20th April, 2019 in the Register of Members. State as to who will be entitled to the dividend declared by the company.

Answer: According to section 123(5), dividend shall be payable only to the registered shareholder of the shares or to his order or to his banker. Facts in the given case state that Mr. Nitin Jha, the holder of equity shares transferred his shares to Mr. Raj whose name was registered on 20th April, 2019. Since, Mr. Raj became the registered shareholder before the declaration of the dividend in the Annual General Meeting of the company held on 25th June, 2019, he will be entitled to the dividend.

F. Prohibition on Declaration of Dividend

Following prohibitions are applicable:

(i) Prohibition in case of any Defaulting Company: Section 123 (6) contains prohibition on declaration of dividend by a company. It specifically provides that a company which fails to comply with the provisions of section 73 (*Prohibition on acceptance of deposits from public*) and section 74 (*Repayment of deposits, etc., accepted before the commencement of this Act of 2013*) shall not, so long as such failure continues, declare any dividend on its equity shares.

(ii) Prohibition in case of Section 8 Companies: According to section 8 (1), a company having licence under Section 8 (*Formation of companies with charitable objects, etc.*) is prohibited from paying any dividend to its members. Its profits are intended to be applied only in promoting the objects for which it is formed.

4. UNPAID DIVIDEND ACCOUNT (UDA)

Section 124 of the Act contains the provisions relating to Unpaid Dividend Account (UDA). These are as follows:

(i) Unpaid or Unclaimed Dividend to be transferred to the Unpaid Dividend Account- In case a dividend has been declared by a company but has not been

paid or claimed within 30 days from the date of declaration, the company shall, within 7 days from the expiry of the 30 days, transfer the total amount of unpaid or unclaimed dividend to a special account called the Unpaid Dividend Account (UDA). The UDA shall be opened by the company in any scheduled bank.

(ii) Preparing of Statement of the Unpaid Dividend- Within 90 days of transferring any amount to the Unpaid Dividend Account, the company shall prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place such statement on its web-site, if any, and also on any other web-site approved by the Central Government for this purpose.

(iii) Payment of Interest if default is made in transferring the Amount- If any default is made in transferring the total unpaid dividend amount or any part thereof to the Unpaid Dividend Account, the company shall pay, from the date of such default, interest at the rate of twelve per cent per annum on the amount not so transferred to the said account. The interest accruing on such amount shall enure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(iv) Claimant to apply for payment of Claimed Amount- Any person claiming to be entitled to any money transferred to the Unpaid Dividend Account may apply to the company concerned for payment of the money so claimed.

(v) Transfer of Unclaimed Amount to Investor Education and Protection Fund (IEPF)- Any money transferred to the Unpaid Dividend Account which remains unpaid or unclaimed for 7 years from the date of such transfer shall be transferred by the company along with interest accrued thereon to the IEPF.

Further, the company shall send a prescribed statement containing the details of such transfer to the IEPF Authority and in turn, the Authority shall issue a receipt to the company as evidence of such transfer.

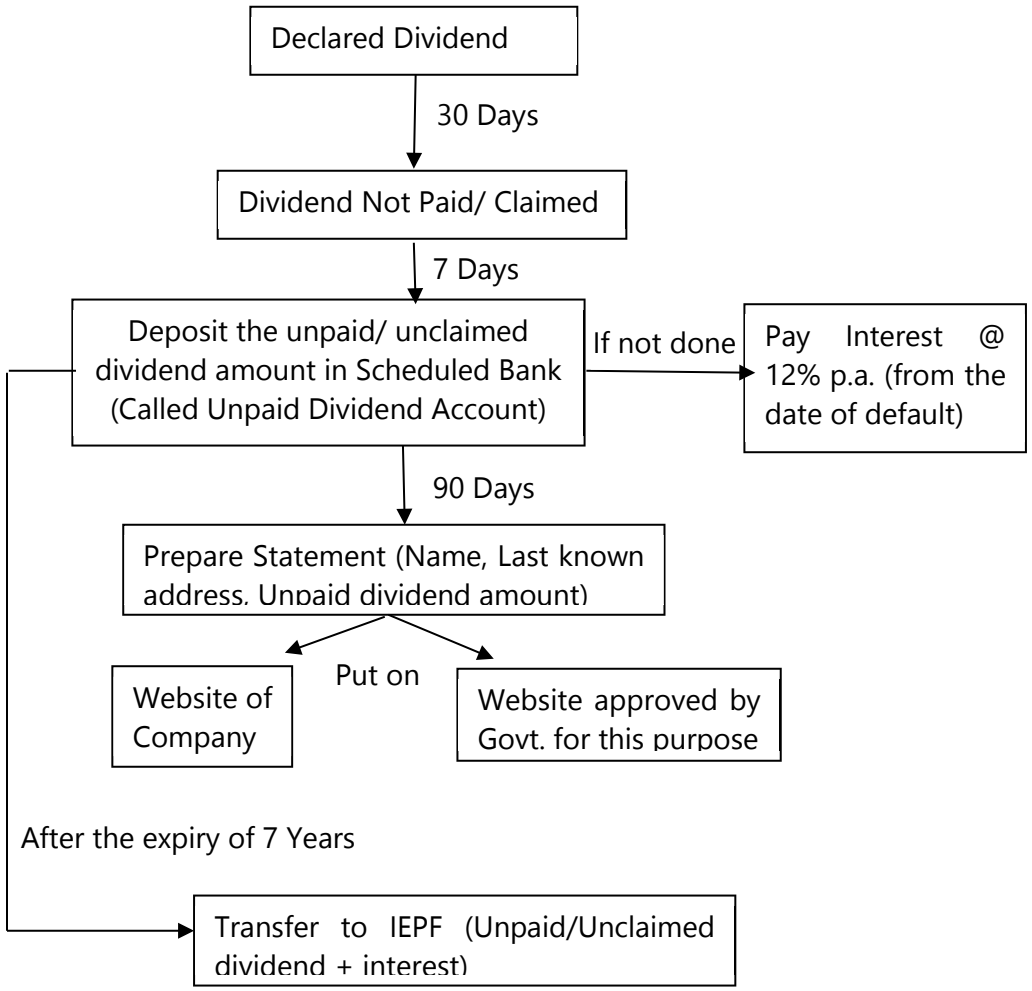
(vi) Transfer of Shares to IEPF- All shares in respect of which dividend has not been paid or claimed for 7 consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing the prescribed details.

By way of Explanation, it is clarified that in case any dividend is paid or claimed for any year during the said period of seven consecutive years, the share shall not be transferred to Investor Education and Protection Fund.

(vii) Right of Owner of 'transferred shares' to Reclaim- Any claimant of shares so transferred to IEPF shall be entitled to reclaim the 'transferred shares' from Investor Education and Protection Fund in accordance with the prescribed procedure and on submission of prescribed documents.

(viii) Punishment for Contravention- If a company fails to comply with any of the requirements relating to unpaid dividend account, it shall be punishable with minimum fine of ₹ five lakhs which may extend to ₹ twenty-five lakhs.

Further, every officer of the company who is in default shall be punishable with minimum of ₹ one lakh which may extend to ₹ five lakhs.



5. INVESTOR EDUCATION AND PROTECTION FUND (IEPF)

Section 125 of the Act along with various Rules framed from time to time including [10]Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016 deal with the Investor Education and Protection Fund (IEPF). This fund, being established by the Central Government, shall be credited with specified amounts and utilized for refund of unclaimed and unpaid amounts, promotion of investors' awareness and protection of the interests of investors, etc. The relevant provisions are given as under:

1. Credit of Specified Amounts to the Fund: Following specified amounts shall be credited to the Fund:

(a) ***Amount given by the Central Government-*** The amount given by the Central Government by way of grants after due appropriation made by Parliament;

(b) ***Donations by the Central Government-*** Donations given by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) ***Amount lying in the Unpaid Dividend Account-*** The amount lying in the Unpaid Dividend Account (UDA) of companies transferred to the Fund under section 124(5) *i.e.* remaining unpaid and unclaimed for a period of seven years;

(d) ***Amount in the General Revenue Account of the Central Government-*** The amount in the General Revenue Account of the Central Government which had been transferred to that account under section 205A(5) of the Companies Act, 1956 as it stood immediately before the commencement of the Companies (Amendment) Act, 1999 and remaining unpaid or unclaimed on the commencement of the Act of 2013;

(e) ***Amount in IEPF-*** The amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) ***Income from Investments-*** The interest or other income received out of investments made from the Fund;

[10] Notified *vide* Notification No. GSR 854 (E), dated 05.09.2016 *w.e.f.* 07.09.2016.

(g) ***Amount received through disgorgement or disposal of Securities-*** The amount received under section 38(4) *i.e.* amount received through disgorgement or disposal of securities seized from a person who has been convicted for personation for acquisition of securities as provided in section 38(3);

(h) ***Application Money-*** The application money received by companies for allotment of any securities and due for refund (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);

(i) ***Matured Deposits-*** Matured deposits with companies other than banking companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);

(j) ***Matured Debentures-*** Matured debentures with companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);

(k) ***Interest-*** Interest accrued on the amounts referred to in clauses (h) to (j);

(l) ***Amount received from Sale Proceeds-*** Amount received from sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(m) ***Redemption Amount-*** Redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) ***Other Amounts-*** Such other amounts as prescribed in Rule 3 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016. They are as under:

  (a) all amounts payable as mentioned in clause (a) to (n) of section 125 (2) of the Act [as stated above];

  (b) all shares in accordance with section 124 (6) i.e. all those shares in whose case dividends have not been claimed or paid for seven consecutive years or more;

  (c) all the resultant benefits arising out of shares held by the Authority under clause (b) above;

  (d) all grants, fees and charges received by the Authority under these rules;

  (e) all sums received by the Authority from such other sources as may be decided upon by the Central Government;

(f) all income earned by the Authority in any year;

(g) all amounts payable as mentioned in section 10B (3) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and section 10B of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980; and

(h) all other sums of money collected by the Authority as envisaged in the Act.

Further, according to Rule 3 (3), in case of term deposits and debentures of companies, due unpaid or unclaimed interest shall be transferred to the Fund along with the transfer of the matured amount of such term deposits and debentures.

2. Utilization of the Fund: According to section 125 (3) the Fund shall be utilized for:

(a) refund of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;

(b) promotion of investors' education, awareness and protection;

(c) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;

(d) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

(e) any other purpose incidental thereto in accordance with the rules framed under the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016.

Refund of Amount- It is provided that in case of a person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to IEPF, after the expiry of 7 years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the fund in respect of such claims in accordance with rules made under this section.

3. Application to the Authority for payment: According to section 125 (4), any person claiming to be entitled to the amount referred in section 125 (2) may

apply to the Authority constituted under section 125 (5) for the payment of the money claimed.

4. Other Provisions governing the IEPF

(i) Constitution of the Authority for Administration of Fund- In terms of Notification dated 13.01.2016[11], the Ministry of Corporate Affairs has notified sub-section (5), sub-section (6) (except with respect to the manner of administration of the Fund) and sub-section (7) of section 125 of the Act w.e.f. 13.01.2016. With this Notification, an Authority is being constituted for the administration and maintenance of accounts as well as other relevant records of the Fund.

Further, with the notification of IEPF Authority (Appointment of Chairperson and Members, holding of Meetings and provision for Offices and Officers) Rules, 2016 on 13.01.2016, the Secretary, Ministry of Corporate Affairs shall be the ex-officio Chairperson of the Authority. In addition, there shall be six members (maximum limit seven) and a Chief Executive Officer who shall be the convenor of the Authority.

(ii) Provision of required Resources by the Central Government for Administration of the Fund- The Central Government may provide to the Authority such offices, officers, employees and other resources in accordance with the *IEPF Authority (Appointment of Chairperson and Members, holding of Meetings and provision for Offices and Officers) Rules, 2016*.

(iii) Authority to work in consultation with CAG of India- The Authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the Comptroller and Auditor-General of India.

(iv) Spending of Money- The Authority shall be competent to spend money out of the Fund for carrying out the objects specified in section 125 (3) *i.e.* purposes for which the fund shall be utilized.

(v) Audit of the Fund- The accounts of the Fund shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him. Such audited accounts together with the audit report

[11] Vide Notification No. GSR 26 (E), dated 13.01.2016.

thereon shall be forwarded annually by the Authority to the Central Government.

(vi) Preparation of Annual Report by the Authority- For each financial year, the Authority shall prepare in the prescribed form and at prescribed time its annual report giving full account of its activities during the financial year and forward a copy thereof to the Central Government. In turn, the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament.

6. RIGHT OF DIVIDEND, RIGHTS SHARES AND BONUS SHARES TO BE HELD IN ABEYANCE PENDING REGISTRATION OF TRANSFER OF SHARES

According to Section 126, in case any instrument of transfer of shares has been delivered by a shareholder for registration and the transfer of such shares has not been registered by the company, such company shall take the following steps:

(a) transfer the dividend in relation to such shares to the Unpaid Dividend Account. Such action of transferring dividend to Unpaid Dividend Account may not be initiated by the company if it is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in the instrument of transfer; and

(b) keep in abeyance in relation to such shares any offer of rights shares under section 62 (1) (a) and any issue of fully paid-up bonus shares in pursuance of first proviso to section 123 (5).

7. PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS WITHIN 30 DAYS

Section 127 of the Act contains time limit for distribution of dividends and punishment for failure to distribute dividend on time. Certain exemptions from punishments are also provided. These provisions are stated as under:

A. Time Limit for Distribution of Dividends

In case a company declares dividend, it must be paid or the dividend warrant thereof must be posted within 30 days from the date of declaration of

dividend to the entitled shareholders. Posting of dividend warrants within 30 days absolves the company from any punishment irrespective of whether it is received by the shareholder concerned within this time or not. The offence is committed only when the company fails to post dividend warrants at the registered address of the members within 30 days of declaration. Non-receipt of dividend warrants by the shareholders within the prescribed time does not attract any punishment.

B. Punishment for Failure

In case a company fails to pay declared dividends or fails to post dividend warrants within 30 days of declaration, following punishments are applicable:

(i) Every **director** of the company shall be punishable with imprisonment maximum up to two years, if he is knowingly a party to the default. Further, he shall also be liable to pay minimum fine of ₹ 1,000 for every day during which such default continues.

(ii) The **company** shall be liable to pay simple interest at the rate of 18% p.a. during the period for which such default continues.

C. Exemption from Punishment

Under the following cases where the company has failed to pay declared dividend within 30 days of declaration, no offence shall be deemed to have been committed and therefore, no punishment is attracted:

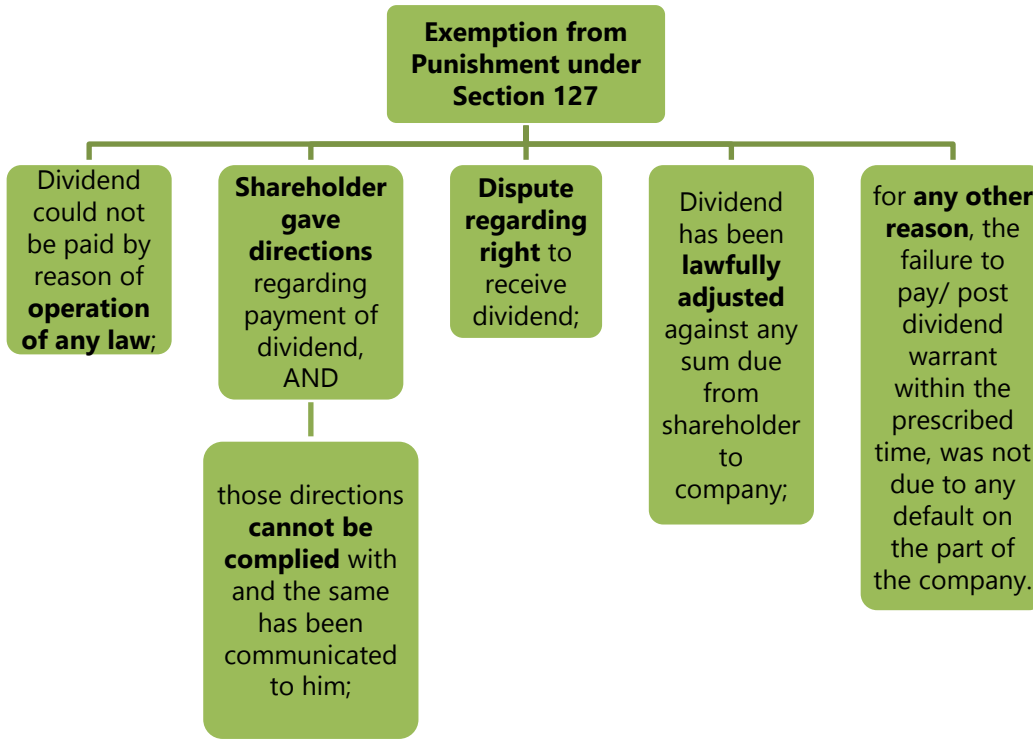
(a) where the dividend could not be paid by reason of the operation of any law;

(b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;

(c) where there is a dispute regarding the right to receive the dividend;

(d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder;

(e) where, for any other reason, the failure to pay the dividend or to post the warrant within the prescribed period of 30 days was not due to any default on the part of the company.



Example: Mr. Alok, holding equity shares of face value of ₹ 10 lakhs, has not paid ₹ eighty thousand towards call money due on shares. Can the dividend amount payable to him be adjusted against such dues? Give reasons for your answer.

Answer: Yes. As per clause (d) of Proviso to Section 127, where the dividend is declared by a company and there remains calls in arrears and any other sum due from a member, then the dividend can be lawfully adjusted by the company against any such dues.

Thus, the action of the company adjusting dividend payable to Mr. Alok towards call money due on shares amounting to ₹ eighty thousand is justified and therefore, no punishment is attracted.

D. Applicability of Section 127 to Nidhis

In terms of *Notification No. GSR 465 (E), dated 05-06-2015*, Section 127 dealing with punishment shall apply to the Nidhis, subject to the following modification:

In case the dividend payable to a member is ₹ 100 or less, it shall be sufficient compliance of the provisions of the section 127, if the declaration of the

dividend is announced in the local language in one local newspaper of wide circulation and announcement of the said declaration is also displayed on the notice board of the Nidhis for at least 3 months.

SUMMARY

- Section 2(35) of the Companies Act, 2013, states that "dividend" includes any interim dividend.
- Dividend can be declared out of:
  - Profits of the current year after depreciation,
  - Profits for any previous financial year or years arrived at after providing for depreciation and remaining undistributed,
  - Both of the above,
  - Money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

    [***Note:*** Depreciation shall be provided in accordance with the provisions of Schedule II.]
- Before declaration of dividend, the company may, at its discretion, transfer any appropriate percentage of its profits to the reserves.
- When there is inadequacy or absence of profits, the company may declare dividend out of free reserves after following the conditions prescribed in the Rules.
- Amount of dividend (including interim dividend) shall be deposited in a separate bank account maintained with a scheduled bank within 5 days from the date of declaration of dividend.
- Payment of dividend-
  - Payable
    - in cash; or
    - by cheque; or
    - by dividend warrant; or
    - by any electronic mode
  - Payable

- ❒ to the registered shareholder of the shares; or
- ❒ to his order; or
- ❒ to his banker.

- In case of Nidhis
  - ❒ any dividend payable in cash may be paid by crediting the same to the account of the member, if the dividend is not claimed within 30 days from the date of declaration of the dividend.

♦ Unpaid Dividend Account (UDA)

- Declared dividend not paid or claimed to be transferred to the Unpaid Dividend Account (UDA).
- Prepare statement of particulars of the unpaid dividend.
- Default in transferring of amount to UDA - Interest @ 12% p.a.
- Entitled shareholders can apply for payment of amount from UDA.
- Transfer unpaid or unclaimed amount of dividend (and shares thereof) to Investor Education and Protection Fund (IEPF) after the expiry of seven years from the date of such transfer to UDA.
- Right of owner of shares transferred to IEPF to claim from IEPF: Claimant of transferred shares is entitled to reclaim the transfer of shares from IEPF by following the prescribed procedure and on submission of prescribed documents.
- In case any dividend is paid or claimed for any year during the said period of 7 consecutive years, the shares shall not be transferred to IEPF.
- Punishment: In case a company fails to pay declared dividends or fails to post dividend warrants within 30 days of declaration, company to pay simple interest at the rate of 18% p.a. for the period of default and every director, if knowingly a party to the default – imprisonment maximum up to two years and minimum fine of ₹ 1,000 for every day during the continuation of default.

♦ Exemptions from punishment under section 127

- dividend could not be paid by reason of operation of any law;
- shareholder gave directions regarding payment of dividend but those directions could not be complied with and the same had been

communicated to him;

- dispute regarding right to receive dividend;
- dividend had been lawfully adjusted against any sum due from the shareholder to the company;
- for any other reason and the failure to pay/post dividend warrant within the prescribed time was not due to any default on the part of the company.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. After declaration of dividend it should be paid within
   (a) 14 days
   (b) 21 days
   (c) 30 days
   (d) 45 days
2. Which of the following amount is not credited to IEPF Account
   (a) Unpaid dividend account of company
   (b) Matured deposit with company
   (c) Profit on sale of asset
   (d) Matured debentures with companies.
3. In how many days from the date of declaration, the interim dividend shall be deposited in a separate bank account
   (a) 5 days
   (b) 7 days
   (c) 15 days
   (d) 21 days
4. After the expiry of -------, the amount of unpaid dividend account should be transferred to Investor Education and Protection Fund
   (a) 3 years
   (b) 5 years

(c) 7 years

(d) 10 years

5. Amount to be transferred to reserves out of profits before any declaration of dividend is _____

(a) 5%

(b) 7.5%

(c) 10%

(d) at the discretion of the company.

6. If declared dividend has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration to any entitled shareholder, the company shall be liable to pay simple interest at the rate of _____ p.a. during the period for which such default continues.

(a) 5%

(b) 6%

(c) 15%

(d) 18%

Answer to MCQs

1. (c) **2.** (c) **3.** (a) **4.** (c) **5.** (d) **6.** (d)

Question and Answer

Question 1

The Annual General Meeting of ABC Bakers Limited held on 30th May, 2019, declared a dividend at the rate of 30% payable on its paid-up equity share capital as recommended by Board of Directors. However, the Company was unable to post the dividend warrant to Mr. Ranjan, an equity shareholder, up to 25th July, 2019. Mr. Ranjan filed a suit against the Company for the payment of dividend along with interest at the rate of 20 percent per annum for the period of default. Decide in the light of provisions of the Companies Act, 2013, whether Mr. Ranjan would succeed? Also, state the directors' liability in this regard under the Act.

Answer

Section 127 of the Companies Act, 2013 lays down the penalty for non-payment of dividend within the prescribed time period of 30 days. According to this section

where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration of dividend to any shareholder entitled to the payment of dividend:

(a) every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment maximum up to two years and with minimum fine of rupees one thousand for every day during which such default continues; and

(b) the company shall be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues.

Therefore, in the given case Mr. Ranjan will not succeed if he claims interest at 20% interest as the limit under section 127 is 18% per annum.

Question 2

The Board of Directors of Future Fashions Limited at its meeting recommended a dividend on its paid-up equity share capital which was later on approved by the shareholders at the Annual General Meeting. In the meantime, the directors at another meeting of the Board decided by passing a board resolution to divert the total dividend to be paid to the shareholders for purchase of certain short-term investments in the name of the company. As a result, dividend was paid to shareholders after 45 days.

Examining the provisions of the Companies Act, 2013, state whether the act of directors is in violation of the provisions of the Act and if so, state the consequences that shall follow for the above violative act.

Answer

According to section 124 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration, the company shall, within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in any scheduled bank to be called the Unpaid Dividend Account.

Further, according to section 127 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration to any entitled shareholder, every director of the company shall, if he is knowingly a party to the default, be liable for the punishment.

In the present case, the Board of Directors of Future Fashions Limited at its meeting recommended a dividend on its paid-up equity share capital which was later on approved by the shareholders at the Annual General Meeting. In the meantime, the directors at another meeting of the Board decided by passing a resolution to divert the total dividend to be paid to the shareholders for purchase of certain short-term investments in the name of the company. As a result, dividend was paid to shareholders after 45 days.

1. Since, declared dividend has not been paid within 30 days from the date of the declaration to any shareholder entitled to the payment of dividend, the company shall, within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in any scheduled bank to be called the Unpaid Dividend Account.

2. The Board of Directors of Future Fashions Limited has violated section 127 of the Companies Act, 2013 as it failed to pay dividend to shareholders within 30 days due to its decision to divert the total dividend to be paid to shareholders for purchase of certain short-term investments in the name of the company.

   Consequences: The following are the consequences for violation of the above provisions:

   (a) Every director of the company shall, if he is knowingly a party to the default, be punishable with maximum imprisonment of two years and shall also be liable for a minimum fine rupees one thousand for every day during which such default continues.

   (b) The company shall also be liable to pay simple interest at the rate of 18% p.a. during the period for which such default continues.

Question 3

Referring to the provisions of the Companies Act, 2013, examine the validity of the following:

The Board of Directors of ABC Tractors Limited proposes to declare dividend at the rate of 20% to the equity shareholders, despite the fact that the company has defaulted in repayment of public deposits accepted before the commencement of this Act.

Answer

Section 123(6) of the Companies Act, 2013, specifically provides that a company which fails to comply with the provisions of section 73 (Prohibition of acceptance of deposits from public) and section 74 (Repayment of deposits, etc., accepted before the commencement of this Act) shall not, so long as such failure continues, declare any dividend on its equity shares.

In the given instance, the Board of Directors of ABC Tractors Limited proposes to declare dividend at the rate of 20% to the equity shareholders, in spite of the fact that the company has defaulted in repayment of public deposits accepted before the commencement of the Companies Act, 2013. Hence, according to the above provision, declaration of dividend by the ABC Tractors Limited is not valid.

Question 4

Star Computers Limited declared and paid dividend in time to all its equity holders for the financial year 2018-19, except in the following two cases:

(i) Mrs. Sheela Bhatt, holding 250 shares had mandated the company to directly deposit the dividend amount in her bank account. The company, accordingly remitted the dividend but the bank returned the payment on the ground that there was difference in surname of the payee in the bank records. The company, however, did not inform Mrs. Sheela Bhatt about this discrepancy.

(ii) Dividend amount of ₹ 50,000 was not paid to the successor of Late Mr. Mohan, in view of the court order restraining the payment due to family dispute about succession.

You are required to analyse these cases with reference to provisions of the Companies Act, 2013 regarding failure to distribute dividends.

Answer

(i) Section 127 of the Companies Act, 2013 provides for punishment for failure to distribute dividend on time. One of such situations is where a shareholder has given directions to the company regarding the payment of the dividend and those directions could not be complied with but the non-compliance was not communicated to him.

In the given situation, the company has failed to communicate to the shareholder Mrs. Sheela Bhatt about non-compliance of her direction regarding payment of dividend. Hence, the penal provisions under section 127 will be applicable.

(ii) Section 127, *inter-alia*, provides that no offence shall be deemed to have been committed where the dividend could not be paid by reason of operation of law.

In the present case, the dividend could not be paid because it was not allowed to be paid by the court until the matter was resolved about succession. Hence, there will not be any liability on the company and its directors, etc.

Question 5

Alpha Herbals, a Section 8 company is planning to declare dividend in the Annual General Meeting for the Financial Year ended 31-03-2019. Mr. Chopra is holding 800 equity shares as on date. State whether the act of the company is according to the provisions of the Companies Act, 2013.

Answer

According to Section 8(1) of the Companies Act, 2013, the companies having licence under Section 8 of the Act (Formation of companies with Charitable Objects, etc.) are prohibited from paying any dividend to its members. Their profits are intended to be applied only in promoting the objects for which they are formed.

Hence, in the instant case, the proposed act of Alpha Herbals, a company having licence under Section 8 of the Companies Act, 2013, which is planning to declare dividend, is not according to the provisions of the Act of 2013.

Question 6

(i) YZ Medical Instruments Limited is a manufacturing company & has proposed a dividend @ 10% for the year 2018-19 out of the profits of current year. The company has earned a profit of ₹ 910 crores during 2018-19. The company does not intend to transfer any amount to the general reserves out of the profits. Is YZ Medical Instruments Limited allowed to do so? Comment.

(ii) Karan, holder of 5000 equity shares of ₹ 100 each of M/s. Rachit Leather Shoes Limited did not pay final call of ₹ 10 per share. M/s. Rachit Leather Shoes Limited declared dividend of 10%. Examine with reference to relevant provisions of the Companies Act, 2013, the amount of dividend Karan should receive.

Answer

(i) According to section 123 of the Companies Act, 2013 a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the

reserves of the company. Such transfer is not mandatory and the percentage to be transferred to reserves is at the discretion of the company.

As per the given facts, YZ Medical Instruments Limited has earned a profit of 910 crores for the financial year 2018-19. It has proposed a dividend @ 10%. However, it does not intend to transfer any amount to the reserves of the company out of the profits of current year.

As per the provisions stated above, the amount to be transferred to reserves out of profits for any financial year is at the discretion of the company acting through its Board of Directors. Therefore, at its discretion, if YZ Medical Instruments Limited decides not to transfer any profit to reserves before the declaration of dividend at 10%, it is legally allowed to do so.

(ii) As per the proviso to section 127 of the Companies Act, 2013, no offence will be deemed to have been committed by a director for adjusting the calls in arrears remaining unpaid or any other sum due from a member against the dividend declared by the company.

Thus, as per the given facts, M/s. Rachit Leather Shoes Limited can adjust the unpaid call money of ₹ 50,000 against the declared dividend of 10%, *i.e.* 5,00,000 x 10/100 = 50,000. Hence, call money of ₹ 50,000 not paid by Karan can be adjusted fully from the entitled dividend amount of ₹ 50,000 payable to him.

CHAPTER 9

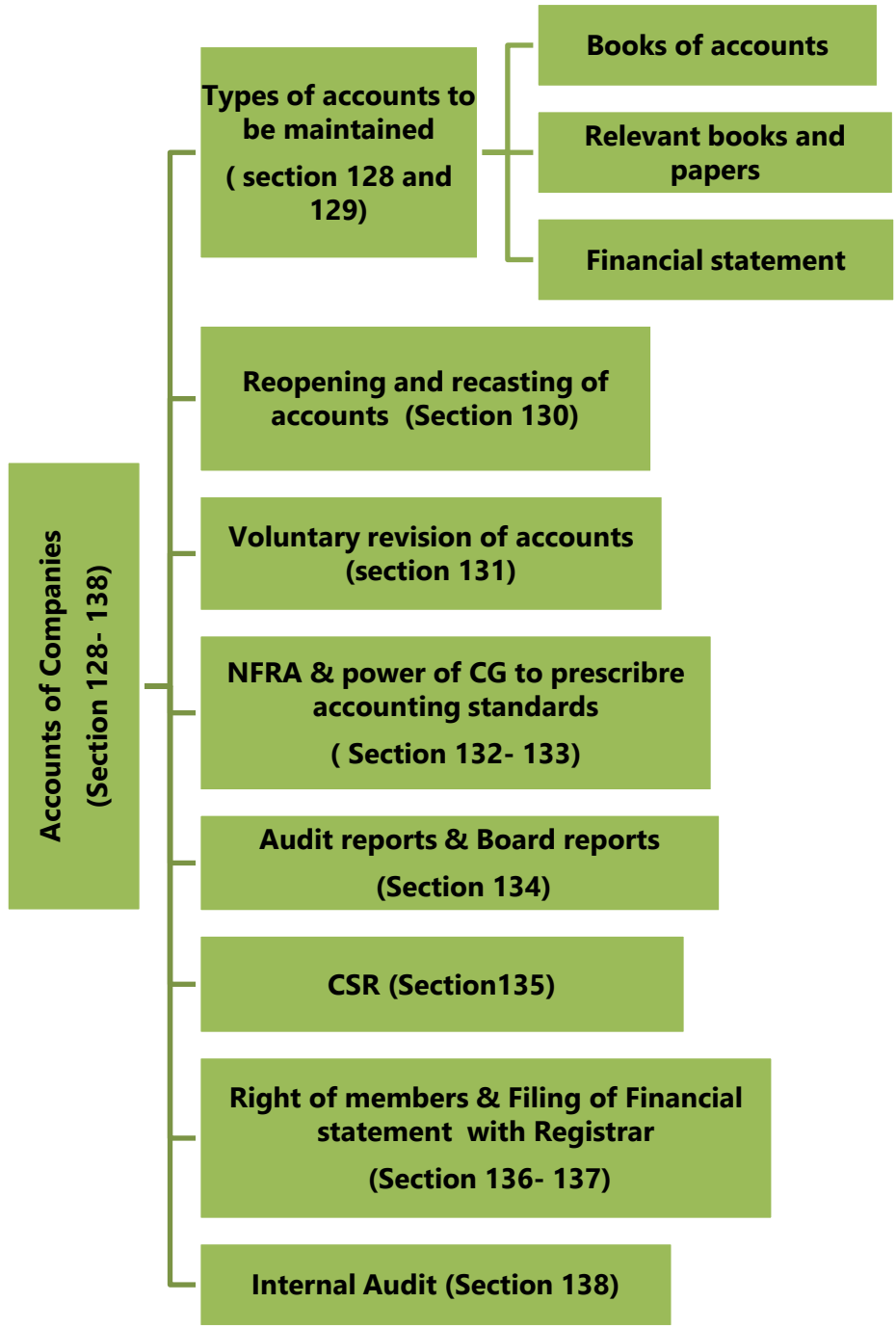
ACCOUNTS OF COMPANIES

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Know about preparation and maintenance of books of Account etc. to be kept by company
- Know about the requirements as to preparation and filing of financial statement and other related matters.
- Know about the reopening and revision of financial statements
- Know about constitution, working and power of National Financial Reporting Authority.
- Explain various concepts related to Corporate Social Responsibility.
- Explain procedure related to internal audit of companies

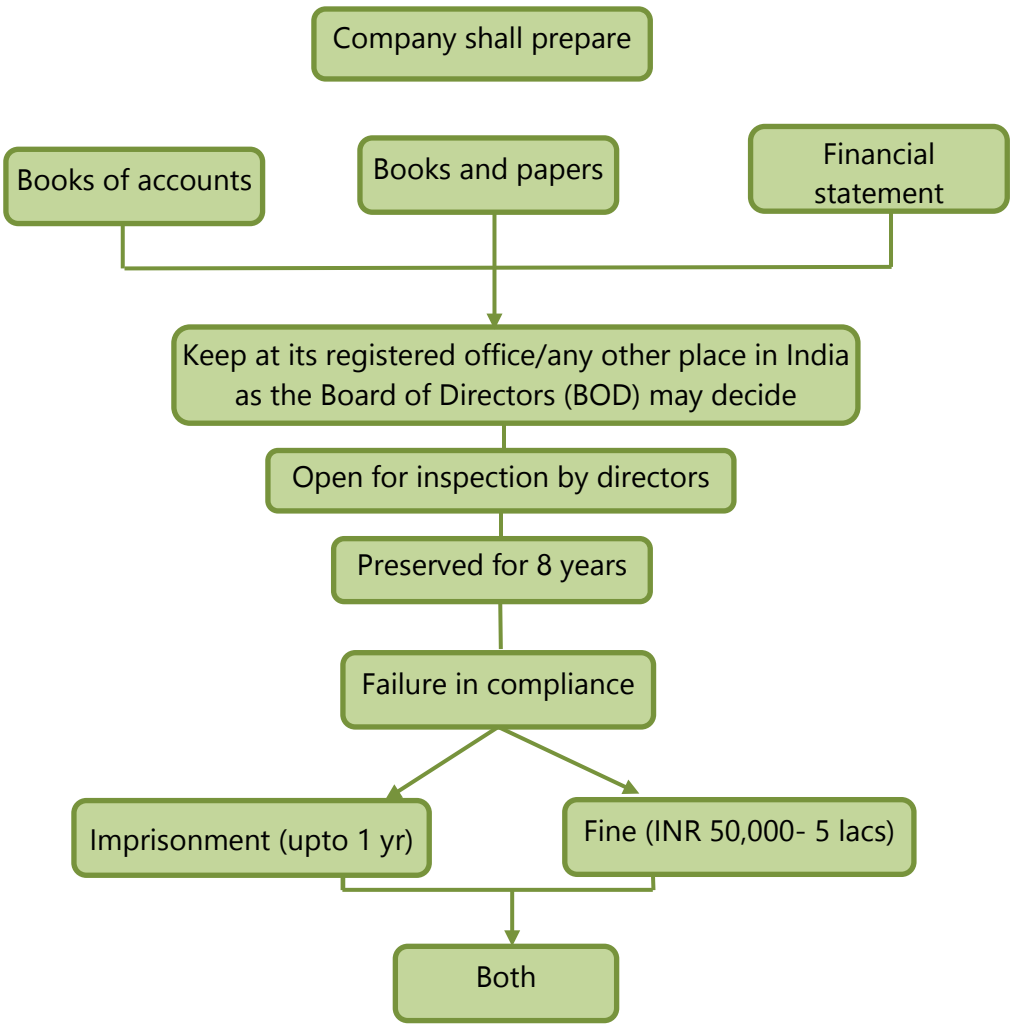
CHAPTER OVERVIEW



1. INTRODUCTION

There is a need for disclosing the annual information to the shareholders by the directors about the working and financial position of the company so that the shareholders are aware of the affairs of the company. The Companies Act, 2013, lays down various provisions related to maintenance of proper books of account of the companies.

2. BOOKS OF ACCOUNTS, ETC., TO BE KEPT BY COMPANY [SECTION 128]



General requirement

Every company shall prepare books of accounts and other relevant books and records and financial statement for every financial year.

These books of accounts should give a true and fair view of the state of the affairs of the company, including that of its branch office(s).

These books of accounts must be kept on accrual basis and according to the double entry system of accounting.

Accrual basis and double-entry system of accounting

Accrual basis of accounting is an accounting assumption or an accounting concept followed in preparation of the financial statements. Accrual concept is one of the four principles of accounting concepts, which involves recording income and expenses as they accrue; distinct from when they are received or paid.

Double entry book-keeping is a method of recording any transaction of a business in a set of accounts, in which every transaction has a dual aspect of debit and credit and therefore, needs to be recorded in at least two accounts. Double aspect enables effective control of business because all the books of accounts must balance.

"Books of account" as defined in Section 2(13) includes records maintained in respect of—

- all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- all sales and purchases of goods and services by the company;
- the assets and liabilities of the company; and
- the items of cost as may be prescribed under section 148 of the Companies Act 2013 ("Act") in the case of a company which belongs to any class of companies specified under that section.

"Book and paper" and "book or paper" as defined in Section 2(12) include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form;

Place of keeping books of account

Section 128(1) requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office.

Provided all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. Where such a decision is taken by the

Board the company shall within seven days thereof file with the registrar a notice in writing giving full address of that other place.

Maintenance of books of account in electronic form

A company has an option of keeping books of account or other relevant papers in electronic mode as per Rule 3 of the *Companies (Accounts) Rules, 2014*. Rule 3 lays down the manner of books of account to be kept in electronic mode.

(1) Such books of accounts or other relevant books or papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent reference.

(2) The information contained in the records shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.

(3) The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.

(4) The information in the electronic record of the document shall be capable of being displayed in a legible form.

(5) The back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.

(6) The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement following relevant information related to service provider—

(a) the name of the service provider;

(b) the internet protocol address of service provider;

(c) the location of the service provider (wherever applicable);

(d) where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.

Books of account - Branch Office

Where a company has a branch office in or outside India, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating

to the transactions effected at the branch office are kept at that office and proper summarized returns periodically are sent by the branch office to the company at its registered office and are kept open for inspection at the registered office of the company or at such other place in India by any director during business hours.

Inspection by Directors

As per Section 128 (3), any director can inspect the books of accounts and other books and papers of the company during business hours. Such inspection may be done by any type of director - nominee, independent, promoter or whole time.

The proviso to sub-section 3 provides that a person can inspect the books of accounts of the subsidiary, only on authorisation by way of the resolution of Board of Directors.

The Director can seek the information only individually and not by or through his attorney holder or agent or representative with respect to financial information maintained outside the country [Rule 4(4) of the *Companies (Accounts) Rules, 2014*].

Period for preservation of books [Section 128(5)]

The books of account of every company relating to a period of not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account shall be kept in good order. The provisions of Income Tax Act shall also be complied with in this regard.

Where an investigation has been ordered in respect of a company, the Central Government may direct that the books of account may be kept for such period longer than 8 years, as it may deem fit and give directions to that effect.

Persons responsible to maintain books

As per Section 128 (6) the person responsible to take all reasonable steps to secure compliance by the company with the requirement of maintenance of books of accounts etc. shall be:

(i) Managing Director,

(ii) Whole-Time Director, in charge of finance

(iii) Chief Financial Officer

(iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128.

Penalty provisions

In case the aforementioned persons referred to in sub-section (6) fail to take reasonable steps to secure compliance, they shall in respect of each offence, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or both.

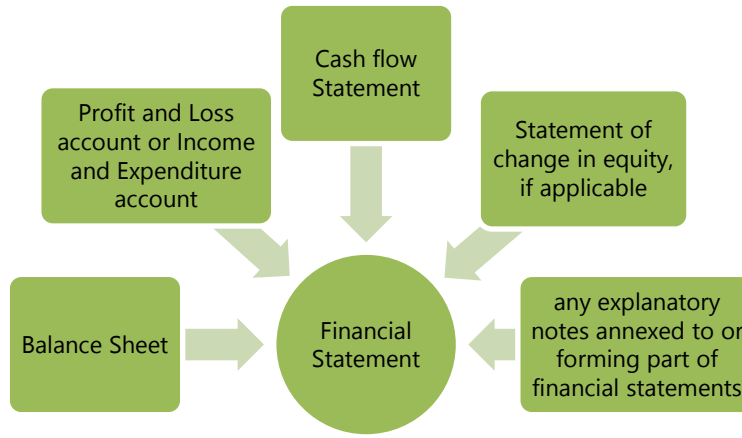
Example: XYZ Ltd. wants to maintain its books of account on cash basis. Is this a valid act of XYZ Ltd?

Answer: The Companies Act 2013 vide section 128(1) requires every company to prepare books of account and other relevant books and papers and financial statement for every financial year on accrual basis and double entry system of accounting. No exception has been given by the Act to any class or classes of companies from the above requirement. Hence XYZ Ltd. cannot maintain its books of accounts on cash basis.

3. FINANCIAL STATEMENT [SECTION 129][1]

Financial Statement — Definition

Financial Statement is defined under Section 2 (40), to include–



[1] Section 129 shall not apply to the Government Companies engaged in defence production to the extent of application of relevant Accounting Standard on segment reporting". [Amendment in the notification number G.S.R. 463(E) dated the 5th June, 2015 vide Notification no. S.O. 802(E) dated 23rd February, 2018]

However, the financial statement with respect to one Person Company, small company and dormant company, may not include the cash flow statement.

Financial statement should be prepared for financial year and as per the requirements of Schedule III.

"Financial year" [Section 2(41)], in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:

Provided further that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause.

Schedule III has been amended vide *Notification No. G.S.R. 404(E)* dated 6 April 2016 according to which Schedule III has been divided into two divisions.

Division I deals with financial statement for a company whose financial statement are required to comply with the *Companies (Accounting Standards) Rules, 2006*.

Division II deals with financial statement for a company whose financial statement are required to comply with the *Companies (Indian Accounting Standards) Rules, 2015*.

True and fair view

As per section 129(1), the financial statements shall give a true and fair view of the state of affairs of the company or companies. It shall comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

Non-applicability

Provided further that nothing contained in this sub-section shall apply to any insurance or banking company or any company engaged in the generation or

supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company:

Provided also that the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—

Type of company	Matters
Insurance company	Matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999
Banking company	Matters which are not required to be disclosed by the Banking Regulation Act, 1949
Company engaged in the generation or supply of electricity	Matters which are not required to be disclosed by the Electricity Act, 2003
Company governed by any other law	Matters which are not required to be disclosed by that law

Laying of financial Statements [Section 129(2)]

At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

Consolidation of financial statements [Section 129(3)]

(1) Where a company has one or more subsidiaries or associate companies, it shall, in addition to financial statements provided under sub-section (2), prepare a consolidated financial statement (CFS) of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with applicable accounting standards, which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2).

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in Form AOC-1 as per Rule 5 of the *Companies (Accounts) Rules, 2014*.

Provided further that the Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed under Rule 6 of the *Companies (Accounts) Rules, 2014*.

Explanation - For the purposes of this sub-section, the word "subsidiary" shall include associate company and joint venture.

Manner of consolidation of Accounts: The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Act and the applicable accounting standards.

In case where company is not required to prepare CFS: A company covered under sub-section (3) of section 129 which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act.

Exemptions from preparation of CFS: As per Companies (Accounts) Amendment Rules, 2016, preparation of consolidated financial statements by a company is not required if it meets the following conditions:

(i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

(ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in or outside India; and

(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Provided also that nothing contained in the relevant rule for consolidation of financial statements shall subject to any other law or regulation, apply for the financial year commencing from the 1st day of April, 2014 and ending on the 31st March, 2015, in case of a company which does not have a subsidiary or subsidiaries but has one or more associate companies or Joint ventures or both, for the consolidation of financial statement in respect of associate companies or joint ventures or both, as the case may be.

Provided also that nothing in this rule shall apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India only for the financial year 2014-15.

(2) The provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to the consolidated financial statements **[Section 129(4)]**.

(3) Without prejudice to sub-section (1), where the financial statements of a company do not comply with the accounting standards referred to in sub-section (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation **[Section 129(5)]**.

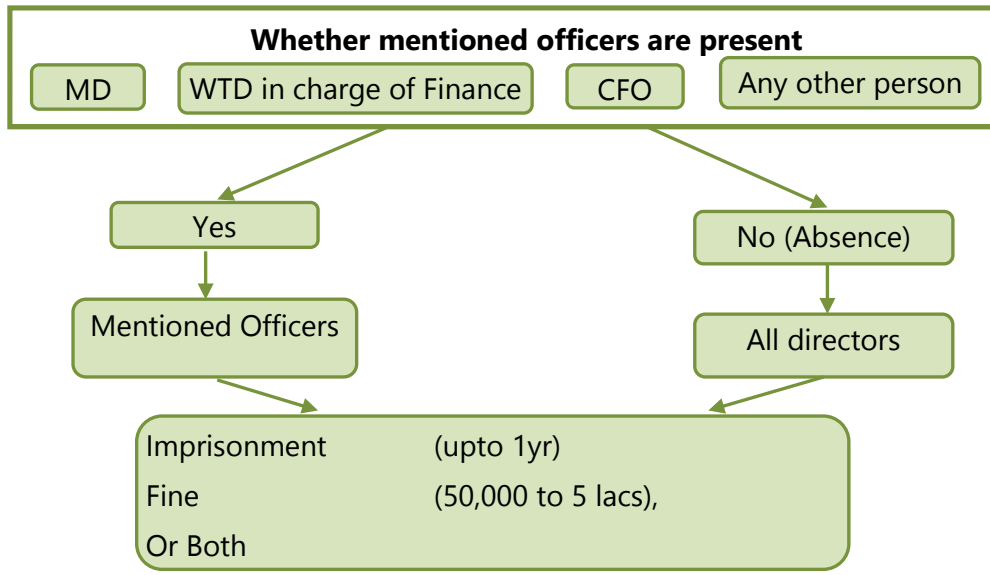
(4) The Central Government may, on its own or on an application by a class or classes of companies, by notification,[2] exempt any class or classes of companies from complying with any of the requirements of this section or the rules made there under, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification **[Section 129(6)]**.

Penal provisions [Section 129(7)]

If a company contravenes the provisions of this section, the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

[2] For exemptions granted to government companies engaged in production of Defence Equipments *Vide notification dated 4-9-2015*.

Company Contravenes the provisions of section 129



Explanation: For the purposes of section 129, any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act.

Example: The Board of Directors of ABC Ltd. wants to circulate unaudited accounts before the Annual General Meeting of the shareholders of the Company. Whether such an act of ABC Ltd. is tenable?

Answer: Section 129(2) of the Companies Act, 2013 provides that at every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year. Further section 134(7) provides that signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of:

(a) any notes annexed to or forming part of such financial statement;

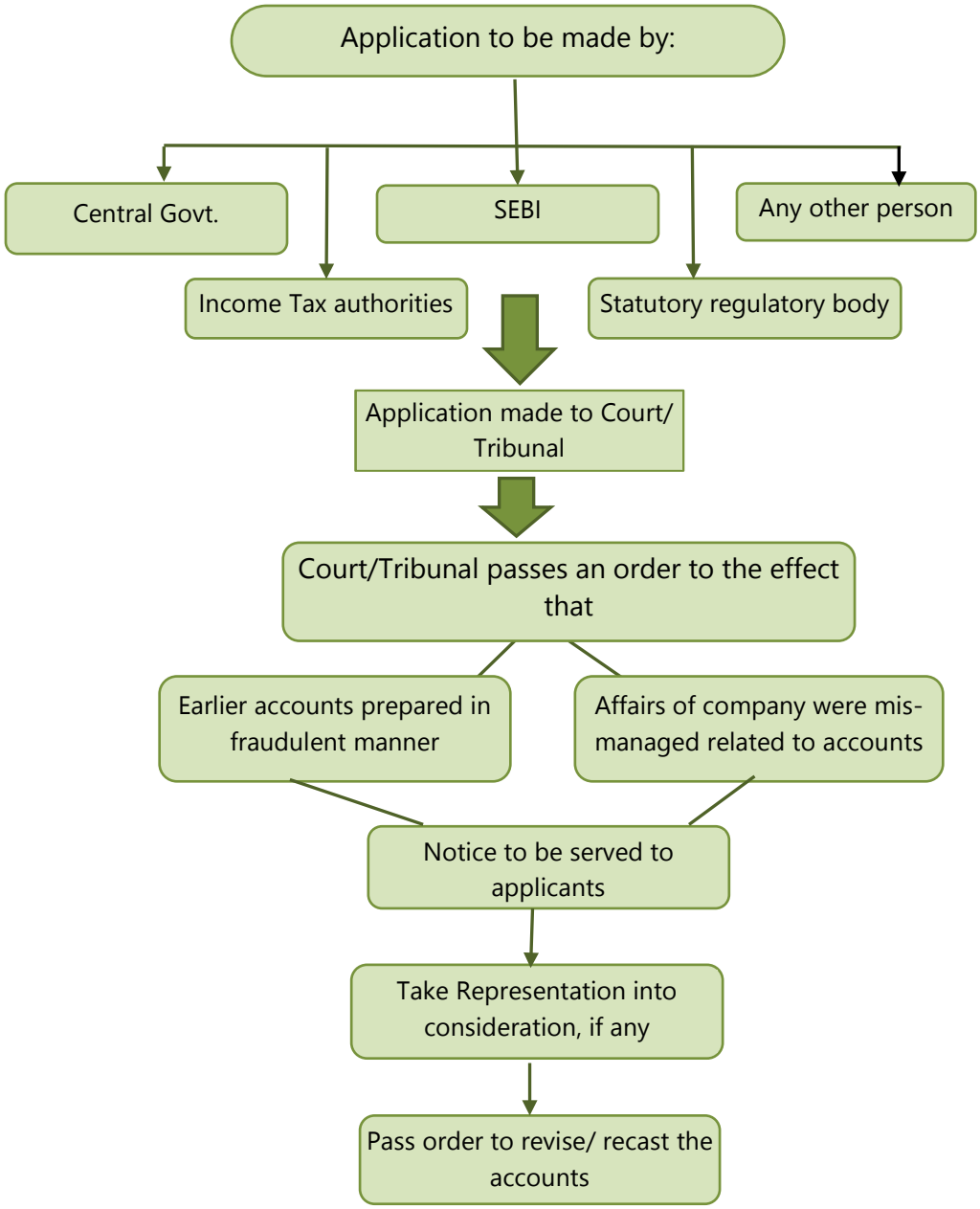
(b) the auditor's report; and

(c) the Board's report.

It, therefore, follows that unaudited accounts cannot be sent to members or unaudited accounts cannot be filed with the Registrar of Companies. So, such an act of ABC Ltd, is not tenable.

4. RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL ORDERS [SECTION 130]

This section seeks to provide for the re-opening of books of accounts and recasting its financial statements.



(1) Apply to court for re-opening of accounts—A company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by-

(a) the Central Government,

(b) the Income-tax authorities,

(c) the Securities and Exchange Board of India (SEBI),

(d) any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that—

(i) the relevant earlier accounts were prepared in a fraudulent manner; or

(ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements:

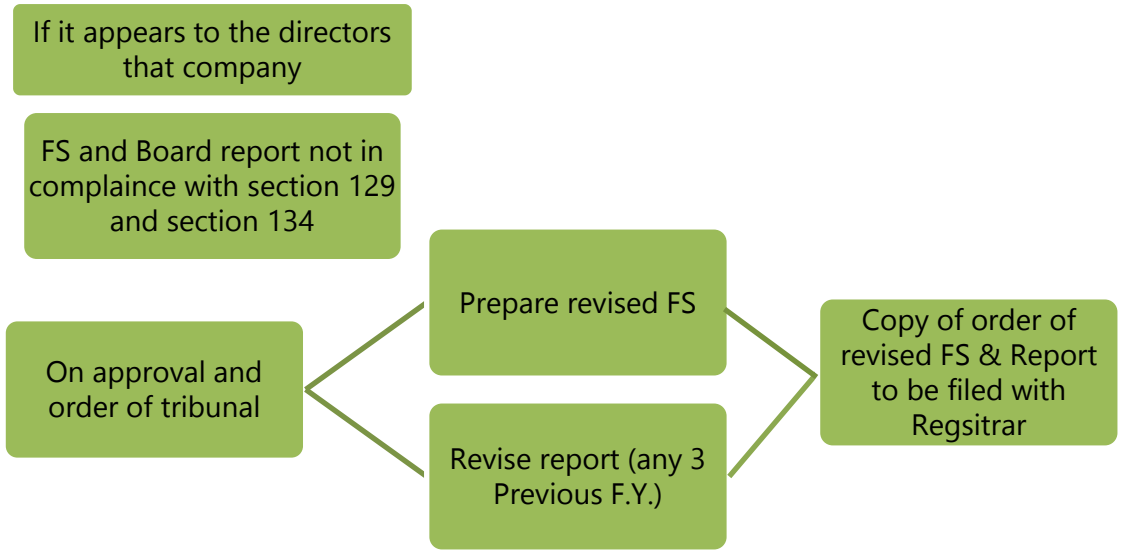
Serving of notice: Provided that the Court or the Tribunal, as the case may be, shall give notice to the Central Government, the Income-tax authorities, the Securities and Exchange Board or any other statutory regulatory body or authority concerned or any other person concerned and shall take into consideration the representations, if any, made by that Government or the authorities, SEBI or the body or authority concerned or the other person concerned before passing any order under this section [Sub- section (1)].

(2) Revised accounts shall be final: The accounts so revised or re-casted, shall be final.

(3) Time Limit in respect of re-opening of books of account: No order shall be made under sub-section (1) in respect of re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year:

Provided that where a direction has been issued by the Central Government under the proviso to sub-section (5) of section 128 for keeping of books of account for a period longer than eight years, the books of account may be ordered to be re-opened within such longer period.

5. VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT [SECTION 131]



(1) Preparation of revised financial statement or revised report on the approval of Tribunal: If it appears to the directors of a company that—

(a) the financial statement of the company; or

(b) the report of the Board,

do not comply with the provisions of section 129 or section 134, they may prepare revised financial statement or a revised report in respect of any of the three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar.

Tribunal to serve the notice:

Provided that the Tribunal shall give notice to the Central Government and the Income tax authorities and shall take into consideration the representations, if any, made by that Government or the authorities before passing any order under this section.

Number of times of revision and recast:

Provided further that such revised financial statement or report shall not be prepared or filed more than once in a financial year.

Reason for revision to be disclosed:

Provided also that the detailed reasons for revision of such financial statement or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made.

(2) Limits of revisions: Where copies of the previous financial statement or report have been sent out to members or delivered to the Registrar or laid before the company in general meeting, the revisions must be confined to—

(a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134; and

(b) the making of any necessary consequential alternation.

(3) Framing of rules by the Central Government in relation to revised financial statement or director's report: The Central Government may make rules as to the application of the provisions of this Act in relation to revised financial statement or a revised director's report and such rules may, in particular—

(a) make different provisions according to which the previous financial statement or report are replaced or are supplemented by a document indicating the corrections to be made;

(b) make provisions with respect to the functions of the company's auditor in relation to the revised financial statement or report;

(c) require the directors to take such steps as may be prescribed

6. CONSTITUTION OF NATIONAL FINANCIAL REPORTING AUTHORITY [SECTION 132]

(1) The Central Government may, by notification, constitute the National Financial Reporting Authority (NFRA) to provide for matters relating to accounting and auditing standards under this Act.

(2) Notwithstanding anything contained in any other law for the time being in force, the NFRA shall—

(a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;

(b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;

(c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and

(d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

(3) The NFRA shall consist of a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law to be appointed by the Central Government and such other members not exceeding fifteen consisting of part-time and full-time members as may be prescribed.

Provided that the terms and conditions and the manner of appointment of the chairperson and members shall be such as may be prescribed.

Provided further that the chairperson and members shall make a declaration to the Central Government in the prescribed form regarding no conflict of interest or lack of independence in respect of his or their appointment.

Provided also that the chairperson and members, who are in full-time employment with NFRA shall not be associated with any audit firm (including related consultancy firms) during the course of their appointment and two years after ceasing to hold such appointment.

(4) Notwithstanding anything contained in any other law for the time being in force, the NFRA shall—

(a) have the power to investigate, either *suo moto* or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.

Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the NFRA has initiated an investigation under this section.

(b) have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:—

(i) discovery and production of books of account and other documents, at such place and at such time as may be specified by the NFRA;

(ii) summoning and enforcing the attendance of persons and examining them on oath;

(iii) inspection of any books, registers and other documents of any person referred to in clause (b) at any place;

(iv) issuing commissions for examination of witnesses or documents;

(c) where professional or other misconduct is proved, have the power to make order for—

(A) imposing penalty of—

(I) not less than one lakh rupees, but which may extend to five times of the fees received, in case of individuals; and

(II) not less than five lakh rupees, but which may extend to ten times of the fees received, in case of firms;

(B) debarring the member or the firm from engaging himself or itself from practice as member of the ICAI referred to in clause (e) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 for a minimum period of six months or for such higher period not exceeding ten years as may be decided by the NFRA.

Explanation — For the purposes of this sub-section, the expression "professional or other misconduct" shall have the same meaning assigned to it as given under section 22 of the Chartered Accountants Act, 1949.

In exercise of the powers conferred under sub-sections (2) and (4) of section 132, the Central Government made the **National Financial Reporting Authority Rules, 2018 (NFRA Rules).**

As per NFRA rules, NFRA shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate:

a) companies whose securities are listed on any stock exchange in India or outside India;

b) unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year;

c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and (f) of section 1 (4) of the Companies Act, 2013;

d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the NFRA by the Central Government in public interest; and

e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d) above, if the income or networth of such subsidiary or associate company exceeds 20% of the consolidated income or consolidated networth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d) above.

Every existing body corporate other than a company governed by these rules, shall inform the NFRA within 30 days of the commencement of NFRA rules, in Form NFRA-1, the particulars of the auditor as on the date of commencement of these rules.

A company or a body corporate other than a company governed under NFRA Rules shall continue to be governed by the NFRA for a period of 3 years after it ceases to be listed or its paid-up capital or turnover or aggregate of loans, debentures and deposits falls below the limit stated therein (i.e. mentioned in points a to e above).

Recommending accounting standards (AS) and auditing standards (SA) - For the purpose of recommending AS or SA for approval by the Central Government, the NFRA -

a) shall receive recommendations from the ICAI on proposals for new AS or SA or for amendments to existing AS or SA;

b) may seek additional information from the ICAI on the recommendations received under clause (a), if required.

The NFRA shall consider the recommendations and additional information in such manner as it deems fit before making recommendations to the Central Government.

Punishment in case of non-compliance - If a company or any officer of a company or an auditor or any other person contravenes any of the provisions of NFRA Rules, the company and every officer of the company who is in default or the auditor or such other person shall be punishable as per the provisions of section 450 of the Act.

[3](5) Any person aggrieved by any order of the NFRA issued under clause (c) of sub-section (4), may prefer an appeal before the Appellate Tribunal in such manner and on payment of such fee as may be prescribed.

(10) The NFRA shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such manner as may be prescribed.

(11) The Central Government may appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the NFRA under this Act and the terms and conditions of service of the secretary and employees shall be such as may be prescribed.

(12) The head office of the NFRA shall be at New Delhi and the NFRA may, meet at such other places in India as it deems fit.

(13) The NFRA shall cause to be maintained such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the Comptroller and Auditor-General of India (CAG) prescribe.

(14) The accounts of the NFRA shall be audited by the CAG at such intervals as may be specified by him and such accounts as certified by the CAG together with the audit report thereon shall be forwarded annually to the Central Government by the NFRA.

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[3] Sub Section (6), (7), (8) and (9) have been omitted [Via Companies (Amendment) Act, 2017, *Notification S. O. 630 (E) dated 9th February*]

(15) The NFRA shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the CAG to be laid before each House of Parliament.

7. CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS [SECTION 133]

Section 133 of the Companies Act, 2013 deals with the power of the Central Government to prescribe the accounting standards.

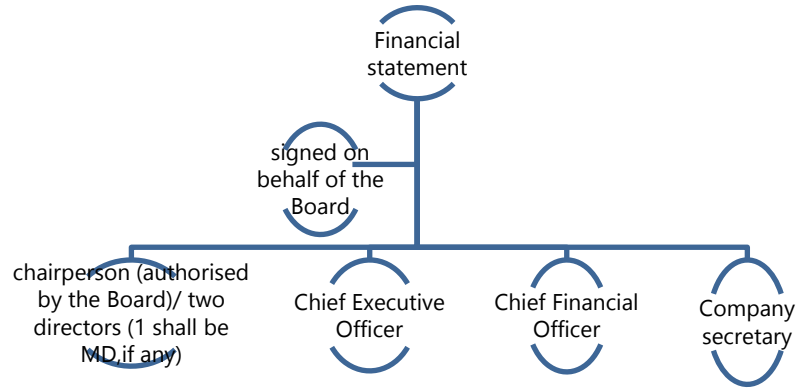
The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the ICAI in consultation with and after examination of the recommendations made by the NFRA.

Provided that until the NFRA is constituted under section 132 of the Companies Act, 2013, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the ICAI in consultation with and after examination of the recommendations made by the NACAS.

8. FINANCIAL STATEMENT, BOARD'S REPORT, ETC. [SECTION 134]

Section 134 deals with financial statements as well as board's report. The auditor's report is to be attached to every financial statement. A report by the Board of directors containing details on the matters specified, including director's responsibility statement, shall be attached to every financial statement laid before company. The Board's report and every annexure has to be duly signed. A signed copy of every financial statement shall be circulated, issued or published along with all notes or documents, the auditor's report and Board's report.

(i) Authentication of Financial statements [Section 134(1), (2) & (7)]:



(a) The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board at least by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director and the Chief Executive Officer, if he is a director in the company, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One person company, only by one director, for submission to the auditor for his report thereon.

(b) The auditors' report shall be attached to every financial statement [Sub-section (2)].

(c) A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—

(1) Any notes annexed to or forming part of such financial statement;

(2) The auditor's report; and

(3) The Board's report [Sub- section (7)].

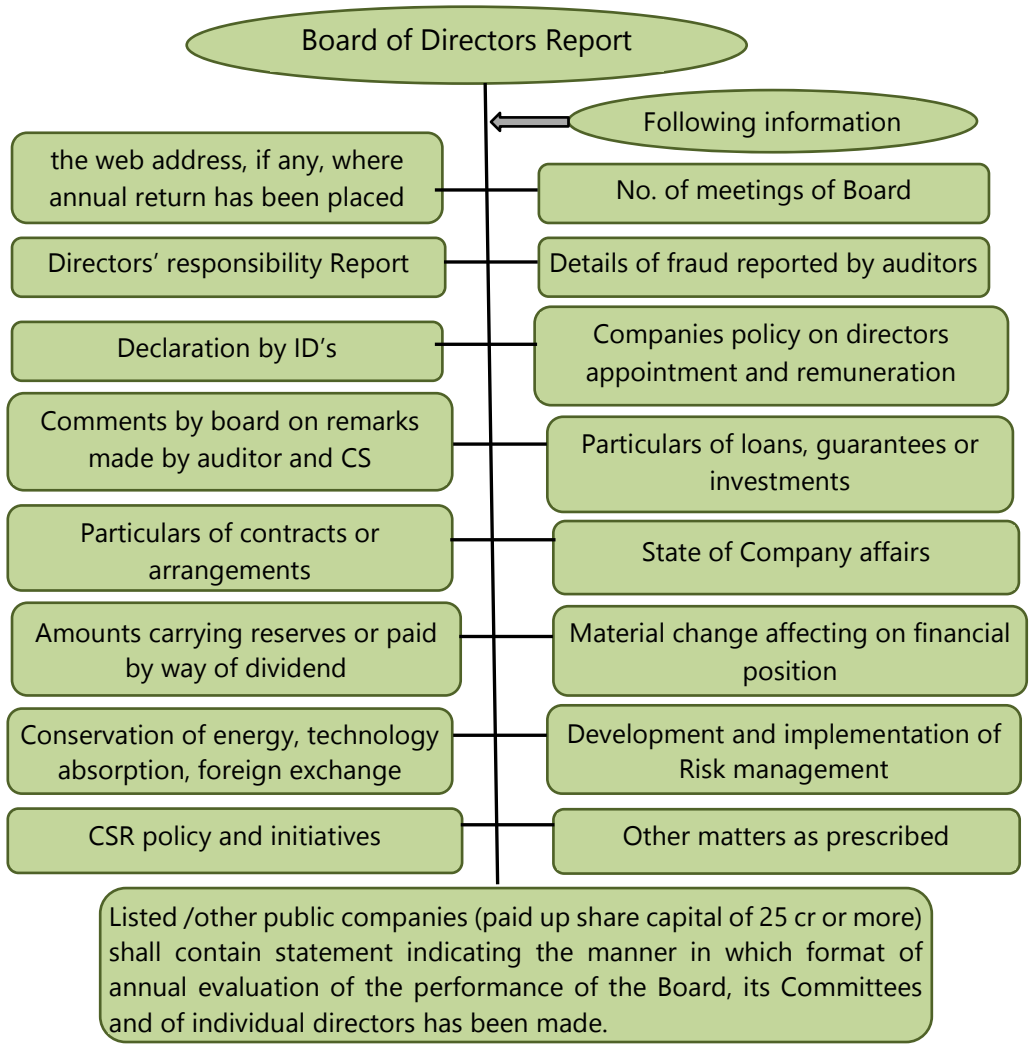
(ii) Board's report [Section 134(3) & (4)]:

(1) According to [4]Rule 8 of the Companies (Accounts) Rules, 2014, the Board's Report shall be prepared based on the standalone financial statement of the

[4] This rule (i.e. Rule 8) shall not apply to One Person Company or Small Company. [Sub Rule (6) of Rule 8]

company and shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report .

(2)[5] There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—



[5] In case of specified IFSC public & IFSC private company, if any information listed in this sub-section is provided in the financial statement, the company may not include such information in the report of the Board of Directors.

(a) the extract of annual return as provided under sub-section (3) of section 92;

(b) number of meetings of the Board;

(c) directors' responsibility statement;

(ca) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government;

(d) a statement on declaration given by independent directors under sub-section (6) of section 149;

(e) in case of a company covered under sub-section (1) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;

(f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—

(i) by the auditor in his report; and

(ii) by the company secretary in practice in his secretarial audit report;

(g) particulars of loans, guarantees or investments under section 186;

(h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form;

(i) the state of the company's affairs;

(j) the amounts, if any, which it proposes to carry to any reserves;

(k) the amount, if any, which it recommends should be paid by way of dividend;

(l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;

(m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;

(n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;

(o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;

(p) in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its Committees and of individual directors has been made;

According to Rule 8(4), every listed company and every other public company having a paid up share capital of twenty five crore rupees or more calculated at the end of the preceding financial year shall include, in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.

Exemption to Government company- This clause [i.e. clause (p)] shall not apply to the Government Company in case the directors are evaluated by the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government, as per its own evaluation methodology [*vide Notification dated 5 June 2015]*.

(q) such other matters as may be prescribed [See **].

Provided that where disclosures referred to in this sub-section have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board's report.

Provided further that where the policy referred to in clause (e) or clause (o) is made available on company's website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board's report and the web-address is indicated therein at which the complete policy is available.

**According to Rule 8 of the *Companies (Accounts) Rules, 2014,* the report of the Board shall also contain–

(i) the financial summary or highlights;

(ii) the change in the nature of business, if any;

(iii) the details of directors or key managerial personnel who were appointed or have resigned during the year;

(iv) the names of companies which have become or ceased to be its subsidiaries, joint ventures or associate companies during the year;

(v) the details relating to deposits like-

  (a) accepted during the year;

  (b) remained unpaid or unclaimed as at the end of the year;

  (c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-

    (1) at the beginning of the year;

    (2) maximum during the year;

    (3) at the end of the year;

(vi) the details of deposits which are not in compliance with the requirements of Chapter V of the Act;

(vii) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;

(viii) the details in respect of adequacy of internal financial controls with reference to the Financial Statements.

(ix) a disclosure, as to whether maintenance of cost records as specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013, is required by the Company and accordingly such accounts and records are made and maintained,

(x) a statement that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013.

Non- applicability of Rule 8 of Companies (Accounts) Rules, 2014: This rule shall not apply to One Person Company or Small Company.

(3) Abridged Board's report [Section 134(3A)]: The Central Government may prescribe an abridged Board's report, for the purpose of compliance with this section by One Person Company or small company.

(4) Board's Report in case of OPC [Section 134(4)]: In case of a One Person Company, the report of the Board of Directors to be attached to the financial statement under this section shall, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

(iii) Directors' Responsibility Statement [Section 134(5)]: The Directors' Responsibility Statement referred to in 134(3) (c) shall state that—

(1) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(2) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(3) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(4) the directors had prepared the annual accounts on a going concern basis; and

(5) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Here, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

(6) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

(iv) Signing of Board's Report [Section 134(6)]:

The Board's report and any annexures thereto shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

(v) Contravention [Section 134(8)]:

Persons liable	**Punishment for contravention of any provision of this section**
Company	fine which shall not be less than ₹ 50,000 but which may extend to ₹ 25 Lacs
Every officer of the company who is in default	(1) Imprisonment for a term which may extend to 3 years; or (2) fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5 Lacs; or (3) Both with imprisonment and fine

Example: ABC Company is a one person company and has only one director. Who shall authenticate the balance sheet and statement of profit & loss and the Board 's report?

Answer: In case of a One Person Company, the financial statements shall be signed by only one director, for submission to the auditor for his report thereon. So, the financial statements signed by one director shall be considered in order.

9. CORPORATE SOCIAL RESPONSIBILITY [SECTION 135][6]

The Companies Act, 2013 lays down the provisions requiring corporates to mandatorily spend a prescribed percentage of their profits on certain specified areas of social upliftment in discharge of their social responsibilities. Broadly, Corporate Social Responsibility (CSR) implies a concept, whereby companies decide to contribute to a better society and a cleaner environment – a concept, whereby the companies integrate social and other useful concerns in their business operations for the betterment of its stakeholders and society in general.

Corporate Social Responsibility: *The Companies (CSR Policy) Rules, 2014 [Rule 2(1)(c)]* provides the exhaustive definition of CSR which provides that the CSR means and includes but is not limited to:

(i) Projects or programs relating to activities areas or subjects specified in Schedule VII to the Act; or

(ii) Projects or programs relating to activities undertaken by the board of directors of a company in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy include activities, areas or subjects specified in Schedule VII of the Act.

According to section 135 of the Companies Act, 2013 read with the *Companies (Corporate Social Responsibility) Rules, 2014:*

(i) Which company is required to constitute CSR committee:

(a) According to section 135(1), every company having

(1) net worth of rupees 500 crore or more, or

(2) turnover of rupees 1000 crore or more or

(3) a net profit of rupees 5 crore or more

during the immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of

[6] In case of specified IFSC public & IFSC private company, section 135 shall not apply for period of 5 years from the commencement of business of a specified IFSC public company

three or more directors, out of which at least one director shall be an independent director.

Provided that where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more directors.

As per Rule 3(1) of the Companies (Corporate Social Responsibility) Rules, 2014-

Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (I) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules.

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and Profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

"Net worth" [As per Section 2(57)] means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

Explanation.—For the purposes of this section (i.e. section 135) **"net profit"** shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198.

Example:

The statutory auditors of a company were required to issue a certificate on the net worth of the company as per the requirement of the management as of 30 September 2018 computed as per the provision of section 2(57) of the Companies Act, 2013.

The company had fair valued its property, plant and equipment in the current year which was mistakenly taken into retained earnings of the company in its

books of accounts. Please advise whether this fair valuation would be covered in the net worth of the company as per the legal requirements.

Solution:

As per sec 2(57) of the Companies Act 2013, any reserves created out of revaluation of assets doesn't form part of net worth. The company fair valued its property, plant and equipment and took that to retained earnings.

Even if the company has taken the fair valuation to the retained earnings in its books of accounts, the resultant credit in reserves (by whatever name called) would be in the category of 'reserves created out of revaluation of assets' which is specifically excluded in the definition of 'net worth' in section 2 (57) and hence should be excluded by the company.

Further the auditors should also consider the matter related to accounting of this reserve separately at the time of audit of books of accounts of the company.

Example: ABC Ltd is a company with a turnover of more than ₹ 1000 crores and having incurred a loss in one of the preceding three financial years. Will it be required to comply with CSR?

Answer: As per section 135(1) of the Act, if any one of the three criteria (whether net worth, or turnover or net profit) gets satisfied then the company is mandatorily required to comply with the CSR provisions. Hence ABC Ltd will be required to comply with CSR based on its turnover.

(ii) Exclusion of Companies [Rule 3(2) of the Companies (CSR) Rules, 2014]

Every company which ceases to be a company covered under subsection (1) of section 135 of the Act for three consecutive financial years shall not be required to-

(a) constitute a CSR Committee; and

(b) comply with the provisions contained in sub-section (2) to (5) of the said section,

till such time it meets the criteria specified in sub-section (1) of section 135.

(iii) Composition of CSR Committee:

(1) The CSR Committee shall be consisting of three or more directors, out of which at least one director shall be an independent director.

Provided that where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more directors.

(2) According to *Rule 5(1) of the Companies (CSR) Rules, 2014*,

The companies mentioned in the rule 3 shall constitute CSR Committee as under.-

(i) an unlisted public company or a private company covered under subsection (1) of section 135 which is not required to appoint an independent director pursuant to sub-section (4) of section 149 of the Act, shall have its CSR Committee without such director ;

(ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

(iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Act and another person shall be nominated by the foreign company

(3) According to *Rule 5(2) of the Companies (CSR) Rules, 2014*, the CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

(4) The Board's report under sub-section (3) of section 134 shall disclose the composition of the CSR Committee.

(iv) Duties of CSR Committee [Section 135(3)]:

The CSR Committee shall-

(a) formulate and recommend to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII;

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and

(c) monitor the CSR Policy of the company from time to time.

(v) Contents of the CSR Policy [Rule 6 of the Companies (CSR) Rules, 2014]:

(a) List of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

(b) monitoring process of such projects or programs:

(c) Provided that the CSR activities do not include the activities undertaken in pursuance of normal course of business of a company.

(d) Provided further that the Board of Directors shall ensure that activities included by a company in its CSR Policy are related to the areas or subjects specified in Schedule VII of the Act.

(e) The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

(vi) Duties of the Board in relation to CSR [Section 135(4)]:

The Board of every company referred to in sub-section (1) shall—

(1) after taking into account the recommendations made by the CSR Committee, approve the CSR Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and

(2) ensure that the activities as are included in CSR Policy of the company are undertaken by the company.

(vii) Amount of contribution towards CSR [Section 135(5)]:

(a) The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR Policy.

(b) Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.

(c) Provided further that if the company fails to spend such amount, the Board shall, in its report, specify the reasons for not spending the amount.

(d) Companies may build CSR capacities of their own personnel as well as those of implementing agencies through institutions with established track records of at least three financial years but such expenditure including expenditure on administrative overhead shall not exceed 5% of total CSR expenditure of the company in one financial year [Rule 4 of the *Companies (CSR Policy) Rules, 2014*].

Example: XYZ Ltd is a listed company having turnover of ₹ 1200 crores during the financial year 2017-18. The CSR committee of the Board of the company formulated and recommended a CSR project which was approved by the Board. The company finalised the project under its CSR initiatives which require funds @ 5 % of average net profit of the company for last three financial years. Will such excess expense be counted in subsequent financial years as a part of CSR expenditure? Please advise.

Answer: In terms of Section 135(5) of the Companies Act, 2013, the Board of every company to which section 135 is applicable, shall ensure that the company spends, in every financial year at least 2 percent of average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR policy. There is no provision for carry forward of excess expenditure to the next year(s). The words used in the section are 'at least'. Therefore, any expenditure over 2% would be considered as voluntary higher spending.

(viii) CSR Activities:

Rule 4 of the *Companies (CSR Policy) Rules, 2014* states the various CSR activities that shall be undertaken by the companies.

(1) The CSR activities shall be taken by the company as per its CSR Policy, as projects or programmes or activities excluding activities undertaken in pursuance of its normal course of business.

(2) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through

(a) a company established under section 8 of the Act or a registered trust or a registered society, established by the company, either singly or alongwith any other company, or

(b) a company established under section 8 of the Act or a registered trust or a registered society, established by the Central

Government or State Government or any entity established under an Act of Parliament or a State legislature:

Provided that- if, the Board of a company decides to undertake its CSR activities through a company established under section 8 of the Act or a registered trust or a registered society, other than those specified in this sub-rule, such company or trust or society shall have an established track record of three years in undertaking similar programs or projects; and the company has specified the projects or programs to be undertaken, the modalities of utilisation of funds of such projects and programs and the monitoring and reporting mechanism.

(3) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

(4) Subject to provisions contained in section 135(5), the CSR projects or programs or activities undertaken in India only shall amount to CSR expenditure.

(5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

(6) Companies may build CSR capacities of their own personnel as well as those of implementing agencies through Institutions with established track records of at least three financial years but such expenditure including expenditure on administrative overhead shall not exceed 5% of total CSR expenditure of the company in one financial year.

(7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

Example

ADV Ltd is engaged in the business of construction and has various projects which are under execution in Delhi-NCR region. The company is also looking for new projects, particularly in Southern part of India based on an understanding that the margins are very high over there.

During the year ended 31 March 2018, the company got covered within the requirements of CSR. Considering the nature of its business, company has a large employee base and it decided to spend CSR on some activity related to construction which would benefit its employees and would indirectly also help the business of the company. Please advise on this.

Solution:

As per the requirements of CSR, the projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act. Accordingly, in the given case, the activity planned by the company related to its business only and that too only for the benefit of its employees would not be considered as part of CSR requirements.

(ix) Exceptions to CSR Activities:

The *Companies (CSR Policy) Rules, 2014* provides for some activities which are not considered as CSR activities:

(1) The CSR projects or programs or activities undertaken outside India [Rule 4(4)].

(2) The CSR projects or programs or activities that benefit only the employees of the company and their families [Rule 4(5)].

(3) Contribution of any amount directly or indirectly to any political party under section 182 of the Act [Rule 4(7)].

(x) Calculation of Average Net profit:

(a) Here, "average net profit" shall be calculated in accordance with the provisions of section 198 [Explanation to section 135].

(b) "Net profit" shall not include the following:

(1) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

(2) Any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act.

However, net profits in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions

of the Companies Act, 1956, shall not be required to be re-calculated in accordance with the provisions of the Act.

It is further provided that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act [Rule 2(f)].

(xi) CSR Reporting (Rule 8):

(a) The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1 April 2014 shall include an annual report on CSR.

(b) In case of a foreign company, the balance sheet filed under section 381(1)(b) shall contain an Annexure regarding report on CSR.

(xii) Activities specified under Schedule VII:

Activities which may be included by companies in their CSR Policies (i.e. Activities as specified under Schedule VII) are as follows:

(1) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;

(2) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(3) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(4) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set up by the Central Government for rejuvenation of river Ganga;

(5) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up

public libraries; promotion and development of traditional arts and handicrafts;

(6) measures for the benefit of armed forces veterans, war widows and their dependents;

(7) training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

(8) contribution to the Prime Minister's National Relief Fund or any other - fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(9) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

(10) rural development projects;

(11) slum area development. [For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.]

The MCA vide *General Circular No. 21/2014 dated 18 June 2014* has provided many clarifications with regard to provisions of Corporate Social Responsibility under section 135 of the Companies Act, 2013 which are as under:

(i) The statutory provision and provisions of CSR Rules, 2014, is to ensure that while activities undertaken in pursuance of the CSR policy must be relatable to Schedule VII of the Companies Act 2013, the entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule.

(ii) It is further clarified that CSR activities should be undertaken by the companies in project/ programme mode. One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. would not be qualified as part of CSR expenditure.

(iii) Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) would not count as CSR expenditure under the Companies Act.

(iv) Salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.

(v) "Any financial year" referred under sub-section (1) of section 135 of the Act read with the Companies CSR Rule, 2014, implies 'any of the three preceding financial years.

(vi) Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

(vii) 'Registered Trust' would include Trusts registered under Income Tax Act 1956, for those States where registration of Trust is not mandatory.

(viii) Contribution to Corpus of a Trust/ society/ section 8 companies etc. will qualify as CSR expenditure as long as (a) the Trust/ society/ section 8 companies etc. is created exclusively for undertaking CSR activities or (b) where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act.

Penal Provisions

The Companies Act requires that—

(i) The Board's report shall disclose the composition of the Corporate Social Responsibility Committee as per subsection (3) of section 134;

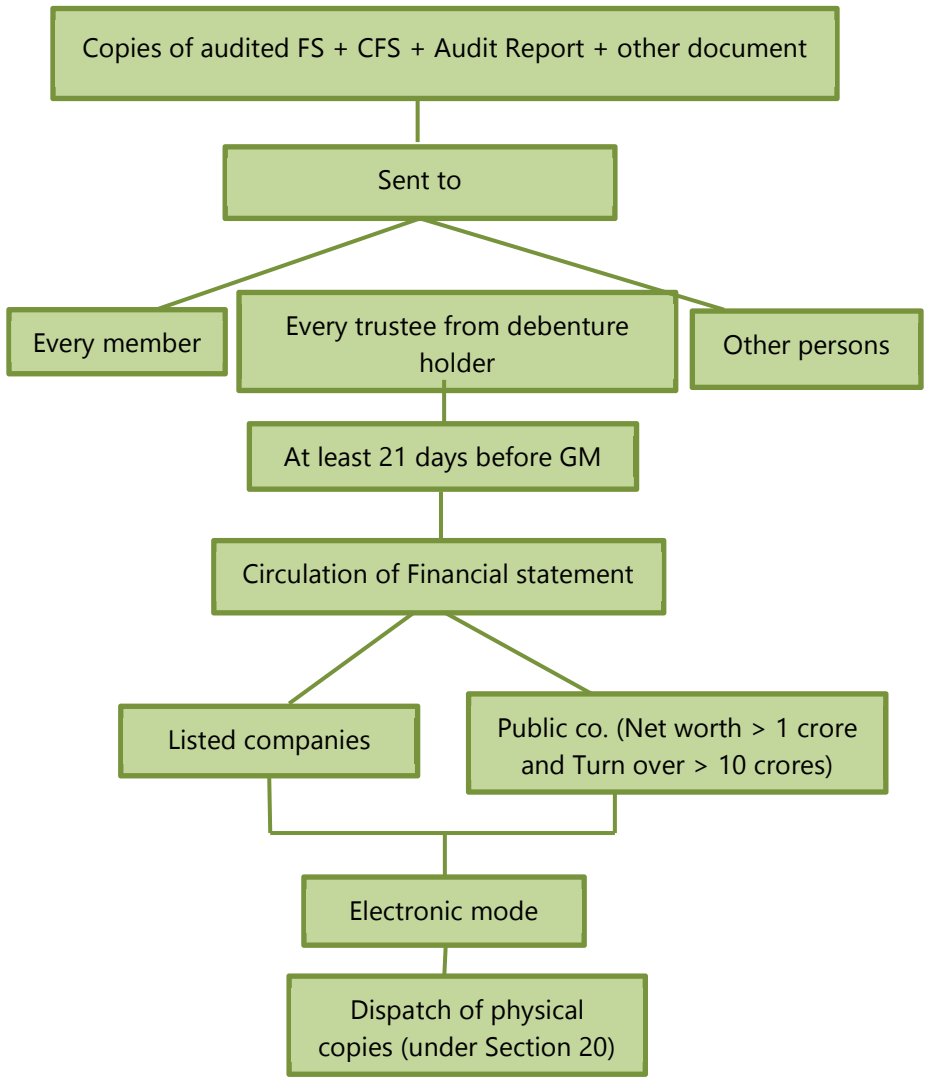
(ii) If the company fails to spend such amount (i.e. at least two percent of the average net profit), the Board shall disclose and specify the reasons for not spending the amount in its report as per Clause (o) of sub-section (3) of section 134.

As per section 134 of Companies Act, 2013 if the Company fails to disclose such information, it shall be punishable with fine, which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term

which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

10. RIGHT TO MEMBERS TO COPIES OF AUDITED FINANCIAL STATEMENT [SECTION 136]

This section seeks to provide that a copy of financial statements including consolidated financial statement and auditor's report shall be sent to every member, every trustee for the debenture holder and all other persons who are so entitled, twenty one days before the date of general meeting.



(i) Who are entitled to audited financial statement?

According to section 136(1) of the Companies Act, 2013,

A copy of the financial statements, including consolidated financial statements, if any, auditor's report and every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting, shall be sent to every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled, not less than twenty-one days before the date of the meeting.

Provided that if the copies of the documents are sent not less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by members—

(a) holding, if the company has a share capital, majority in number entitled to vote and who represent not less than ninety-five per cent. Of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(b) having, if the company has no share capital, not less than ninety five percent of the total voting power exercisable at the meeting:

Provided further that in the case of a listed company, the provisions of this sub-section shall be deemed to be complied with, if the copies of the documents are made available for inspection at its registered office during working hours for a period of twenty-one days before the date of the meeting and a statement containing the salient features of such documents in the prescribed form or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than twenty-one days before the date of the meeting unless the shareholders ask for full financial statements.

Provided further that the Central Government may prescribe the manner of circulation of financial statements of companies having such net worth and turnover as may be prescribed.

Provided further that a listed company shall also place its financial statements including consolidated financial statements, if any, and all other documents

required to be attached thereto, on its website, which is maintained by or on behalf of the company.

Provided also that every listed company having a subsidiary or subsidiaries shall-

a) place separate audited accounts in respect of each of subsidiary on its website, if any;

b) provide a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder of the company who asks for it.

Provided also that a listed company which has a subsidiary incorporated outside India (herein referred to as "foreign subsidiary")—

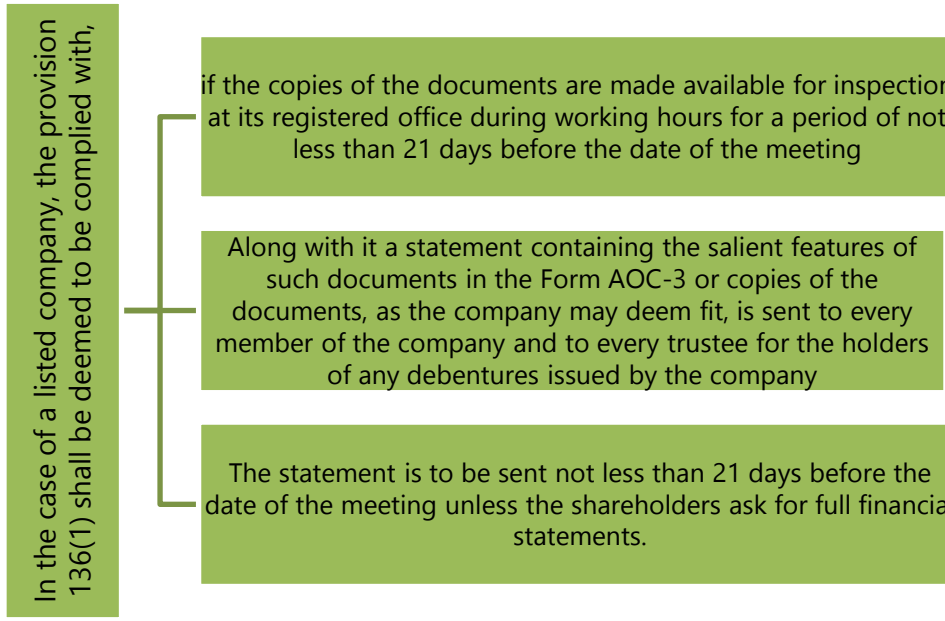
(a) where such foreign subsidiary is statutorily required to prepare consolidated financial statement under any law of the country of its incorporation, the requirement of this proviso shall be met if consolidated financial statement of such foreign subsidiary is placed on the website of the listed company;

(b) where such foreign subsidiary is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the holding Indian listed company may place such unaudited financial statement on its website and where such financial statement is in a language other than English, a translated copy of the financial statement in English shall also be placed on the website.

***__Exemption to Section 8 Companies:__** In case of section 8 company - in Sub-section (1) of Section 136 for the words "twenty one days", the words "fourteen days" shall be substituted. - *Notification dated 5 June 2015*.

In case of Nidhi company - Section 136 (1) shall apply, subject to the modification that, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than one per cent, of the total paid-up share capital, whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by public notice in newspaper circulated in the district in which the Registered Office of the company is situated stating the date, time and venue of AGM and the financial statement with its enclosures can be inspected at the registered office of the company and the financial statement with enclosures

are affixed in the notice board of the company and a member is entitled to vote either in person or through proxy (*Notification dated 5 June 2015).*



A company shall also allow every member or trustee of the debenture holder to inspect the audited financial statement at its registered office during business hours.

(ii) Manner of circulation of financial statements in certain cases:

(a) In case of all listed companies and such public companies which have a net worth of more than one crore rupees and turnover of more than ten crore rupees, the financial statements may be sent *[Rule 11 of the Companies (Accounts) Rules, 2014]*-

(1) by electronic mode to such members whose shareholding is in dematerialized format and whose email Ids are registered with Depository for communication purposes;

(2) where shareholding is held otherwise than by dematerialized format, to such members who have positively consented in writing for receiving by electronic mode (this may not be relevant considering that shareholding is not held otherwise than by dematerialized form anymore); and

(3) by dispatch of physical copies through any recognised mode of delivery as specified under section 20 of the Act, in all other cases.

(iii) Contravention:

(a) If any default is made in complying with the provisions of this section, the company shall be liable to a penalty of ₹ 25,000.

(b) Every officer of the company who is in default shall be liable to a penalty of ₹ 5,000.

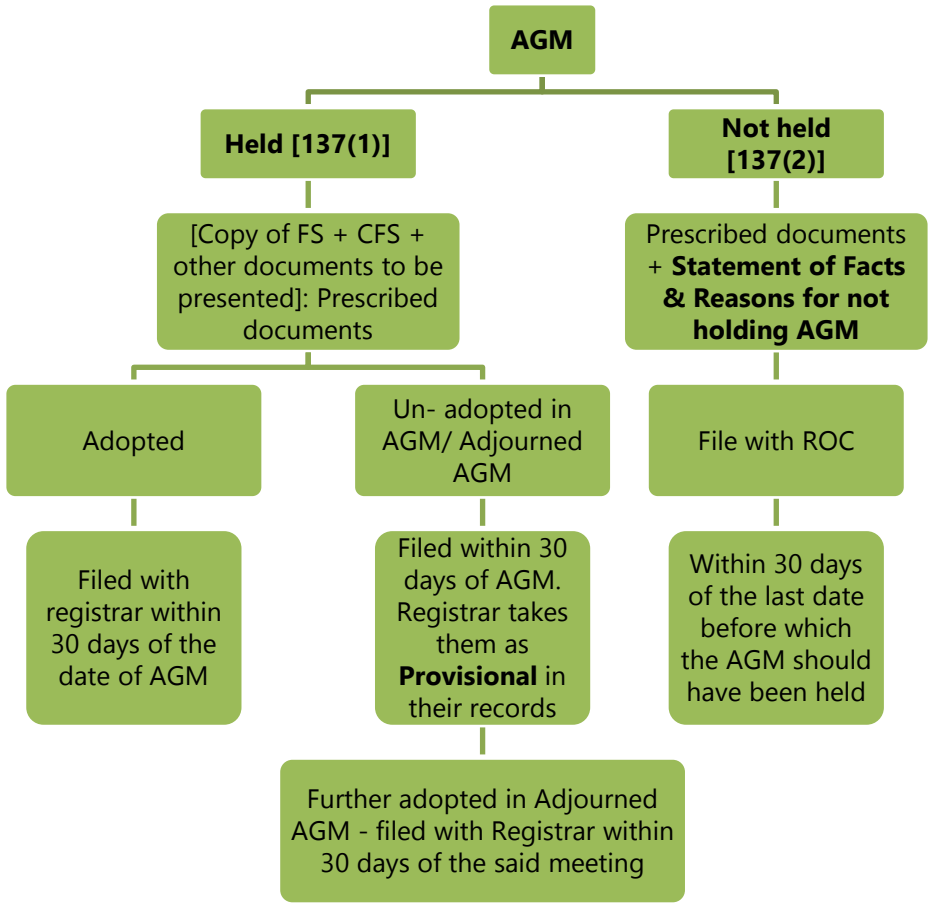
Vide General Circular No. 11/2015, dated 21 July 2015, clarification was issued by MCA with regard to circulation and filing of financial statement.

It has been clarified that a company holding general meeting after giving shorter notice as provided under section 101 of the Act may also circulate financial statements (to be laid/ considered in the same general meeting) at such shorter notice.

It has also been clarified that in case of foreign company which is not required to get its accounts audited as per the legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding or parent Indian company may place or file such unaudited accounts to comply with requirements of section 136(1) and 137(1), as applicable. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.

11. COPY OF FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR [SECTION 137]

This section provides that copies of financial statement including consolidated financial statement, if any, along with all the documents annexed to financial statement and adopted at AGM shall be filed with Registrar.



(i) Filing of financial statements [Section 137(1)]:

(1) A copy of the financial statements, including consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the AGM of the company, shall be filed with the Registrar within 30 days of the date of AGM in such manner, with such fees or additional fees as may be prescribed.

As per Rule 3 of the *Companies (Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015*-

The following class of companies shall file their financial statements and other documents under section 137 of the Act with the Registrar in e-form AOC-4 XBRL as per Annexure-I:

(i) companies listed with stock exchanges in India and their Indian subsidiaries;

(ii) companies having paid up capital of five crore rupees or above;

(iii) companies having turnover of one hundred crore rupees or above;

(iv) all companies which are required to prepare their financial statements in accordance *with Companies (Indian Accounting Standards) Rules, 2015*.

Provided that the companies preparing their financial statements under the *Companies (Accounting Standards) Rules, 2006* shall file the statements using the Taxonomy provided in Annexure-II and companies preparing their financial statements under *Companies (Indian Accounting Standards) Rules, 2015*, shall file the statements using the Taxonomy provided in Annexure-II A.

Provided further that non-banking financial companies, housing finance companies and companies engaged in the business of banking and insurance sector are exempted from filing of financial statements under these rules.

(2) The companies which have filed their financial statements under sub-section (1) and erstwhile rules shall continue to file their financial statements and other documents though they may not fall under the class of companies specified therein in succeeding years.

(ii) If the financial statements are not adopted [Section 137(1)]:

(a) Where the financial statements are not adopted at AGM or adjourned AGM, such unadopted financial statements along with the required documents shall be filed with the Registrar within 30 days of the date of AGM.

(b) The Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned AGM for that purpose.

(c) If the financial statements are adopted in the adjourned AGM, then they shall be filed with the Registrar within 30 days of the date of such adjourned AGM with such fees or such additional fees as may be prescribed.

(iii) Filing by One Person Company [Section 137(1)]:

A One Person Company shall file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within 180 days from the closure of the financial year.

(iv) Company having subsidiaries [Section 137(1)]:

A company shall, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary or subsidiaries which have been incorporated outside India and which have not established their place of business in India (fourth proviso to Section 137(1)).

Provided also that in the case of a subsidiary which has been incorporated outside India (herein referred to as "foreign subsidiary"), which is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the requirements of the fourth proviso shall be met if the holding Indian company files such unaudited financial statement along with a declaration to this effect and where such financial statement is in a language other than English, along with a translated copy of the financial statement in English.

It has also been clarified vide *General Circular no. 11/2015 dated 21 July 2015* that in case of foreign company which is not required to get its accounts audited as per the legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding or parent Indian company may place or file such unaudited accounts to comply with requirements of section 136(1) and 137(1) as applicable. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.

Example:

Vandana Ltd, based out of India, has many subsidiaries in India and outside India. It also had associates and joint ventures. For the purpose of finalization of the consolidated financial statements of the company for the year ended 31 March 2019, the company's management requested its foreign subsidiary, based out of Italy, to provide its standalone financial statements. The Italian subsidiary company prepares its financial statements in the local language of

the country and the same is provided to the Indian parent unaudited as the audit is not required by the Italian subsidiary company. Please advise how should the Indian parent deal with this financial statement.

Solution:

Vandana Ltd would have to get the standalone financial statements of Italian subsidiary company translated in Indian and also get those aligned as per the its accounting policies for the purpose of consolidation.

Further as per the requirements of section 137(1) of the Companies Act 2013, Vandana Ltd would need to file such unaudited financial statement of Italian subsidiary company along with a declaration to this effect along with a translated copy of the financial statement in English.

Further the format of accounts of Italian subsidiary company should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.

(v) Annual General meeting not held [Section 137(2)]:

Where the AGM of a company for any year has not been held, the financial statements along with the documents required to be attached, duly signed along with the statement of facts and reasons for not holding the AGM shall be filed with the Registrar within thirty days of the last date before which the AGM should have been held and in such manner, with such fees or additional fees as may be prescribed.

(vi) Penalty [Section 137(3)]: If any of the provisions of this section are contravened-

(a) The company shall be liable to a penalty of ₹ 1,000 for every day during which the failure continues but which shall not be more than ₹ 10 lacs; and

(b) The managing director and the Chief Financial Officer of the company, if any, and, in the absence of the managing director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be:

(1) punishable with imprisonment for a term which may extend to 6 months or

(2) liable to a penalty which shall not be less than ₹ 1 lac but which may extend to ₹ 5 lacs, or

(3) both.

Person liable	Punishment for contravention of section 137
Company	with fine of ₹ 1,000 for every day during which the failure continues but which shall not be more than ₹ 10 lacs,
Officers— managing director and the Chief Financial Officer of the company, if any In their absence, any other director who is charged by the Board with the responsibility In its absence, all the directors of the company.	(1) Imprisonment for a term which may extend to 6 months or (2) Fine which shall not be less than ₹ 1 lac but which may extend to ₹ 5 lacs, or (3) Both with imprisonment and fine.

Example: The AGM of R Ltd., for laying the Annual Accounts there at for the year ended 31 March 2018 was not held. What remedy is available with the company regarding compliance of the provisions of section 137 of the Companies Act, 2013 for filing of copies of financial statements with the Registrar of Companies?

Answer: In the present case, though AGM was not held, it ought to be held by 30 September 2018 under sections 96 of the Companies Act, 2013.

Therefore, under the provisions of section 137(2), the financial statements along with the documents required to be attached under this Act, duly signed along with the statement of facts and reasons for not holding the AGM shall be filed with the Registrar within thirty days of the last date before which the AGM should have been held i.e. by 30 October 2018 along with such fees or additional fees as may be prescribed.

Example: Will it make any difference in case the Annual Accounts were duly laid before the AGM held on 27 September 2018 but the same were not adopted by the shareholders?

Answer: Since the AGM has been held in time on 27 September 2018, the un-adopted financial statements along with the required documents under sub-section (1) of section 137 shall be filed with the Registrar within thirty days of the date of AGM and the Registrar shall take them in his records as provisional till the financial statements are filed with him after its adoption in the adjourned AGM for that purpose.

12. INTERNAL AUDIT [SECTION 138][7]

Section 138 is to read with Rule 13 of the Companies (Accounts) Rules, 2014 in relation to internal audit in a company.

Extract of the Act

"(1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

(2) The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board."

(i) Companies required to appoint Internal Auditor:

(a) The following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate, namely:

(1) every listed company;

(2) every unlisted public company having-

(A) paid up share capital of 50 crore rupees or more during the preceding financial year; or

[7] In case of a specified IFSC public company & IFSC private company, section 138 shall apply if the articles of the company provides for the same.

(B) turnover of 200 crore rupees or more during the preceding financial year; or

(C) outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year; or

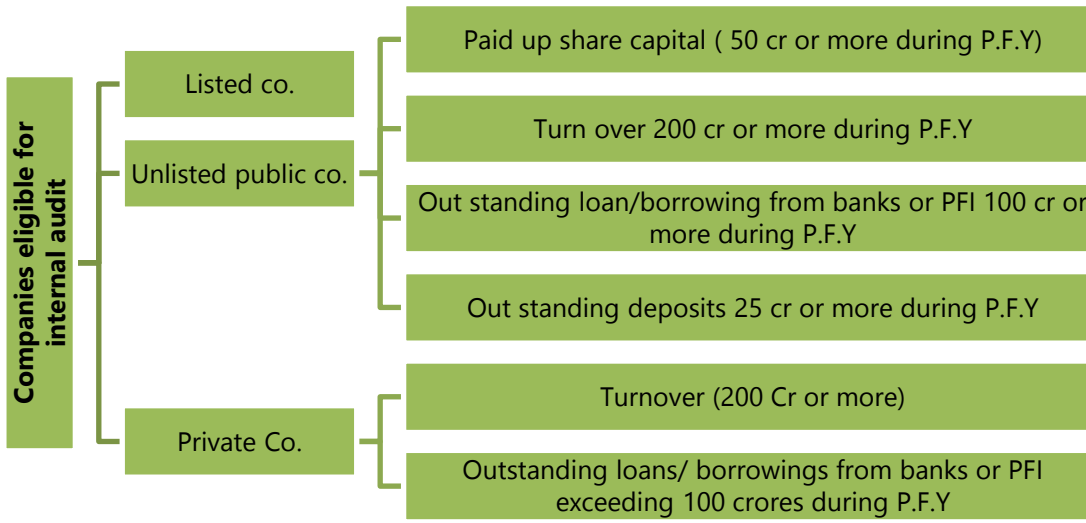
(D) outstanding deposits of 25 crore rupees or more at any point of time during the preceding financial year; and

(3) every private company having—

(A) turnover of 200 crore rupees or more during the preceding financial year; or

(B) outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year.

(b) The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.



(ii) Transitional period:

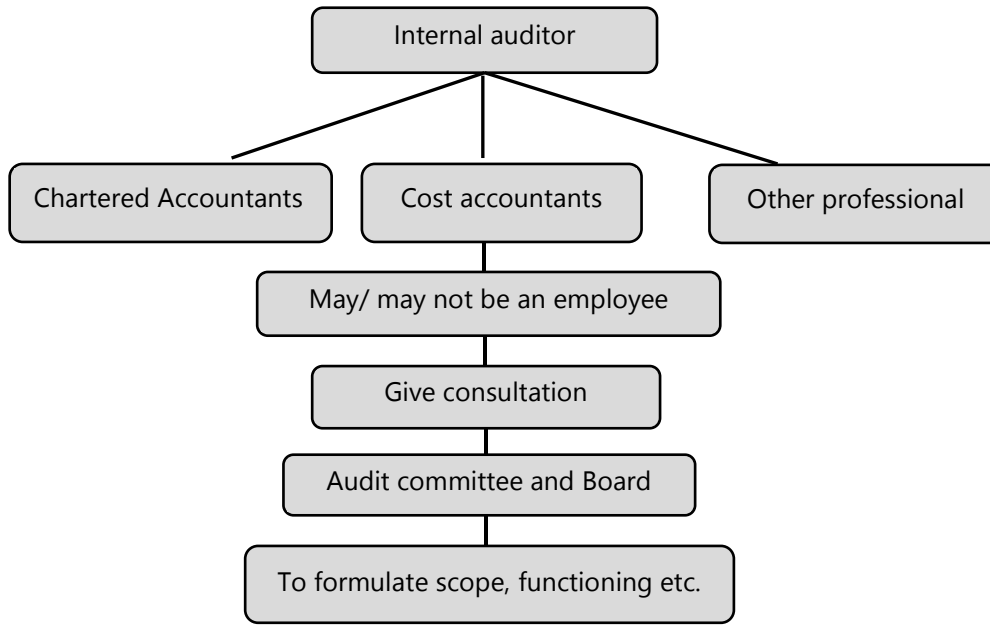
An existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within 6 months of commencement of such section.

(iii) Who is Internal Auditor

(a) Internal Auditor shall either be a Chartered Accountant or a Cost Accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

The term "Chartered Accountant" or "Cost Accountant" shall mean a "Chartered Accountant" or a "Cost Accountant", as the case may be, whether engaged in practice or not'.

(b) The internal auditor may or may not be an employee of the company.



Example:

Perfect Ltd is a listed company. The company is in the business of manufacturing of steel and had its head office at Karnataka. The company's operations are spread out across India. The company appointed a firm of Chartered Accountants, N & Co LLP, as its internal auditors for the year ended 31 March 2019. However, for the financial year 2019-20, the company is planning to have an in-house internal audit system commensurate with its size and operations. If the company does that then it is planning not to continue with N & Co LLP as its internal auditors. Please advise.

a. The company being listed needs to have a firm of CA as its internal auditors and hence the company needs to continue with N & Co LLP or appoint some other firm.

b. The company being listed needs to have a firm of CA as its internal auditors and hence the company needs to continue with N & Co LLP or may appoint some other consultant which may not be a firm.

c. The company being listed should not change its internal audit process within a year and hence should continue with N & Co LLP.

d. If the internal audit function of the company is fine as per its size and operations then it may decide not to continue with N & Co LLP.

Solution – Option d

SUMMARY

- **Financial statement- Section 2(40)**

  Financial statement in relation to a company includes:

  - A balance sheet as at the end of the FY;
  - A profit & loss account, or in case of a company carrying on any activity not for profit an income & exp. Account for the FY;
  - Cash flow statement for the FY;
  - A statement of changes in equity, if applicable; and
  - Any explanatory note annexed to, or forming part of, any document referred above.

  the financial statement with respect to one Person Company, small company and dormant company, may not include the cash flow statement.

- **Financial Year–Section 2(41)**

  - Uniform financial year in Companies Act, 2013.
  - Financial year in relation to a company means the period ending on 31st day of March every year.

- **Section 128– Books of Accounts to be kept by Company**

  - Books of Accounts to be kept at registered office of the Company;

- Books of Accounts & relevant papers, books & financial statements shall give a true fair view of the financial position of the Company including that of its branch offices or other offices, if any;
- The books of accounts shall remain open for inspection by directors of the Company or such other place, during business hours;
- The books of accounts relating to a period not less than eight preceding financial years, shall be kept in good order;
- Penalty for contravention: Officer in default under this section shall be punishable with imprisonment for a term which may extend to one year or with a fine minimum of 50,000 and maximum of 5 lakhs.

➢ **Proviso to section 128(1)**

- Books of Accounts & other relevant papers, can be kept at such other place in India as the Board of Directors may decide;
- The Company shall within seven days, file with the registrar a notice in writing giving full address of that other place.

➢ **Section 129-Financial Statement**

- The financial statements shall give a true and fair view of the state of affairs of the company or companies.
- It shall comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III**.**

➢ **Re-opening of Accounts- Section-130**

The Company may, if it appears to the directors that the Financial Statements or Board's Report are not in compliance with the provisions of the Act, may prepare revised financial statement or a revised Board's Report with the approval of Tribunal.

➢ **Internal Audit-Section 138**

- Every Listed Co.
- Every Public Co. having – Paid up Share Capital of 50 Crores or more /Turnover of 200 crores or more / outstanding loans & borrowing from banks & Public financial institutions exceeding 100 crore.

- Every Pvt Co. having – turnover of 200 crores or more / outstanding loans & borrowing from banks & Public financial institutions exceeding 100 crore
- Above Companies are required to appoint Internal Auditors
- Audit committee in consultation with Internal Auditor formulates the scope, functioning and methodology for internal audit.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. The books of accounts of every company shall be maintained in order for:
   (a) 3 Years
   (b) 5 years
   (c) 8 years
   (d) 10 years
2. A company can re-open/ recast its book of accounts on an application to Tribunal made by:
   (a) Registrar
   (b) Member
   (c) Board of Directors
   (d) Income –tax authorities
3. CSR Committee of the Board shall consist of:
   (a) Directors forming 1/3rd of the total no of directors
   (b) At least 2 directors
   (c) 3 or more directors
   (d) 3 or more directors, out of which at least 1 director shall be an independent director.
4. Provisions of CSR are applicable to:
   (a) Companies with net worth of 500 cr or more
   (b) Companies with turnover of 1000 cr or more

(c) Companies with net profit of 5 cr or more in any financial year

(d) All of the above

5. One Person Company shall file a copy of the duly adopted financial statements to the Registrar in:

(a) 30 days of the date of meeting in which it was adopted

(b) 90 days of the date of meeting in which it was adopted

(c) 90 days from the closure of the financial statement

(d) 180 days from the closure of the financial statement

6. Who can be appointed as an internal auditor?

(a) Chartered Accountants

(b) Cost accountants

(c) Any other professional

(d) All of the above

Answer to MCQs

1. (c) **2.** (d) **3.** (d) **4.** (d) **5.** (d) **6.** (d)

Question and Answer

Question 1

The registered office of the company is situated in a classified backward area of Maharashtra. The Board wants to keep its books of account at its corporate office in Mumbai which is conveniently located. The Board seeks your advice about the feasibility of maintaining the accounting records at a place other than the registered office of the company. Please advise.

Answer

According to section 128(1) of the Companies Act, 2013, every company is required to prepare and keep the books of accounts and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

The proviso to section 128(1) further provides that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place. Further company may keep such books of accounts or other relevant papers in electronic mode as per the Rule 3 of the *Companies (Accounts) Rules, 2014*.

Therefore, the Board of Bharat Ltd. can keep its books of account at its corporate office in Mumbai by following the abovementioned procedure.

Question 2

The Board of Directors of Vishwakarma Electronics Limited consists of Mr. Ghanshyam (Director), Mr. Hyder (Director) and Mr. Indersen (Managing Director). The company has also employed a full time Secretary.

The Profit and Loss Account and Balance Sheet of the company were signed by Mr. Ghanshyam and Mr. Hyder. Examine whether the authentication of financial statements of the company was in accordance with the provisions of the Companies Act, 2013?

Answer

According to section 134(1) of the Companies Act, 2013, the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

In the instant case, the Balance Sheet and Profit and Loss Account have been signed by Mr. Ghanshyam and Mr. Hyder, the directors. In view of Section 134(1) of the Companies Act, 2013, Mr. Indersen, the Managing Director should be one of the two signing directors. Since, the company has also employed a full- time Secretary, he should also sign the Balance Sheet and Profit and Loss Account.

Question 3

ABC Limited has on its Board, four Directors viz. W, X, Y and Z. In addition, the company has Mr. D as the Managing Director. The company also has a full time Company Secretary, Mr. Wise, on its rolls. The financial statements of the company

for the year ended 31 March 2019 were authenticated by two of the directors, Mr. X and Y under their signatures.

Referring to the provisions of the Companies Act, 2013:

(i) Examine the validity of the authentication of the Balance Sheet and Statement of Profit & Loss and the Board's Report.

(ii) What would be your answer in case the company is a One Person Company (OPC) and has only one Director, who has authenticated the Balance Sheet and Statement of Profit & Loss and the Board's Report?

Answer

In accordance with the provisions of the Companies Act, 2013, as contained under section 134 (1), The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

The Board's report and annexures thereto under section 134(3), shall be signed by its Chairperson of the company, if he is authorized by the Board and where he is not so authorized, shall be signed by at least two directors one of whom shall be a managing director or by the director where there is one director.

(i) In the given case, the Balance Sheet and Profit & Loss Account have been signed by Mr. X and Mr. Y, the directors. In view of the provisions of Section 134 (1), the Managing Director, Mr. D should be one of the two signatories. Since, the company has also employed a full- time Secretary, he should also sign the Balance Sheet and Profit & Loss Account. Therefore, authentication done by two directors is not valid.

(ii) In case of OPC, the financial statements should be signed by one director and hence, the authentication is in order.

Question 4

A Housing Finance Ltd. is a housing finance company having a paid up share capital of ₹ 11 crores and a turnover of ₹ 145 crores during the financial year 2017-18. Explain with reference to the relevant provisions and rules, whether it is necessary for A Housing Finance Ltd. to file its financial statements in XBRL mode.

Answer

Filing of financial statements in XBRL Mode

As per Rule 3 of *the Companies (Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015*, following class of companies shall file their financial statements and other documents under section 137 of the Act with the Registrar in e-form AOC-4 XBRL as per Annexure-I:

(i) companies listed with stock exchanges in India and their Indian subsidiaries;

(ii) companies having paid up capital of five crore rupees or above;

(iii) companies having turnover of one hundred crore rupees or above;

(iv) all companies which are required to prepare their financial statements in accordance *with Companies (Indian Accounting Standards) Rules, 2015*.

Provided further that non-banking financial companies, housing finance companies and companies engaged in the business of banking and insurance sector are exempted from filing of financial statements under these rules.

Hence A housing Finance Ltd., being a housing finance company, is exempted from filing its financial statement in XBRL mode.

CHAPTER 10

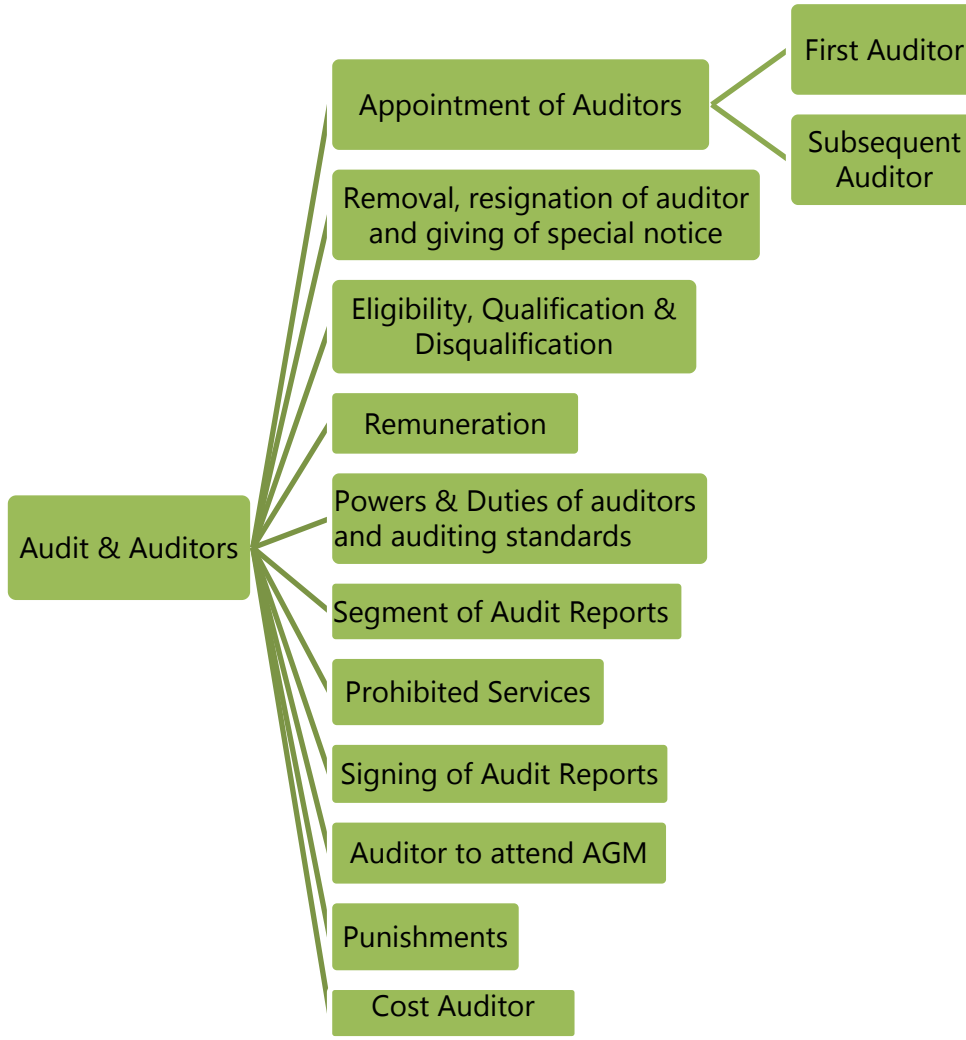
AUDIT AND AUDITORS

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Understand the procedure for appointment of auditors, their removal, resignation, eligibility, qualifications, disqualifications and remuneration
- Know the powers and duties of auditors
- Know about auditing services and certain services which an auditor cannot render

CHAPTER OVERVIEW



1. INTRODUCTION

Large business corporations are managed by the directors who represent the members who are the real owners of the company. In the absence of any check the directors may mismanage the finances of the organisation. Thus, members appoint auditor to look into the true and fair view of the financial affairs of the company. These auditors are independent from the management of the company and hence can express an un-biased opinion.

2. APPOINTMENT OF AUDITORS [SECTION 139]

Section 139 of the Companies Act, 2013 (Act) provides for appointment of auditors. According to this section:

(i) Appointment of auditor [Section 139(1)]:

(a) Every company shall, at the first annual general meeting (AGM), appoint an individual or a firm as an auditor of the company.

(b) The auditor shall hold office from the conclusion of 1st AGM till the conclusion of its 6th AGM and thereafter till the conclusion of every sixth AGM and the manner and procedure of selection of auditors by the members of the company at AGM has been prescribed under the *Companies (Audit and Auditors) Rules, 2014.* According to the Rules:

(c) Manner and procedure of selection and appointment of auditors:

(1)

Categories of Companies	Competent authority	Responsibility of the competent authority
A company which is required to constitute an Audit Committee under section 177[1]	Audit Committee	(i) The competent authority shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such
A Company which is not required to constitute an Audit	Board of Directors	

[1] **Companies that require to constitute an audit committee**

For the purpose of constitution of Audit Committee, section 177 of the Act, read with Companies (Meetings of Board and its Powers) Rules, 2014 provides that:

The Board of directors of every listed companies and the following classes of companies shall constitute an Audit Committee-

(i) all public companies with a paid up capital of ten crore rupees or more;

(ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation: The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited financial statements shall be taken into account for the purposes of this rule.

Committee under section 177		qualifications and experience are commensurate with the size and requirements of the company.
		(ii) It shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India (ICAI) or any competent authority or any Court. (iii) It may call for such other information from the proposed auditor as it may deem fit.

(2)

Categories of Companies	Competent authority	Responsibility of the competent authority
A company which is required to constitute an Audit Committee under section 177	Audit Committee	the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration
A Company which is not required to constitute an Audit Committee under section 177	Board	the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment

(3) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the AGM.

(4) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.

(5) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the AGM; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.

(d) Before the appointment is made, the written consent of the auditor to such appointment and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

Certificate by Auditor: *The Companies (Audit and Auditors) Rules, 2014* provides the content of the Certificate. According to this, the auditor appointed shall submit a certificate that–

(A) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

(B) the proposed appointment is as per the term provided under the Act;

(C) the proposed appointment is within the limits laid down by or under the authority of the Act;

(D) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(e) The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 [Section 141 provides provisions on

eligibility, qualification and disqualification of Auditor which will be discussed later] of the Companies Act, 2013.

(f) **Communication to Auditor:** Further, the company shall inform the auditor concerned of his or its appointment, and also file a notice (in the *Form ADT-1*) of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

Here, "appointment" includes reappointment.

National Financial Reporting Authority Rules, 2018 (NFRA Rules)

As per NFRA Rules, every existing body corporate other than a company governed by NFRA rules, shall inform the National Financial Reporting Authority (NFRA) within 30 days of the commencement of the NFRA rules, in Form NFRA-1, the particulars of the auditor as on the date of commencement of the NFRA rules.

Every body corporate, other than a company as defined in clause (20) of section 2 of the Act, formed in India and governed under NFRA Rules shall, within 15 days of appointment of an auditor under sub-section (1) of section 139, inform the NFRA in Form NFRA-1, the particulars of the auditor appointed by such body corporate. Provided that a body corporate governed under clause (e) of sub-rule (1) of NFRA Rules shall provide details of appointment of its auditor in Form NFRA-1.

(ii) Term of Auditor [Section 139(2)]:

(a) Section 139(2) provides that listed companies and other prescribed class or classes of companies (except one person companies and small companies) shall not appoint or re-appoint—

(1) an individual as auditor for more than one term of five consecutive years; and

(2) an audit firm as auditor for more than two terms of five consecutive years.

(b) Rule 5 of the *Companies* (*Audit and Auditors) Rules, 2014* has prescribed the following classes of companies for the purposes of section 139(2):

(1) all unlisted public companies having paid up share capital of rupees 10 crores or more;

(2) all private limited companies having paid up share capital of rupees 50 crore or more;

(3) all companies having paid up share capital of below threshold limit mentioned in (2) and (3) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crores or more.

(c) **Cooling off Period:**

(1) An individual auditor who has completed his term (i.e. one term of five consecutive years) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;

(2) An audit firm which has completed its term (i.e. two terms of five consecutive years) shall not be eligible for re- appointment as auditor in the same company for five years from the completion of such term.

Example: XYZ Ltd. which is a listed company appoints Mr. Raghav as an auditor in its AGM dated 29th September, 2016. Mr. Raghav will hold office of Auditor from the conclusion of this meeting upto conclusion of sixth AGM i.e. AGM to be held in the year 2021. Now as per sub-section (2), Mr. Raghav shall not be re-appointed as Auditor in XYZ Ltd. for further term of five years i.e. he cannot be appointed as Auditor upto year 2026.

Example: XYZ Ltd. which is a listed company appoints M/s Raghav & Associates as an audit firm in its AGM dated 29th September, 2016. M/s Raghav & Associates will hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2021. Now as per sub-section (2), M/s Raghav & Associates can be appointed or re-appointed as auditor for one more term of five years i.e. upto year 2026. It shall not be re-appointed as Audit firm in XYZ Ltd. for further term of five years i.e. upto year 2031.

(d) Further, as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

Example: M/s Krishna & Associates is an audit firm having 2 partners namely Mr. Krishna and Mr. Shyam. Mr. Shyam is also a partner of another audit firm named M/s Kukreja & Associates. M/s Krishna & Associates was appointed as the auditors in the company Golden Smith

Ltd. for two consecutive periods of 5 years i.e. from year 2016 to year 2026. Now, if Golden Smith Ltd. wants to appoint M/s Kukreja & Associates as its audit firm, it cannot do so because Mr. Shyam was the common partner between both the Audit firms. This prohibition is only for 5 years i.e. upto year 2031. After 5 years, Golden Smith Ltd. may appoint M/s Kukreja & Associates as its auditors.

(e) **Transitional period:** Every company, existing on or before the commencement of this Act which is required to comply with the provisions as mentioned in above mentioned points (a) to (d) (i.e. provisions of this sub-section), shall comply with those provisions within a period which shall not be later than the date of the first AGM of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act."

(f) It is also provided that nothing contained in above mentioned points (a) to (d) (i.e. this sub-section) shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

(iii) Rotation of auditor [section 139(3) and (4)]:

(a) Members of a company may resolve to provide that—

(1) in the audit firm appointed by them, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or

(2) the audit shall be conducted by more than one auditor.

(b) The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors.

(c) Manner of rotation of auditors by the companies on expiry of their term as provided under the *Companies (Audit and Auditors) Rules, 2014*:

(1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.

(2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of

rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

(3) For the purpose of the rotation of auditors:

(i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;

(ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

The term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

(iii) For the purpose of rotation of auditors:

(A) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation.

(B) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Illustration explaining rotation in case of individual auditor:

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	**Maximum number of consecutive years for which he may be appointed in the same company (including transitional period)**	**Aggregate period which the auditor would complete in the same company in view of column I and II**
I	**II**	**III**
5 years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years

2 years	3 years	5 years
1 year	4 years	5 years

Here,

(a) Individual auditor shall include other individuals or firms whose name or trade mark or brand is used by such individual, if any.

(b) Consecutive years shall mean all the preceding financial years for which the individual auditor has been the auditor until there has been a break by five years or more.

Illustration explaining rotation in case of audit firm

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	**Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)**	**Aggregate period which the firm would complete in the same company in view of column I and II**
I	**II**	**III**
10 years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 years	7 years	10 years
2 years	8 years	10 years
1 year	9 years	10 years

Here,

(a) Audit Firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.

(b) Consecutive years shall mean all the preceding financial years for which the firm has been the auditor until there has been a break by five years or more.

(4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

(d) Here, the word "firm" shall include a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008.

(iv) First auditors [Section 139(6)]:

(a) Notwithstanding anything contained in sub-section (1) of Section 139 i.e. point 2(i) mentioned above, the first auditor of a company, other than a Government Company, shall be appointed by the Board of directors within 30 days of the date of registration of the company and the auditor so appointed shall hold office until the conclusion of the first AGM.

(b) If the Board fails to exercise its powers i.e. appointment of first auditor, it shall inform the members of the company and the company may appoint the first auditor within 90 days at an extra ordinary general meeting (EGM) and such auditor shall hold office till the conclusion of the first AGM.

Example: Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director.

Answer: Provisions and Explanation: Section 139(6) of the Companies Act, 2013 lays down that "the first auditor or auditors of a company shall be appointed by the Board of directors within 30 days from the date of registration of the company". In the instant case, the

appointment of Shri Ganapati, a practicing Chartered Accountant as first auditors by the Managing Director of PQR Ltd by himself is in violation of Section 139(6) of the Companies Act, 2013, which requires the Board of Directors to appoint the first auditor of the company.

Conclusion: In view of the above, the Managing Director of PQR Ltd cannot appoint the first auditor of the company himself.

(v) Filling up casual vacancy [Section 139(8)]:

(a) The Board may fill any casual vacancy in the office of an auditor within 30 days but where such vacancy is caused by the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.

(b) Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.

Example: Prakash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2016. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2016 for personal reasons. The Board of directors seeks advice for filling up the vacancy by appointment of Mr. Albert as auditor.

In the present case, as the auditor has resigned, the casual vacancy so created can be filled up by the Board appointing Mr. Albert. However, the appointment of Mr. Albert must be approved by the company by passing of an ordinary resolution at a general meeting of the company which must be convened by the Board within 3 months of the recommendation of the Board.

Mr. Albert will be entitled to hold office till the conclusion of the next Annual General Meeting.

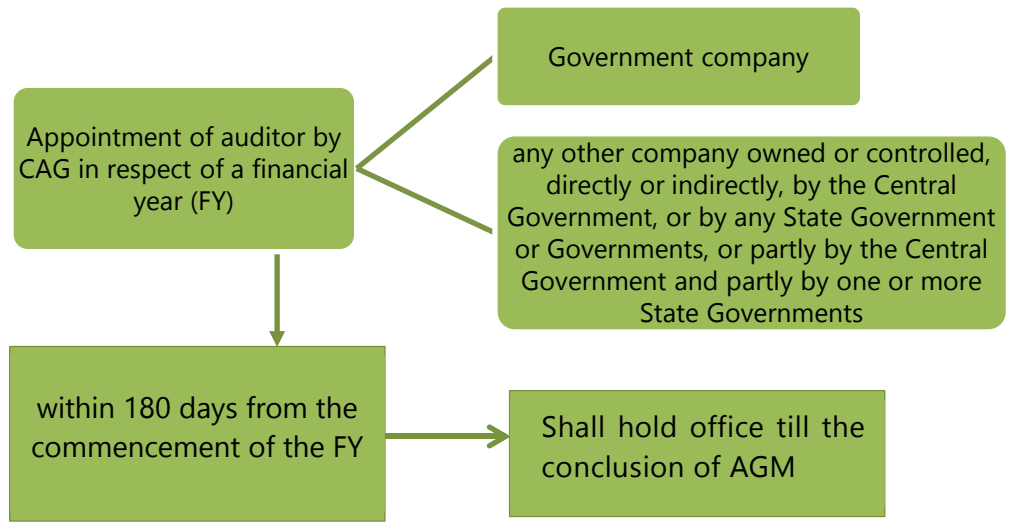
(vi) Appointment of auditors in case of Government Company or any other company controlled by the State Government or the Central Government [Section 139(5), 139(7) and 139(8)]

(a) As per section 139(5), the Comptroller and Auditor-General of India (CAG) shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act in the case of:

(1) a Government company; or

(2) any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments.

(b) The auditor shall be appointed within a period of 180 days from the commencement of the financial year. The auditor appointed shall hold office till the conclusion of the annual general meeting.



(c) First auditor [section 139(7)]:

(1) in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State

Governments, the first auditor shall be appointed by the CAG within 60 days from the date of registration of the company.

(2) In case the CAG does not appoint first auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next 30 days.

(3) Further, in the case of failure of the Board to appoint such auditor within the next 30 days, it shall inform the members of the company who shall appoint such auditor within the 60 days at an EGM, who shall hold office till the conclusion of the first annual general meeting.

(d) **Casual vacancy [section 139(8)]:**

(1) In the case of a company whose accounts are subject to audit by an auditor appointed by the CAG, casual vacancy of an auditor shall be filled by the CAG within 30 days.

(2) In case the CAG does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.

(vii) Re-appointment of retiring auditor [section 139(9), (10) and (11)]:

(a) A retiring auditor may be re-appointed at an AGM if—

(1) he is not disqualified for re-appointment;

(2) he has not given the company a notice in writing of his unwillingness to be re-appointed; and

(3) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

(b) Where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

(viii) Audit committee's recommendation [Section 139(11)]:

Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

As per NFRA Rules, every auditor referred to in Rule 3 shall file a return with the NFRA on or before 30th April every year in such form as may be specified by the Central Government.

As per NFRA Rules, following provisions are relevant for the understanding of the students:

Monitoring and enforcing compliance with auditing standards -

(1) For the purpose of monitoring and enforcing compliance with auditing standards (SA) under the Act by a company or a body corporate governed under rule 3, the NFRA may:

(i) review working papers (including audit plan and other audit documents) and communications related to the audit;

(ii) evaluate the sufficiency of the quality control system of the auditor and the manner of documentation of the system by the auditor; and

(iii) perform such other testing of the audit, supervisory, and quality control procedures of the auditor as may be considered necessary or appropriate.

(2) The NFRA may require an auditor to report on its governance practices and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk of failure of the auditor and may take such action on the report as may be necessary.

(3) The NFRA may seek additional information or may require the personal presence of the auditor for seeking additional information or explanation in connection with the conduct of an audit.

(4) The NFRA shall perform its monitoring and enforcement activities through its officers or experts with sufficient experience in audit of the relevant industry.

(5) The NFRA shall publish its findings relating to non-complainces on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing.

(6) The NFRA shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing.

(7) The NFRA may send a separate report containing proprietary or confidential information to the Central Government for its information.

(8) Where the NFRA finds or has reason to believe that any law or professional or other standard has or may have been violated by an auditor, it may decide on the further course of investigation or enforcement action through its concerned Division.

Overseeing the quality of service and suggesting measures for improvement (As per NFRA Rules)

(1) On the basis of its review, the NFRA may direct an auditor to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.

(2) It shall be the duty of the auditor to make the required improvements and send a report to the NFRA explaining how it has complied with the directions made by the NFRA.

(3) The NFRA shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor.

(4) The NFRA may refer cases with regard to overseeing the quality of service of auditors of companies or bodies corporate referred to in rule 3 to the Quality Review Board constituted under the Chartered Accountants Act, 1949 (38 of 1949) or call for any report or information in respect of such auditors or companies or bodies corporate from such Board as it may deem appropriate.

(5) The NFRA may take the assistance of experts for its oversight and monitoring activities.

3. REMOVAL, RESIGNATION OF AUDITOR AND GIVING OF SPECIAL NOTICE [SECTION 140]

Section 140 of the Companies Act, 2013 provides for removal, resignation of auditor and giving of special notice. According to this section:

(i) Removal of auditor before the expiry of his term [Section 140(1)]:

(a) The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company and after obtaining the previous approval of the Central

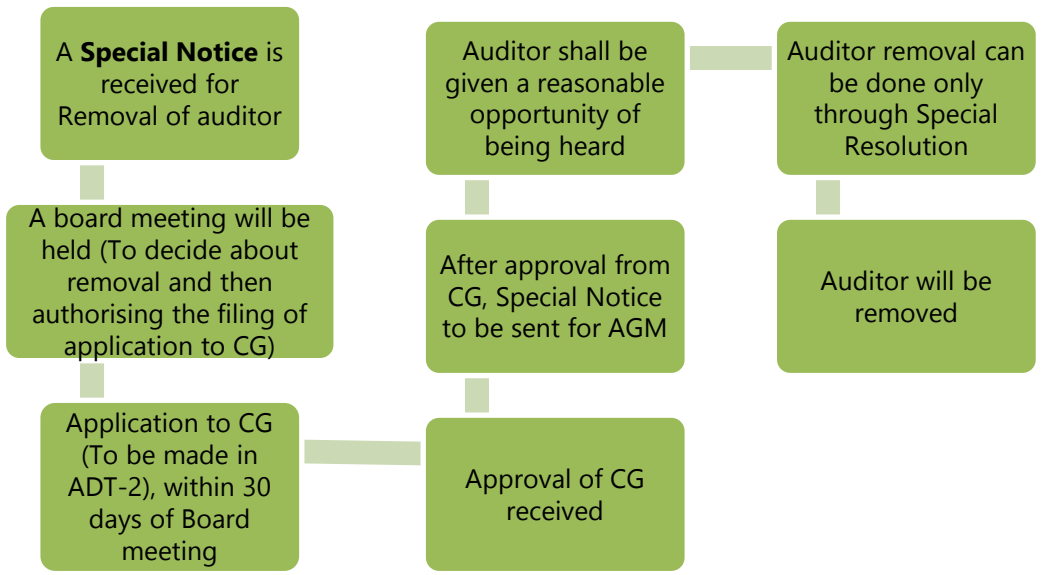
Government[2] by making an application in Form ADT-2 and shall be accompanied with the prescribed fees.

(b) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.

(c) The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

(d) **Giving opportunity of being heard** (*Audi Alteram Partem*): Before taking any action for removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

STEPS FOR REMOVAL OF AUDITOR



Example: Mr. Suresh, a Chartered Accountant, was appointed by the Board of Directors of AB Limited as the First Auditor. The company in General Meeting removed Mr. Suresh without seeking the approval of the Central

[2] Powers are delegated to Regional Director

Government and appointed Mr. Gupta as auditor in his place. The first auditor appointed by the Board of Directors can be removed in accordance with the provision of Section 140(1) of the Companies Act, 2013 only and hence the removal of the first auditor in this case is invalid. The company contravened the provision of the Act.

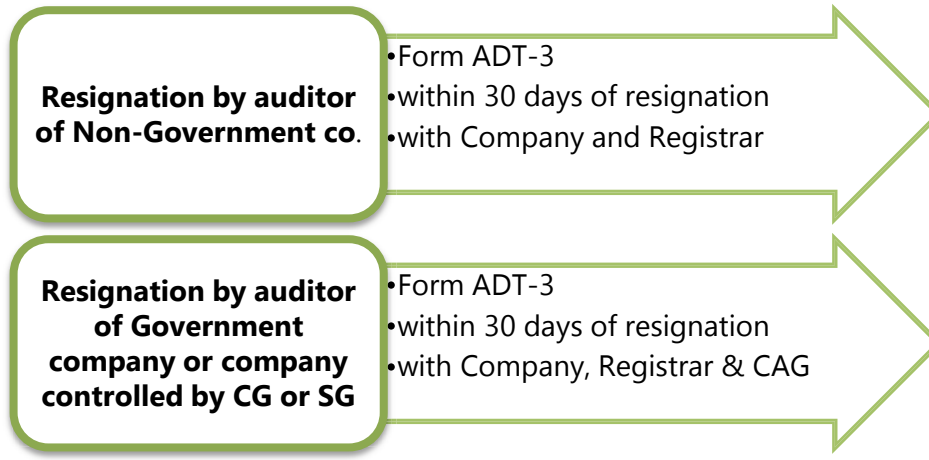
(ii) Resignation by Auditor [Section 140(2) & (3)]

(a) If the Auditor has resigned from the company, he shall file within a period of 30 days from the date of resignation, a statement in the form ADT-3 with the company and the Registrar.

(b) The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation, in the statement.

(c) In case of government companies or companies controlled by Central Government or State Government, the auditor shall file such statement with the CAG along with the company and the Registrar.

(d) If the auditor does not comply with aforesaid provision, he or it shall be liable to a penalty of ₹ 50,000 or an amount equal to the remuneration of the auditor, whichever is less, and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of ₹ 5 lacs.



(iii) Appointing Auditor other than the Retiring Auditor [Section 140(4)]

(a) If the retiring auditor has not completed a consecutive tenure of 5 years or, as the case may be, 10 years, as provided under sub-section (2) of section 139, special notice shall be required for a resolution at an annual

general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.

(b) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(c) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,—

(1) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(2) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company.

(d) If a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

(e) However, if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.

(f) If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then the copy of the representation may not be sent and the representation need not be read out at the meeting.

(iv) Auditor acts in a fraudulent manner or abetted or colluded in any fraud [Section 140(5)]

(a) **On satisfaction of Tribunal that the auditor of a company has acted in a fraudulent manner etc.:** Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either—

suo motu; or

on an application made to it by the Central Government; or

by any person concerned,

if it is satisfied that the auditor of a company has, whether directly or indirectly, **acted in a fraudulent manner or abetted or colluded in any fraud by,** or in relation to, the company or its directors or officers,

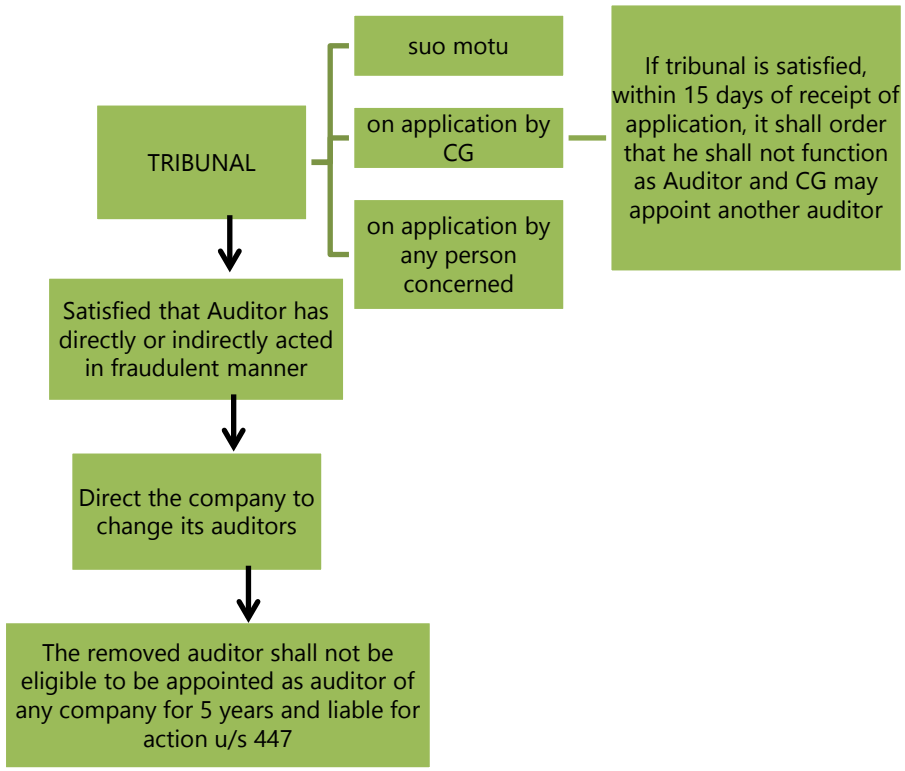
may, by order, direct the company to change its auditors.

(b) **Requirement for change of auditor:** If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

(c) **Ineligibility of auditor to be appointed:** An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447 of the Companies Act 2013.

(d) **Explanation I.**—It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

(e) **Explanation II.**—For the purposes of this Chapter the word "auditor" includes a firm of auditors.



Example:

FLP Ltd, engaged in the business of real estate and energy, defaulted on its borrowings which amounted to thousands of crores. During the year ended 31 March 2019, a fraud was uncovered in respect of various transactions of the company and it was observed by the Central Govt that the auditors of the company were involved in such fraud. Please suggest what can be the course of action in this case.

Solution

The Central Government may apply to the Tribunal in respect of such matter highlighting that the auditors miserably failed to fulfil their duties as auditors of the company. If the Tribunal is satisfied that the auditors were involved in the fraud with the company, the Tribunal may direct the company to change its auditors and those auditors shall not be eligible to be appointed as auditor of any company for 5 years and also liable for action under section 447 of the Companies Act 2013.

4. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS [SECTION 141]

Section 141 of the Companies Act, 2013 provides for eligibility, qualifications and disqualifications of auditors. This section deals with:

(i) Qualifications of an auditor [Section 141(1) & (2)]:

(a) A person shall be eligible to be appointed as auditor of a company only if he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

(b) A firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

(c) Where a firm including a Limited Liability Partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

(ii) Disqualifications of auditors [Section 141(3)]:

(a) The following persons shall not be qualified for appointment as auditor of a company—

(1) A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(2) an officer or employee of the company;

(3) a person who is a partner, or who is in the employment, of an officer or employee of the company;

Example: Mr. A, a Chartered accountant, is a partner of a firm and has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September 2016, in which he accepted the assignment. Subsequently, in January 2017 he offered B, another Chartered Accountant, who is the Manager Finance of Laxman Ltd., to join the firm of A as a partner.

Answer: Provisions and Explanation: Section 141(3) (c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will

be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, A is auditor of M/s Laxman Ltd and any employee of Laxman Ltd cannot become the Partner of the firm where A is a Partner. In case that happens, he/the firm shall be deemed to have vacated office of the auditor of M/s Laxman Limited.

(4) a person who, or his relative or partner—

(A) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company (i.e. fellow subsidiary):

Provided that the relative may hold security or interest in the company of face value not exceeding ₹ 1,00,000 as prescribed under the *Company (Audit and Auditors) Rules, 2014*.

The *Company (Audit and Auditors) Rules, 2014* provides that a relative of an auditor may hold securities in the company of face value not exceeding ₹ 1 Lac. Further, the above condition shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities. If the relative acquires any security or interest above the prescribed threshold i.e. ₹ 1 Lac, the corrective action to maintain the limits as specified above shall be taken by the auditor within sixty days of such acquisition or interest.

Example 1: "Mr. A", a practicing Chartered Accountant, is holding securities of "XYZ Ltd." having face value of ₹ 900/-. Whether Mr. A is qualified for appointment as an Auditor of "XYZ Ltd."?

Answer: As per section 141 (3)(d) (i) an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the

company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

In the present case, Mr. A. is holding security of ₹ 900 in the XYZ Ltd, therefore he is not eligible for appointment as an Auditor of "XYZ Ltd".

Example 2: "Mr. P" is a practicing Chartered Accountant and "Mr. Q", the relative of "Mr. P", is holding securities of "ABC Ltd." having face value of ₹ 90,000/-. Whether "Mr. P" is qualified for being appointed as an auditor of "ABC Ltd."?

Answer: As per section 141 (3)(d)(i) an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Further as per proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

In the present case, Mr. Q. (relative of Mr. P, an auditor), is having securities of ₹ 90,000 face value in ABC Ltd., which is as per requirement of proviso to section 141 (3)(d)(i). Therefore, Mr. P will not be disqualified to be appointed as an auditor of ABC Ltd.

Example 3: "BC & Co." is an audit firm having partners "Mr. B" and "Mr. C" and "Mr. A", relative of "Mr. C", is holding securities of "MWF Ltd." having face value of ₹ 1,01,000. Whether "BC & Co." is qualified for appointment as auditor of "MWF Ltd."?

Answer: As per section 141 (3)(d) (i) an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Further as per proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

In the instant case, BC & Co, will be disqualified for appointment as an auditor of MWF Ltd as the relative of Mr. C i.e. partner of BC & Co., is holding the securities in MWF Ltd which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).

(B) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ` 5 Lacs; or

(C) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ` 1 Lac.

(5) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company. According to the *Companies (Audit and Auditors) Rules, 2014,* the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except–

(A) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;

(B) commercial transactions which are in the ordinary course of business of the company at arm's length price like sale of products or services to the auditor as customer by the companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

(6) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

(7) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20

companies other than one person companies, small companies and private companies having paid-up share capital less than one hundred crore rupees.

Ceiling on numbers of audits: Before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in section141 (3)(g) of the Companies Act, 2013 which prescribes that a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore (*MCA notification dated 5 June 2015*).

Example: "ABC & Co." is an audit firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an auditors in 4, 6 and 10 companies respectively.

(i) Provide the maximum number of audits remaining in the name of "ABC & Co."

(ii) Provide the maximum number of audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.

Fact of the Case: In the instant case, Mr. A is holding appointment in 4 companies, Mr. B is having appointment in 6 companies and Mr. C is having appointment in 10 companies. In aggregate all three partners are having 20 audits.

Provisions and Explanations: As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person

companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

As per section 141 (3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits. Sometimes, a Chartered Accountant may be a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits only on his account.

Conclusion:

(i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

Total Number of audits for which the firm would be eligible = 20*3 = 60

Number of audits already taken by all the partners

In their individual capacity = 4+6+10 = 20

Remaining number of audits available to the firm = 40

(ii) With reference to above provisions, an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor. Hence

(1) Mr. A can hold: 20 – 4 = 16 more audits.

(2) Mr. B can hold 20 - 6 = 14 more audits and

(3) Mr. C can hold 20-10 = 10 more audits.

Note:

It has been assumed that the companies given in the question are not one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

(8) a person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction;

(9) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

Explanation.—For the purposes of this clause, the term "directly or indirectly" shall have the meaning assigned to it in the Explanation to section 144 (section 144 deals with certain services not to be tendered by auditor).

(iii) Vacation of office by an auditor [Section 141(4)]:

If a person appointed as an auditor of a company incurs any of the disqualifications specified in Section 141(3), he shall be deemed to have vacated his office. Such vacation shall be deemed to be a casual vacancy in the office of the auditor.

5. REMUNERATION OF AUDITORS [SECTION 142]

Section 142 of the Companies Act, 2013 provides for remuneration of auditors. According to this section:

(i) The remuneration of the auditors of a company shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

(ii) In the case of first auditor, remuneration may be fixed by the Board.

(iii) The remuneration mentioned aforesaid shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him. But the remuneration does not include any remuneration paid to him for any other service rendered by him at the request of the company.

MCQ 1:

SHRD Private Ltd is engaged in the business of software and consultancy. The company has an annual turnover of INR 2,000 crores but its profit margins are not very good as compared to the industry standards. For the financial year ended 31 March 2019, the company proposed appointment of its statutory auditors at its Board meeting, however, the remuneration was not finalized. The statutory auditors completed the engagement formalities including the engagement letter between the company and the auditors and it was decided that the engagement letter be

signed without fee i.e. with the clause that the fee to be mutually decided. Please provide your views on this.

a. Such engagement letter is not valid.

b. Engagement letter with such arrangement is valid.

c. Engagement letter should specify the fee of last year, if applicable, if the fee for the current year is not yet finalized at the time of signing of the engagement letter.

d. Engagement letter should specify 10% increase in the fee as compared to last year as per the norms of the ICAI, in case the fee is not finalized at the time of signing of the engagement letter.

Solution: Please refer page 49.

6. POWERS AND DUTIES OF AUDITORS AND AUDITING STANDARDS [SECTION 143]

(i) Powers of Auditors [Section 143(1)]:

(a) **Access to books of accounts and vouchers:** Every auditor of a company shall have a right of access at all times to the books of accounts and vouchers of the company, whether kept at the registered office of the company or at any other place.

(b) **Entitled to have necessary information and explanation:** He shall be entitled to require from the officers of the company such information and explanations as the auditor may consider necessary for the performance of his duties as auditor.

(c) **Access to record of all its subsidiaries:** The auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries and associate companies.

(ii) Duties of Auditors

(a) **Matters of inquiry:** The auditor shall inquire into the following matters, namely—

(1) Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on

which they have been made are prejudicial to the interests of the company or its members;

(2) Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

(3) Where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

(4) Whether loans and advances made by the company have been shown as deposits;

(5) Whether personal expenses have been charged to revenue account;

(6) Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

(b) The auditor shall make a report to the members of the company on the following:

(1) On the accounts examined by him; and

(2) On every financial statements which are required by or under this Act to be laid before the company in general meeting; and

(c) The auditor while making the report shall take into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under section 143(11).

(d) The auditor shall express his opinion on the accounts and financial statements examined by him. He shall express an opinion, according to him and to the best of his information and knowledge, whether the said accounts/financial statements give a true and fair view of the state of

the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

(e) The auditors' report shall also state—

(1) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(2) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(3) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(4) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(5) whether, in his opinion, the financial statements comply with the accounting standards;

(6) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(7) whether any director is disqualified from being appointed as a director under sub section (2) of section 164;

(8) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(9) whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;

As per the Rule 10A inserted by the Companies (Audit and Auditors) Amendments Rules, 2014 vide Notification dated 14th October, 2014, for the purposes of clause (i) of sub-section (3) of section 143 (i.e. point 9 mentioned above), for the financial years commencing on or after 1 April 2015, the report of the auditor shall state about existence of internal financial controls with reference to financial statements and its operating effectiveness:

Provided that auditor of a company may voluntarily include the statement referred to in this rule for the financial year commencing on or after 1 April 2014 and ending on or before 31 March 2015.

Exemption to Private Company: 'In case of Private Company - Clause (i) of Sub-Section (3) of Section 143 shall not apply to a private company:-

(i) which is a one person company or a small company; or

(ii) which has turnover less than rupees fifty crores as per latest audited financial statement and which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than rupees 25 crore. - *Notification Dated 13th June, 2017*

The aforesaid exceptions, modifications and adaptations shall be applicable to a Private company which has not committed a default in filing of its financial statements under section 137 or annual return under section 92 of the said Act with the Registrar.'

[Notification No. G.S.R. 583(E) dated 13th June, 2017 stated that requirements of reporting under section 143(3)(i) read with Rule 10A of the Companies (Audit and Auditors) Rules, 2014 of the Companies Act 2013 shall not apply to certain private companies. Through issue of this circular, it was clarified that the exemption shall be applicable for those audit reports in respect of financial statements pertaining to financial year, commencing on or after 1 April 2016, which are made on or after the date of the said notification. (Clarification regarding applicability of exemption given to certain private companies under section 143(3)(i) vide circular no. 08/2017 dated 25th July 2017)]

(10) such other matters as may be prescribed.

(f) Rule 11 of the *Companies (Audit and Auditors) Rules, 2014* provides that the auditor's report shall also include their views and comments on the following matters, namely:

(1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

(2) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

(3) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

(4) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8 November 2016 to 30 December 2016 and if so, whether these are in accordance with the books of accounts maintained by the company" (this provision is not relevant now, however, till the time this requirement is not removed from the law, it will continue to be reported as not applicable for any financial year post 31 March 2017).

(g) Where any of the matters is answered in the negative or with a qualification, the auditor's report shall state the reason for the same.

Example:

MNO Ltd is a listed company engaged in the business of trading of various products. The company also plans to start manufacturing of certain products which are currently traded.

During the course of its audit, the auditors completed all the procedures related to audit of financial statements. However, the auditor got stuck on one procedure because of which audit has not got concluded.

Auditors are waiting for certain additional information – Directors report and Management Discussion and Analysis (MD&A) for their review. However, the management is not ready with this information and wants the auditors to complete their work without review of this information. Please advise as per the legal requirements.

Solution:

In the given case, the requirement of the auditors regarding additional information i.e. Directors report and MD&A without which they have not been able to conclude the audit doesn't look valid. The auditor is required to audit the financial statements and express an opinion on the same. The auditor does not audit these additional information.

Hence the auditor should conclude the work without delaying because of this additional information.

(h) **Compliance with auditing standards [Section 143(9) and 143(10)]:**

(1) Every auditor shall comply with the auditing standards

(2) The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA).

(3) It is further provided that until any auditing standards are notified, any standard or standards of auditing specified by the ICAI shall be deemed to be the auditing standards.

(i) **Additional matters to be reported in case of specified companies [Section 143(11)]:** In respect of such class or description of companies, as may be specified in the general or special order by the Central Government, may in consultation with the NFRA direct, the auditor's report shall also include a statement on such matters as may be specified therein.

Accordingly, CARO 2016 [Companies (Auditor's Report) Order 2016] is issued in pursuance of Section 143 (11) of Companies Act 2013 for inclusion of the matters specified therein in auditors' report. CARO 2016 issued by MCA should be complied by the statutory auditor of every company on which it applies.

CARO 2016 is also applicable to a foreign company as defined in clause (42) of Section 2 of the Companies Act 2013.

(iii) Reporting of frauds by auditors [Section 143(12)]:

Notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been

committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.

(1) The Companies (Audit and Auditors) Amendment Rules, 2015, issued by the MCA, on 14 December 2015, amended Rule 13 of the Companies (Audit and Auditors) Rules, 2014. The amended Rule 13 has introduced the thresholds for the purpose of reporting on frauds and a differential reporting responsibilities of the statutory auditor with respect to the fraud(s) above or below the notified threshold.

As per the amended Rule 13, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve an amount of ₹ one crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government in following manner:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs (MCA) in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(f) The report shall be in the form of a statement as specified in Form ADT-4.

(2) In case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of fraud and he shall report the matter specifying the following:

(i) Nature of fraud with description;

(ii) Approximate amount involved; and

(iii) Parties involved.

The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) of amended Rule 13 during the year shall be disclosed in the Board's Report:

(i) Nature of fraud with description;

(ii) Approximate amount involved;

(iii) Parties involved, if remedial action not taken; and

(iv) Remedial actions taken.

(4) The provision of this section shall mutatis mutandis apply to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204 respectively.

(5) No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred above if it is done in good faith.

(6) **Penalty for non compliance of section 143(12):** If any auditor, cost auditor or the Secretarial auditor, as mentioned above, do not comply with the provisions of this section (i.e. section 143(12)), he shall be punishable with fine which shall not be less than ₹ 1 lacs but which may extend to ₹ 25 lacs.

Example

NSH Ltd is engaged in the business of retail and is listed on National stock exchange. The company recently acquired a business undertaking to expand its business. During the year, certain transactions amounting to thousands of rupees were carried out by the employees/ Directors of the company which the management found suspicious and appointed a forensic consultant to carry out their review. Pursuant to this review process, certain suspect transactions were identified by the management and the management reported these transactions to the appropriate authorities. During the course of statutory audit, such transactions were also made known to the statutory auditors. How should the auditor dealt with such matter?

Solution:

The auditors need to report about this matter appropriately in their CARO report.

As per Section 143(12) of the Companies Act, 2013, the auditor is required to report to the Audit Committee or to the Board of Directors and, where applicable, to the Central Government an offence of fraud in the company by its officers or employees only if he is the first person to identify/note such instance in the course of performance of his duties as an auditor. In this case, the suspicious transactions have been identified by the management first and information about the same has been given by the management to the auditor. Accordingly, the auditor should report about this matter to the Audit Committee/ Board of Directors but the auditor would not be required to report the same to Central Government.

(iv) Audit of Government Companies [Section 143(5), (6) & (7)]:

(a) In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the CAG shall appoint the auditor under section 139(5) or 139(7) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the CAG.

(b) The audit report among other things, include the following:

(1) the directions, if any, issued by the CAG;

(2) the action taken thereon; and

(3) its impact on the accounts and financial statement of the company.

(c) The CAG shall within 60 days from the date of receipt of the audit report have a right to—

(1) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorise in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the CAG may direct; and

(2) comment upon or supplement such audit report.

(d) Any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under section 136(1) and also be placed before the AGM of the company at the same time and in the same manner as the audit report.

(e) **Test Audit:** For Government Company or Company controlled by State Government or Central Government, the CAG may, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company, without prejudice to the provisions related to Audit and Auditors. The provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

(v) Audit of accounts of branch office of company [Section 143(8)]:

(a) **Branch office in India:**

Where a company has a branch office, the accounts of that office shall be audited either by:

(A) the company's auditor appointed under section 139, or

(B) by any other person qualified for appointment as an auditor of the company under section 139.

(b) **Branch office outside India:**

If the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by:

(A) the company's auditor or

(B) by an accountant or

(C) by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

(c) The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.

(d) The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

(e) The provisions regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

(vi) Application of provisions of section 143 to Cost Accountants and Company Secretary [Section 143(14)]: The provisions of this section shall mutatis mutandis apply to:

(a) the cost accountant conducting cost audit under section 148; or

(b) the company secretary in practice conducting secretarial audit under section 204.

7. AUDITOR NOT TO RENDER CERTAIN SERVICES [SECTION 144]

Section 144 of the Companies Act, 2013 provides for Auditor not to render certain services. According to this section:

(i) An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be. But such services shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely—

(a) accounting and book keeping services;

(b) internal audit;

(c) design and implementation of any financial information system;

(d) actuarial services;

(e) investment advisory services;

(f) investment banking services;

(g) rendering of outsourced financial services;

(h) management services; and

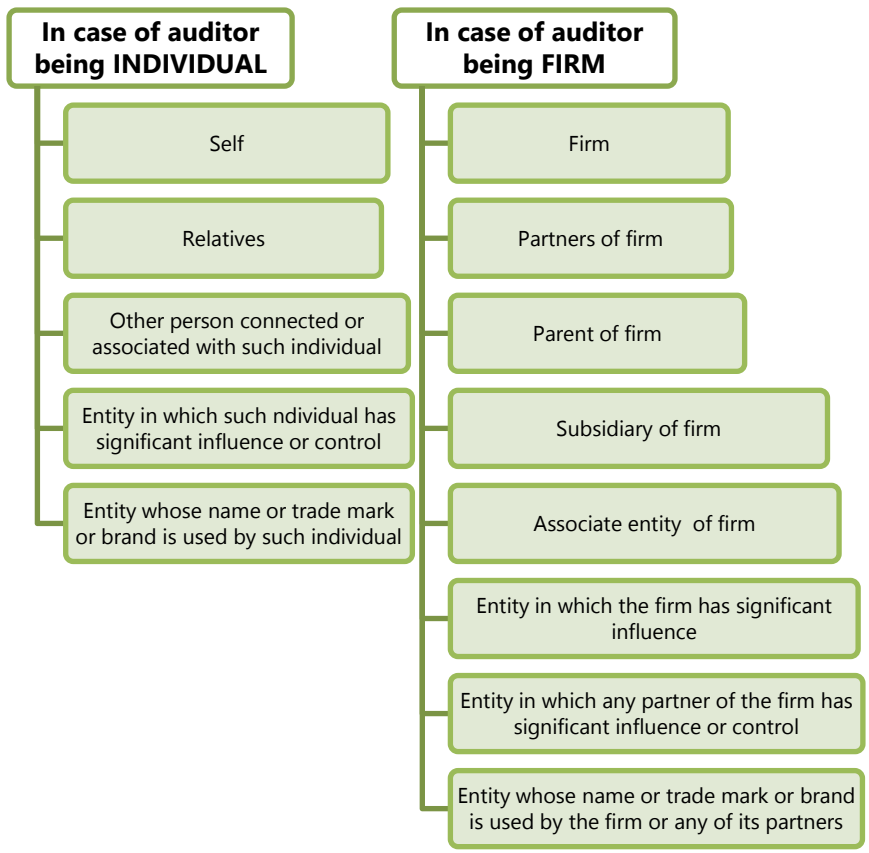
(i) any other kind of services as may be prescribed. [However no other kind of services has been prescribed till date]

(ii) **Explanation:** The term "directly or indirectly" shall include rendering of services by the auditor,—

(1) in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trademark or brand is used by such individual;

(2) in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trademark or brand is used by the firm or any of its partners.

RENDERING OF SERVICES 'DIRECTLY OR INDIRECTLY'



MQC 2:

MNP Ltd is a medium-sized company engaged in the business of pharmaceuticals. For the year ended 31 March 2018, the company is looking for appointment of GST (Goods and Services Tax) auditor. The company wants to appoint somebody for this work who is familiar with the business of the company i.e. who would have worked with the company in the past so that lesser efforts are required to get the GST audit completed. The company has following options, please suggest which one would be better for the company.

a. Statutory auditors can be appointed for this work.

b. Internal auditors can be appointed for this work.

c. Both statutory and internal auditors can be jointly appointed for this work.

d. Internal auditors along with the tax consultants of the company can be appointed for this work.

Solution: Please refer page 49.

8. AUDITORS TO SIGN AUDIT REPORTS, ETC. [SECTION 145]

Section 145 of the Companies Act, 2013 provides for auditors to sign audit reports, etc. According to this section:

(i) The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141 (i.e. in case of firm including LLP, only Chartered Accountants are authorised to act as statutory auditors and sign).

(ii) The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

MCQ 3:

GP & Co LLP is a firm of Chartered Accountants having 35 partners. The firm has 9 branches across India. The firm was appointed as statutory auditor of PQR Ltd for the year ended 31 March 2018. The firm designated Mr. NG Goel as the signing and engagement partner for the statutory audit of PQR Ltd. During the course of audit,

NG Goel was fully involved, however, the finalization of financial statements took long and the time when they got finalized, NG Goel had to travel for some urgent work for a month outside India. As regards the signing of the financial statements, please suggest which of the following options is correct?

a. PQR Ltd should wait till the time NG Goel returns and if required, NG Goel can sign the financial statements back dated.

b. PQR Ltd should wait till the time NG Goel returns and only after that financial statements will be signed.

c. In the absence of NG Goel, any other partner of the firm, being a CA, can sign the financial statements of PQR Ltd.

d. In the absence of NG Goel, any other partner of the firm, being a CA, can sign the financial statements of PQR Ltd, but the firm should intimate about the same to the ROC and Income Tax authority.

Solution: Please refer page 49.

9. AUDITORS TO ATTEND GENERAL MEETING [SECTION 146]

Section 146 of the Companies Act, 2013 provides for auditors to attend general meeting. According to this section:

(i) All notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company.

(ii) The auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting.

(iii) The auditor shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

10. PUNISHMENT FOR CONTRAVENTION [SECTION 147]

Section 147 of the Companies Act, 2013 provides for punishment for contravention. According to this section:

(i) Penalty on company [Section 147(1)]:

If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than ` 25,000 but which may extend to ` 5 lacs.

(ii) Penalty on officers [Section 147(1)]:

If any of the provisions of sections 139 to 146 (both inclusive) is contravened, every officer of the company who is in default shall be punishable with

(1) imprisonment for a term which may extend to 1 year or

(2) with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 1 lac; or

(3) both with imprisonment and fine.

(iii) Penalty on auditor [Section 147(2) & (3)]:

(a) If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5 lacs or four times the remuneration of the auditor, whichever is less.

(b) If an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with-

(1) imprisonment for a term which may extend to 1 year and

(2) with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less.

(c) Further, where an auditor has been convicted as above, he shall be liable to—

(1) refund the remuneration received by him to the company; and

(2) pay for damages to the company, statutory bodies or authorities or to members or creditors of the company for loss arising out of incorrect or misleading statements of particulars made in his audit report.

(iv) The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons. Such body, authority or officer shall after payment

of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification. **[Section 147(4)]**

(v) Liability of Audit firm [Section 147(5)]:

Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in the Companies Act, 2013, or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally and shall also be liable under section 447.

Provided that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

11. CENTRAL GOVERNMENT TO SPECIFY AUDIT OF ITEMS OF COST IN RESPECT OF CERTAIN COMPANIES [SECTION 148]

Section 148 of the Companies Act, 2013 provides the provisions for Central Government to specify audit of items of cost in respect of certain companies. According to this section:

(i) Notwithstanding anything contained in the provisions related to audit and auditor (Chapter X), the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept under section 128 by that class of companies.

(ii) The Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(iii) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered aforesaid and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(iv) The cost audit shall be conducted by a Cost Accountant who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed.

(v) Rule 14 of the Companies (Audit and Auditors) Rules, 2014 provides that—

(1) in the case of companies which are required to constitute an audit committee-

(A) the Board shall appoint an individual, who is a cost accountant, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;

(B) the remuneration recommended by the Audit Committee under (A) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders.

(2) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

Companies required to constitute Audit Committee	**Companies not required to constitute Audit Committee**
(a) The Board shall appoint the cost auditor on the recommendation of the Audit Committee. (b) The Audit Committee shall recommend the remuneration for cost auditor. (c) Such remuneration as recommended by the Audit	(a) The Board shall appoint the cost auditor. (b) The remuneration of such cost auditor shall be ratified by shareholders subsequently.

Committee shall be considered and approved by the Board of Directors. (d) Then this remuneration subsequently to be ratified by the shareholders.	

(vi) No person appointed under section 139 as an auditor of the company (i.e. company auditor) shall be appointed for conducting the audit of cost records.

(vii) **Cost auditor to comply with cost auditing standards:** The auditor conducting the cost audit shall comply with the cost auditing standards.

Here, the expression "cost auditing standards" mean such standards as are issued by the Institute of Cost and Works Accountants of India (ICWA), constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

(viii) An audit conducted under section 148 shall be in addition to the audit conducted under section 143.

(ix) The qualifications, disqualifications, rights, duties and obligations applicable to auditors (i.e. applicable to company auditor) shall, so far as may be applicable, apply to a cost auditor appointed under section 148 and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

(x) The report on the audit of cost records shall be submitted by the cost accountant to the Board of Directors of the company.

(xi) A company shall within 30 days from the date of receipt of a copy of the cost audit report furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

Vide Notification dated 9th September, 2015 under the Rule 4 of the Companies (Filing of Documents and forms in Extensible Business Reporting Language) Rules, 2015, a company which is required to furnish cost audit report and other documents to the Central Government under sub- section 6 of the section 148 of the Act and rules made thereunder, shall file such report and other documents using the XBRL taxonomy given in Annexure III for the

financial year commencing on or after 1 April 2014 in e-form CRA-4 specified under the Companies (Cost Records and Audit) Rules, 2014.

(xii) If, after considering the cost audit report and the information and explanation furnished by the company, the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

(xiii) **Contravention:** If any default is made in complying with the provisions of section 148—

(a) The company and every officer of the company who is in default shall be punishable in the manner as provided in section 147(1);

(b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

(xiv) The provisions of section 143 shall mutatis mutandis apply to the cost accountant conducting cost audit under section 148.

SOLUTIONS OF EXAMPLES GIVEN ABOVE

MCQ 1 – Option b

MCQ 2 - Option a

MCQ 3 - Option c

SUMMARY

- **First auditor:** The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days of the date of registration of the company, and the auditor so appointed shall hold office until the conclusion of the first AGM.

  If the Board fails to appoint first auditor, it shall inform the members of the company and the company may appoint the first auditor within 90 days at an extra ordinary general meeting.

- **Appointment of Auditors:**
  - Auditors to be appointed at 1st AGM for period of 5 years
  - Consent of auditors required

- Auditors to attend AGM (have right to be heard in matters concerning him)

➢ **Rotation of Auditors:**

- Individual auditors: one term of 5 years
- Audit Firm: Two terms of 5 years each
- No reappointment for 5 years from expiry of term.

➢ **Removal of Auditors:**

- Auditor to be given reasonable opportunity to be heard
- Prior approval of CG required
- Special resolution in GM
- Special notice to be given in case retiring auditor is not appointed in AGM.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. For appointing an auditor other than the retiring auditor,
   (a) Special notice is required.
   (b) Ordinary notice is required.
   (c) Neither ordinary nor special notice is required
   (d) Approval of Central Government is required.
2. After registration of a company, first auditors shall be appointed within
   (a) 30 days
   (b) 90 months
   (c) 180 days
   (d) One year
3. The auditor of a Government Company shall be appointed or re-appointed by
   (a) The Central Government
   (b) Comptroller and Auditor General of India.

(c) Central Government on the advise of Comptroller and Auditor General of India.

(d) None of the above

4. Which of the following is a prohibited service to be rendered by the auditor of the Company

(a) design and implementation of any financial information system

(b) making report to the members of the company on the accounts examined by him

(c) compliance with the auditing standards

(d) Reporting of fraud against the company by officers or employees to the Central Government

Answer to MCQs

1. (a) **2.** (a) **3.** (b) **4.** (a)

Question and Answer

Question 1

State the procedure for the following, explaining the relevant provisions of the Companies Act, 2013:

(i) Appointment of First Auditor, when the Board of directors did not appoint the First Auditor within one month from the date of registration of the company.

(ii) Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.

Answer

(i) Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days of the registration of the company.

Section 139 (6) continues to provide further that if the Board of Directors fails to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

From the above provisions of law if the Board of Directors fails to appoint the first auditors within the stipulated 30 days, it shall take the following steps:

a. Inform the members of the Company;

b. Immediately take steps to convene an extra ordinary general meeting not later than 90 days;

c. Members shall at that extra ordinary meeting appoint the first auditors of the company;

d. The first auditors so appointed shall hold office upto the conclusion of the first AGM of the company.

(ii) Section 140 of the Companies Act, 2013 prescribes certain procedure for removal of auditors. Under section 140 (1) the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner. From this sub section it is clear that the approval of the Central Government shall be taken first and thereafter the special resolution of the company should be passed.

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

Therefore, in terms of section 140 (1) of the Companies Act, 2013 read with Rule 7 of the *Companies (Audit & Auditors) Rules, 2014*, the following steps should be taken for the removal of an auditor before the completion of his term:

The application to the Central Government for removal of auditor shall be made in Form ADT-2 and accompanied with fees as provided for this purpose under the *Companies (Registration Offices and Fees) Rules, 2014*.

The application shall be made to the Central Government within thirty days of the resolution passed by the Board.

The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

Question 2

One-fourth of the subscribed capital of AMC Limited was held by the Government of Rajasthan. Mr. Neeraj, a Chartered Accountant, was appointed as an auditor of the Company at the Annual General Meeting held on 30 April 2018 by an ordinary resolution. Mr. Sanjay, a shareholder of the Company, objects to the manner of appointment of Mr. Neeraj on the ground of violation of the Companies Act 2013. Decide whether the objection of Mr. Sanjay is tenable? Also examine the consequences of the above appointment under the said Act.

Answer

As per the section 2(45) of the Companies Act, 2013, the holding of 25% shares of AMC Ltd. by the Government of Rajasthan does not make it a government company. Hence, it will be treated as a non-government company.

Under section 139 of the Companies Act, 2013, the appointment of an auditor by a company vests generally with the members of the company except in the case of the first auditors and in the filling up of the casual vacancy not caused by the resignation of the auditor, in which case, the power to appoint the auditor vests with the Board of Directors. The appointment by the members is by way of an ordinary resolution only and no exceptions have been made in the Act whereby a special resolution is required for the appointment of the auditors.

Therefore, the contention of Mr. Sanjay is not tenable. The appointment is valid under the Companies Act, 2013.

Question 3

EF Limited appointed an individual firm, Naresh & Company, Chartered Accountants, as Auditors of the company at the Annual General Meeting held on 30 September 2018. Mrs. Kamala, wife of Mr. Naresh, invested in the equity shares face value of ₹ 1 lakh of EF Limited on 15 October 2018. But Naresh & Company continues to function as statutory auditors of the company. Advice

Answer

Disqualification of auditor: According to section 141(3)(d)(i) of the Companies Act, 2013, a person who, or his relative or partner holds any security of the company or its subsidiary or of its holding or associate company a subsidiary of such holding company, which carries voting rights, such person cannot be appointed as auditor of the company. Provided that the relative of such person may hold security or

interest in the company of face value not exceeding 1 lakh rupees as prescribed under the Companies (Audit and Auditors) Rules, 2014.

In the case Mr. Naresh, Chartered Accountants, did not hold any such security. But Mrs. Kamala, his wife held equity shares of EF Limited of face value ` 1 lakh, which is within the specified limit.

Further Section 141(4) provides that if an auditor becomes subject, after his appointment, to any of the disqualifications specified in sub-section 3 of section 141, he shall be deemed to have vacated his office of auditor. Hence, Naresh & Company can continue to function as auditors of the Company even after 15 October 2018 i.e. after the investment made by his wife in the equity shares of EF Limited.

Question 4

Explain how the auditor will be appointed in the following cases:

(i) A Government company within the meaning of section 394 of the Companies Act 2013.

(ii) A public company whose shareholders include XYZ Bank (a nationalized bank) holding 18% of the subscribed capital of the company.

Answer

(i) The appointment and re-appointment of auditor of a Government Company or a government controlled company is governed by the provisions of section 139 of the Companies Act, 2013 which are summarized as under:

The first auditor shall be appointed by the Comptroller and Auditor General of India within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing government companies, the Comptroller & Auditor General of India shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

(ii) In the given case as the total shareholding of the XYZ Bank is just 18% of the subscribed capital of the company, it is not a government company. Hence

the provisions applicable to non-government companies in relation to the appointment of auditors shall apply.

The auditor shall be appointed as follows:

(1) The company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

(2) Before such appointment of auditor is made, the written consent of the auditor to such appointment, and a certificate from him or firm of auditors that the appointment, if made, shall be obtained from the auditor:

Further, the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

Question 5

Examine the following situations in the light of the Companies Act, 2013

(i) Mr. Ayush, a Chartered Accountant, has been appointed as an auditor of X Ltd. in the Annual General Meeting of the company held in September 2018, in which he accepted the assignment. Subsequently, in January 2019 he joined B, as a partner in the consultancy firm of Mr. B. Mr. B is also working as a Finance Executive of X Ltd.

(ii) "Mr. Abhi", a practicing Chartered Accountant, is holding securities of Abhiman Ltd. having face value of ₹ 1000/-. Whether Mr. Abhi is qualified for appointment as an Auditor of Abhiman Ltd.?

Answer

(i) **Provisions and Explanation:** Section 141(3) (c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, Ayush, an auditor of X Ltd., joined as partner with consultancy firm where B is also a partner and B is also the Finance

executive of X Ltd. Hence Ayush has attracted clause (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of X Limited.

(ii) As per section 141(3)(d)(i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holds any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

In the present case, Mr. Abhi. is holding security of ₹ 1000 in the Abhiman Ltd, therefore, he is not eligible for appointment as an auditor of Abhiman Ltd.

Intermediate Course
Study Material
(Modules 1 to 2)

Paper 2

Corporate and Other Laws

Module – 2

BOARD OF STUDIES

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Edition	:	July, 2019
Website	:	www.icai.org
E-mail	:	bosnoida@icai.org
Committee/ Department	:	Board of Studies
ISBN No.	:	
Price (All Modules)	:	₹
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002, India.
Printed by	:	

CONTENTS

DETAILED CONTENTS: MODULE – 2

CHAPTER 1 : THE INDIAN CONTRACT ACT, 1872

UNIT-1 : CONTRACT OF INDEMNITY AND GUARANTEE

UNIT -2 : BAILMENT AND PLEDGE

CHAPTER 2 : THE NEGOTIABLE INSTRUMENTS ACT, 1881

CHAPTER 3 : THE GENERAL CLAUSES ACT, 1897

CHAPTER 4 : INTERPRETATION OF STATUTES

DETAILED CONTENTS: MODULE – 2

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UNIT-1 : CONTRACT OF INDEMINITY AND GUARANTEE

UNIT -2 : BAILMENT AND PLEDGE

CHAPTER 4 : INTERPRETATION OF STATUTES

CHAPTER 1

THE INDIAN CONTRACT ACT, 1872

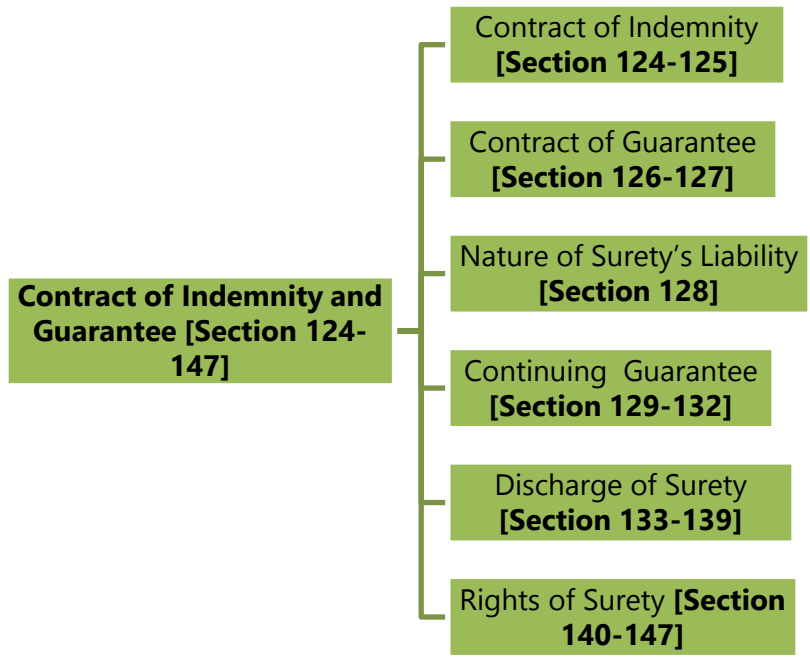
UNIT–1 : CONTRACT OF INDEMNITY AND GUARANTEE

LEARNING OUTCOMES

After studying this unit, you would be able to:

- Identify special type of contracts i.e. Indemnity contracts and Guarantee contracts and also the nature of obligations and rights of each of the parties to the contracts.
- Explain distinction between these contracts.

UNIT OVERVIEW



1. INTRODUCTION

Contract of Indemnity and Guarantee are the **specific types of contracts** given under sections 124 to 147 of the Indian Contract Act, 1872. Along with the specific provisions (Section 124 to Section 147 of the Indian Contract Act, 1872), the general principles of contracts are also applicable to such specific contracts. Both the contracts are modes of compensation based on certain similar principles. However, both differs from each other on several issues.

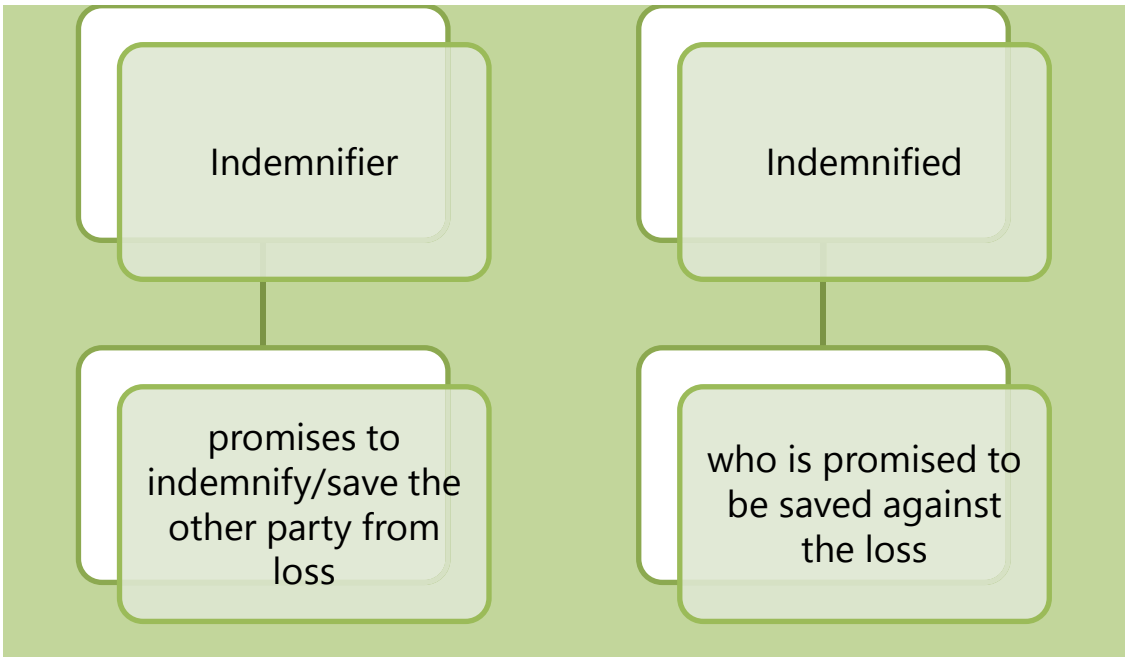
In this unit, the law relating to indemnity and guarantee are discussed in detail.

2. CONTRACT OF INDEMNITY

The term **"Indemnity"** means to make good the loss or to compensate the party who has suffered some loss**.** The term **"Contract of Indemnity"** is defined under **Section 124** of the Indian Contract Act, 1872. It is "*a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person*."

Example: Mr. X contracts with the Government to return to India after completing his studies at University of Cambridge and serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.

There are **two parties** in this form of contract. The party who promises to indemnify/ save the other party from loss is known as **'indemnifier'**, where as the party who is promised to be saved against the loss is known as **"indemnified" or "indemnity holder".**



Example 1 : A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ` 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

Example 2 : X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Here, there is contract of indemnity between X and the company.

Example 3: X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighbouring property blows over. If the tree then blows over and damages Y's fence, X will be liable for the cost of fixing the fence.

Analysis

To indemnify means to compensate or make good the loss. Thus, under a contract of indemnity the "existence of loss" is essential. Unless the promisee has suffered a loss, he cannot hold the promisor liable on the contract of indemnity.

However, the above definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused :

(i) By the conduct of the promisor himself, or

(ii) By the conduct of any other person.

Thus, loss occasioned by the conduct of the promise, or accident, or an act of God is not covered.

Mode of contract of indemnity: A contract of indemnity like any other contract may be express or implied.

a. A contract of indemnity is said to be express when a person expressly promises to compensate the other from loss

b. A contract of indemnity is said to be implied when it is to be inferred from the conduct of the parties or from the circumstances of the case

A contract of indemnity is like any other contract and must fulfil all the **essentials of a valid contract** which includes:

a. Offer and acceptance

b. Intention to create legal obligation

c. Consideration

d. Competency to contract

e. Free consent

f. Lawful object

g. The agreement must not be expressly declared to be void- eg: an agreement in restraint of trade/ marriage etc.

h. The terms of the agreement must not be vague or uncertain

i. The agreement must be capable of performance- An agreement to do an impossible act is void.

j. Legal formalities

Example: A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined ₹ 1000, B cannot claim this amount from A because the object of the agreement is unlawful.

A contract of Fire Insurance or Marine Insurance is always a contract of indemnity. But there is no contract of indemnity in case of contract of Life Insurance.

Rights of Indemnity—holder when sued (Section 125) : The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor/indemnifier—

(1) **all damages** which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) **all costs** which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit;

(3) **all sums** which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

Analysis :

We can understand from the above provisions that, in a contract of indemnity, the promisee i.e., indemnity- holder acting within the scope of his authority is entitled to recover from the promisor i.e., indemnifier the following rights:

(a) **all damages** which he may be compelled to pay in any suit

(b) **all costs** which he may have been compelled to pay in bringing/ defending the suit and

(c) **all sums** which he may have paid under the terms of any compromise of suit.

It may be understood that the rights contemplated under section 125 are **not exhaustive**. The indemnity holder/ indemnified has other rights besides those

mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

Please note that the Indian Contract Act is silent about the rights which the Indemnifier has on carrying out his promise to indemnify. But they are similar to the rights of a surety under section 141 of the Indian Contract Act.

When does the liability of an indemnifier commence?

Although the Indian Contract Act, 1872, is silent on the time of commencement of liability of indemnifier, however, on the basis of judicial pronouncements it can be stated that the liability of an indemnifier commences **as soon as the liability of the indemnity-holder becomes absolute and certain.** This principle has been followed by the courts in several cases.

Example: A promises to compensate X for any loss that he may suffer by filling a suit against Y. The court orders X to pay Y damages of Rs 10000 . As the loss has become certain, X may claim the amount of loss from A and pass it to Y.

3. CONTRACT OF GUARANTEE

"Contract of guarantee", "surety", "principal debtor" and "creditor" [Section 126]

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

Three parties are involved in a contract of guarantee

- **Surety**- person who gives the guarantee,
- **Principal debtor**- person in respect of whose default the guarantee is given,
- **Creditor**- person to whom the gurantee is given

Example 1 : When A requests B to lend ` 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C falling to do so, he (A) will himself pay to B, there is a contract of guarantee.

Here, B is the creditor, C the principal debtor and A the surety.

Example 2 : Where 'A' obtains housing loan from LIC Housing and if 'B' promises to pay LIC Housing in the event of 'A' failing to repay, it is a contract of guarantee.

Example 3 : X and Y go into a car showroom where X says to the dealer to supply latest model of Wagon R to Y. In case of Y's failure to pay, X will be paying for it. This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

Analysis

From the definition, it can be analysed that, Guarantee is a **promise to pay a debt owed by a third person** in case the latter does not pay.

Any guarantee given may be **oral** or **written**.

From the above definition, it is clear that in a contract of guarantee is **a tripartite agreement between principal debtor, creditor and surety**. There are, in effect three contracts

(i) A **principal contract** between the principal debtor and the creditor

(ii) A **secondary contract** between the creditor ad the surety.

(iii) A **implied contract** between the surety and the principal debtor whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.

The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.

ESSENTIAL FEATURES OF A GUARANTEE

The following are the requisites of a valid guarantee

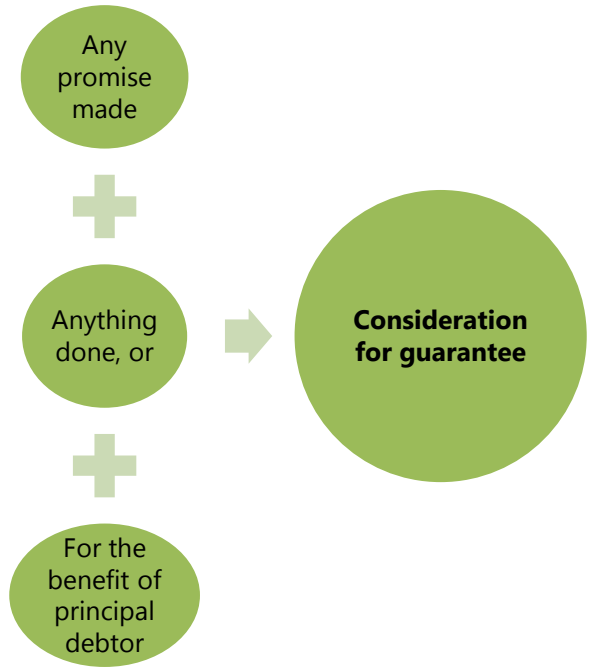
1. **Principal Debt**: The purpose of a guarantee being to **secure** the **payment of a debt**, the existence of recoverable debt is necessary. It is of the essence of a guarantee that there should be someone liable as a principal debtor and the surety undertakes to be liable on his default. If there is no principal debt, there can be no valid guarantee.

2. **Consideration:** Like every other contract, a contract of guarantee should also be supported by some consideration. A guarantee without consideration is void, but there need be no direct consideration between the surety and the creditor. As per Section

127 consideration received by the principal debtor is sufficient consideration to the surety for giving the guarantee, but past consideration is no consideration for the contract of guarantee. Even if the principal debtor is incompetent to contract, the guarantee is valid. But, if surety is incompetent to contract, the guarantee is void.

Example 1: B requests A to sell and deliver to him goods on credit. A agrees to do so provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A 's promise to deliver the goods. As per Section 127, there is a sufficient consideration for C's promise. Therefore the guarantee is valid.

Example 2 : A sell and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.



Example 3: A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

3. **Existence of a liability**: There must be an **existing liability or a promise** whose performance is guaranteed. Such liability or promise must be enforceable by law. The liability must be legally enforceable and not time barred.

4. **No misrepresentation or concealment (section 142 and 143)**: Any guarantee which has been obtained by the means of **misrepresentation** made by the creditor, or **with his knowledge and assent**, concerning a material part of the transaction, is invalid (section 142)

   Any guarantee which the creditor has obtained by means of **keeping silence** as to material circumstances, is invalid (section 143)

   Example 1: A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C, with his previous conduct. B afterwards make default. The guarantee is invalid.

5. **Writing not necessary**: **Section 126** expressly declares that a guarantee may be either oral or written.

6. **Joining of the other co-sureties (Section 144):** Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join. That implies, the guarantee by a surety is not valid if a condition is imposed by a surety that some other person must also join as a co-surety, but such other person does not join as a co-surety.

4. TYPES OF GUARANTEE

Guarantee may be classified under two categories:

A. **Specific Guarantee**- A guarantee which **extends to a single debt/ specific transaction** is called a specific guarantee. The surety's liability comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

Example: A guarantees payment to B of the price of the five bags of rice to be delivered by B to C and to be paid for in a month. B delivers five bags to C, C pays for them. This is a contract for specific

guarantee because A intended to guarantee only for the payment of price of the first five bags of rice to be delivered one time [*Kay v Groves*]

B. Continuing Guarantee [Section 129]- A guarantee which extends to a **series of transaction** is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee.

Example: On A's recommendation B, a wealthy landlord employs C as his estate manager. It was the duty of C to collect rent on 1st of every month from the tenant of B and remit the same to B before 5th of every month. A, guarantee this arrangement and promises to make good any default made by C. This is a contract of continuing guarantee.

5. DISTINCTION BETWEEN A CONTRACT OF INDEMNITY AND A CONTRACT OF GUARANTEE

Point of distinction	Contract of Indemnity	Contract of Guarantee
Number of party/Parties to the contract	there are **only two parties** namely the indemnifier [promisor] and the indemnified [promisee]	there are **three parties** creditor, principal debtor and surety.
Nature of liability	The liability of the indemnifier is **primary** and **unconditional**	The liability of the surety is **secondary** and **conditional** as the primary liability is that of the principal debtor.
Time of liability	The liability of the indemnifier arises only on the happening of a contingency.	The liability arises only on the non performance of an existing promise or non paymemnt of an existing debt.
Time to Act	The indemnifier need not act at the request of	The surety acts at the request of principal

	indemnity holder	debtor.
Right to sue third party	indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	All parties must be competent to contract	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

6. NATURE AND EXTENT OF SURETY'S LIABILITY [SECTION 128]

The liability of the surety is **co-extensive with that of the principal debtor** unless it is otherwise provided by the contract. [Section 128]

Analysis :

(i) The term "**co-extensive with that of principal debtor**" means that the surety is liable for what the principal debtor is liable. However, the liability of the surety may be made less than that of the principal debtor by an express contract to that effect.

(ii) The **liability** of a **surety** arises **only on default by the principal debtor**. But as soon as the principal debtor defaults, the liability of the surety begins and runs co-extensive with the liability of the principal debtor, in the sense that the surety will be liable for all those sums for which the principal debtor is liable. If there is a condition precedent for surety's liability, the surety would be liable only when such condition is fulfilled. A partial recognition of this principal is found in Section 144 (Joining of co surety)

(iii) Where a debtor **cannot be held liable** on account of any defect in the document, the **liability** of the **surety also ceases**.

(iv) **Surety's liability continues** even if the principal debtor has not been sued or is omitted from being sued. In other words, a creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.

Example : A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

Nature of Surety's liability can be summed up as (a) Liability of surety is of secondary nature as he is liable only on default of principal debtor. (b) his liability arises immediately on the default by the principal debtor (c) The Creditor has a right to sue the surety directly without first proceeding against principal debtor.

7. CONTINUING GUARANTEE

Continuing guarantee (Section 129): A guarantee which extends to a series of transactions is called a "**continuing guarantee**". The essence of continuing guarantee is that it applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.

Example 1 : A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of ₹ 5,000 rupees, for due collection and payment by C of those rents. This is a continuing guarantee.

Example 2 : A guarantees payment to B, a tea-dealer, to the amount of ₹ 100, for any tea he may from time to time supply to C. B supplies C with tea to above the value of ₹ 100, and C pays B for it. Afterwards B supplies C with tea to the value of ₹ 200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of ₹ 100.

Example 3 : A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

In the continuing guarantee, the **liability of surety continues** till the **performance** or the **discharge** of all the transactions entered into or the **guarantee is withdrawn**.

8. LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT AFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT.

Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other, the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence. (Section 132)

Example : A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

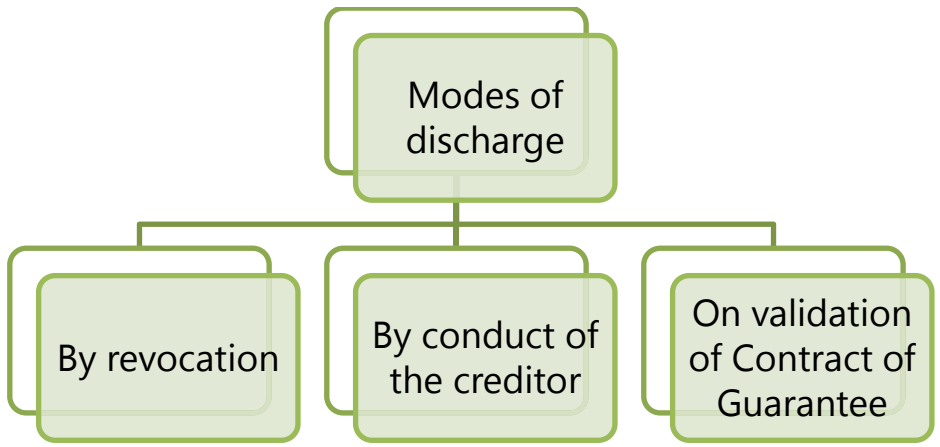
9. DISCHARGE OF A SURETY

A surety is said to be discharged when his liability as surety comes to an end. The various modes of discharge of surety are discussed below:

(i) By revocation of the contract of guarantee.

(ii) By the conduct of the creditor, or

(iii) By the invalidation of the contract of guarantee.



By revocation of the Contract of Guarantee

(a) **Revocation of continuing guarantee by Notice (Section 130):** The continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors. A specific guarantee can be revoked only if liability to principal debtor has not accrued.

Example 1: A, in consideration of B's discounting, at A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 50,000 rupees. B discounts bills for C to the extent of 20,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 20,000 rupees, on default of C.

Example 2: A guarantees to B, to the extent of 100,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonors the bill at maturity. A is liable upon his guarantee.

Example 3: X gives guarantee to the extent of ₹ 50,000 for the loans given from time to time by A to B. A gave a loan of ₹ 10,000 to B. Afterwards, X gives notice of revocation. X is discharged from all liability to A for any loan granted after the revocation of guarantee but he is liable to A for ₹ 10,000 on default of B.

(b) **Revocation of continuing guarantee by surety's death (Section 131):** In the absence of any contract to the contrary, the death of surety operates as a revocation of a continuing guarantee as to the future transactions taking place after the death of surety. However, the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.

(c) **By novation [Section 62]:** The surety under original contract is discharged if a **fresh contract is entered** into either between the same parties or between the other parties, the consideration being the mutual discharge of the old contract.

By conduct of the creditor

(a) **By variance in terms of contract (Section 133):** Where there is any variance in the terms of contract between the principal debtor and creditor **without surety's consent**, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Example 1: A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

Example 2: A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.

Example 3: C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.

Example 4: A gives to C a continuing guarantee to the extent of ₹ 3,00,000 for any oil supplied by C to B on credit. Afterwards B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement.

Example 5: C contracts to lend B ₹ 5,00,000 on the 1st March. A guarantees repayment. C pays the ₹ 5,00,000 to B on the 1st January. A is discharged from his liability, as the contract has been varied, in as much as C might sue B for the money before the 1st March.

Variation which is not substantial or material or which is beneficial to the surety will not discharge him of his liability. In *M.S Anirudhan v Thomco's Bank Ltd. AIR 1963 SC 746,* the surety guaranteed the repayment of loan provided by the bank to the principal debtor of only upto ₹ 25,000. Subsequently, since the bank was willing to provide loan only upto ₹ 20,000, the principal debtor reduced the amount to ₹ 20,000 in the guarantee form and without intimation to the surety gave it to the bank which was then accepted. On default by the principal debtor, the court held that the surety's

liability was not discharged as the alteration was beneficial to him and not substantial.

(b) By release or discharge of principal debtor (Section 134): The surety is discharged if the creditor:

i. enters into a fresh/ new contract with principal debtor; by which the principal debtor is released, or

ii. does any act or omission, the legal consequence of which is the discharge of the principal debtor.

Example: A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

(c) Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sector 135]: A contract between the creditor and the principal debtor, by which the creditor makes a **composition** with, or **promises to give time** to, or **promises not to sue**, the principal debtor, discharges the surety, unless the surety assents to such contract.

i. *Composition:* If the creditor makes a composition with the principal debtor, without consulting the surety, the latter is discharged. Composition inevitably involves variation of the original contract, and, therefore, the surety is discharged.

ii. *Promise to give time:* When the time for the payment of the guaranteed debt comes, the surety has the right to require the principal debtor to pay off the debt. Accordingly, it is one of the duties of the creditor towards the surety not to allow the principal debtor more time for payment.

iii. *Promise not to sue:* If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged. The main reason is that the surety is entitled at any time to require the creditor to call upon the principal debtor to pay off the debt when it is due and this right is positively violated when the creditor promises not to sue the principal debtor. This is, however, subject to two important qualifications. In the first place, the promise not to sue should be distinguished from a mere "forbearance to sue."" A promise not to sue is an engagement which ties the hand of the creditor". It is not

negatively refraining; not exacting the money at the time, but it is the act of the creditor depriving himself the power of suing. Section 137 incorporates this principal.

Cases where surety not discharged

i. **Surety not discharged when agreement made with third person to give time to principal debtor [Section 136]:** Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

Example: C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

ii. **Creditor's forbearance to sue does not discharge surety [Section 137]:** Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not in the absence of any provision in the guarantee to the contrary, discharge the surety.

Example: B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

(d) Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Section 139]: If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged. It is the plain duty of the creditor not to do anything inconsistent with the rights of the surety. A surety is entitled after paying off the creditor, to his indemnity from the principal debtor. If the creditors act or omission deprives the surety of the benefit of this remedy, the surety is discharged.

In a case before the Supreme Court of India, "A bank granted a loan on the security of the stock in the godown. The loan was also guaranteed by the surety. The goods were lost from the godown on account of the negligence of the bank officials. The surety was discharged to the extent of the value of the stock so lost." *[State bank of Saurashtra V Chitranjan Rangnath Raja (1980) 4 SCC 516]*

Example 1: B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment.

Example 2: A puts M as apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

By the invalidation of the contract of guarantee

(a) Guarantee obtained by misrepresentation invalid [Section 142]: Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

(b) Guarantee obtained by concealment invalid [Section 143]: Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Example 1: A engages B as a clerk to collect money for him, B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

Example 2: A guarantees to C payment for iron to be supplied by him to B for the amount of ₹ 2,00,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

(c) Guarantee on contract that creditor shall not act on it until co-surety joins (Section 144): Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

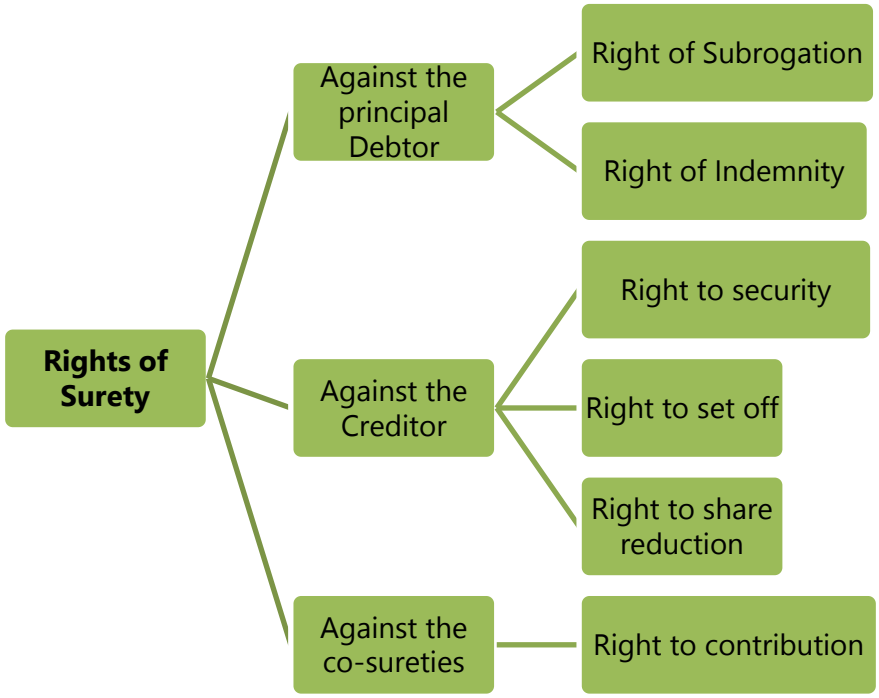
10. RIGHTS OF A SURETY

The surety enjoys the following rights against the creditor:

(a) Rights against the creditor,

(b) Rights against the principal debtor,

(c) Rights against co-sureties.



Right against the principal debtor

(a) Rights of subrogation [Section 140]: Where, a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

This right is known as right of subrogation. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of the creditor.

(b) Implied promise to indemnify surety [Section 145]: In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety. The surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but not sums which he paid wrongfully.

Example 1: B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A

defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

Example 2: C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands payment of it from A, and, on A's refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

Example 3: A guarantees to C, to the extent of 2,00,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,00,000 rupees, but obtains from A payment of the sum of 2,00,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

Right against the Creditor

Surety's right to benefit of creditor's securities [Section 141]: A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Example 1: C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

Example 2: C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

Example 3: A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives the up the further security, A is not discharged.

Right to set off: If the creditor sues the surety, for payment of principal debtor's liability, the surety may have the benefit of the set off, if any, that the principal debtor had against the creditor.

Right to share reduction: The surety has right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.

Rights against co-sureties

"Co-sureties (meaning)- When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties"

(a) Co-sureties liable to contribute equally (Section 146): Equality of burden is the basis of Co-suretyship. This is contained in section 146 which states that "when two or more persons **are co-sureties** for the **same debt**, or duty, **either jointly, or severally** and **whether under the same or different contracts** and **whether with or without the knowledge of each other**, the co-sureties in the absence of any contract to the contrary, are **liable**, as between themselves, **to pay each an equal share of the whole debt**, or of that part of it which remains unpaid by the principal debtor".

Example 1: A, B and C are sureties to D for the sum of 3,00,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,00,000 rupees each.

Example 2: A, B and C are sureties to D for the sum of 1,00,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one- half. E makes default in payment. As between the sureties, A is liable to pay 25,000 rupees, B 25,000 rupees, and C 50,000 rupees.

(b) Liability of co-sureties bound in different sums (Section 147): The principal of equal contribution is, however, subject to the maximum limit fixed by a surety to his liability. Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Example 1: A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 3,00,000 rupees. A, B and C are each liable to pay 1,00,000 rupees.

Example 2: A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.

Example 3: A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.

SUMMARY

- **A contract of indemnity-**A contract where one, party promises to indemnify the other from loss caused to him by the conduct of the promisor or by the conduct of any other person.
- **A contract of guarantee-**A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the Surety, the person for whom the guarantee is given is called the Principal Debtor, and the person to whom the guarantee is given is called the Creditor.
- Contract of guarantee must be supported by consideration. The consideration received by the principal debtor may be sufficient consideration to the surety for giving guarantee.
- The liability of surety is co-extensive with that of principle debtor. In certain cases surety will be liable though principal debtor is not liable-(i) principal debtor is incompetent to contract. (ii) Principal debtor is adjudged insolvent. (iii) The debts become time-barred. The rights of a surety can be divided into 3 heads: (i) Right against the principal debtor; (ii) Right against the creditor; (iii) Right against the co- sureties.
- The surety is discharged from its liability (i) By revocation of the contract of guarantee. (ii) By the conduct of the creditor, or (iii) By the invalidation of the contract of guarantee.
- **Specific/simple guarantee:** Guarantee for single debt/particular transaction.
- **Continuing guarantee:** Guarantee that extends to a series of transactions.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. A contract of indemnity is a
   (a) Contingent Contract
   (b) Wagering contract
   (c) Quasi Contract
   (d) Void agreement
2. A contracts to save B against the consequences of any proceedings, which C may take against B in respect of a certain sum of 500 rupees. This is a:
   (a) Contract of guarantee
   (b) Quasi contract
   (c) Contract of indemnity
   (d) Void contract
3. In a Contract of Guarantee there is/are :
   (a) One contract
   (b) Two contracts
   (c) Three contracts
   (d) Four contracts.
4. S and P go into a shop. S says to the shopkeeper, C, "Let P have the goods, and if he does not pay you, I will." This is a
   (a) Contract of Guarantee
   (b) Contract of Indemnity
   (c) Wagering agreement
   (d) Quasi-contract
5. A guarantee obtained by a creditor by keeping silence as to material circumstances is :
   (a) valid
   (b) voidable

(c) unenforceable

(d) invalid

6. In a contract of guarantee, a person, who promises to discharge another's liability is called:

(a) Principal debtor

(b) Creditor

(c) Indemnifier

(d) Surety

Answer to MCQs

1. (a) **2.** (c) **3.** (c) **4.** (a) **5.** (d) **6.** (d)

QUESTION AND ANSWER

Question 1

M advances to N ₹ 5,000 on the guarantee of P. The loan carries interest at the rate ten percent per annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to six per cent per annum and does not sue N for one year after the loan becomes due. N becomes insolvent. Can M sue P?

Answer

M cannot sue P, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety (Section 133, Indian Contract Act, 1872).

Question 2

What are the rights of the indemnity-holder when sued?

Answer

Rights of Indemnity- holder when sued (Section 125): The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor—

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit;

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

It may be understood that the rights contemplated under section 125 are not exhaustive. The indemnity holder/ indemnified has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

Question 3

Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid?

Answer

Section 124 of the Indian Contract Act,1872 states that "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity".

Section 126 of the Indian Contract Act, 1872 states that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default." is called as "contract of guarantee".

The conditions under which the guarantee is invalid or void are stated in section 142,143 and 144 of the Indian Contract Act are:

(i) Guarantee obtained by means of misrepresentation.

(ii) creditor obtained any guarantee by means of keeping silence as to material circumstances.

(iii) When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

Question 4

Mr. X, is employed as a cashier on a monthly salary of ₹ 2,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of ₹ 1,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y ?

Answer

If the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change. In the instant case Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary. [Section 133, Indian Contract Act, 1872].

Question 5

A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability.

Answer

According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission for the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case the B omits to supply the necessary construction material. Hence C is discharged from his liability.

Question 6

Mr. D was in urgent need of money amounting ₹ 5,00,000. He asked Mr. K for the money. Mr. K lent the money on the sureties of A, B and N without any contract between them in case of default in repayment of money by D to K. D makes default in payment. B refused to contribute, examine whether B can escape liability?

Answer

Co-sureties liable to contribute equally (Section 146 of the Indian Contract act, 1872): Equality of burden is the basis of Co-suretyship. This is contained in section 146 which states that "when two or more persons are co-sureties for the same

debt, or duty, either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor".

Accordingly, on the default of D in payment, B cannot escape from his liability. All the three sureties A, B and N are liable to pay equally, in absence of any contract between them.

Question 7

Mr. Chetan was appointed as Site Manager of ABC Constructions Company on a two years contract at a monthly salary of ₹ 50,000. Mr. Pawan gave a surety in respect of Mr. Chetan's conduct. After six months the company was not in position to pay ₹ 50,000 to Mr. Chetan because of financial constraints. Chetan agreed for a lower salary of ₹ 30,000 from the company. This was not communicated to Mr. Pawan. Three months afterwards it was discovered that Chetan had been doing fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole duration of Chetan's Appointment.

Answer

As per the provisions of Section 133 of the Indian Contract Act, 1872, if the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change.

In the instant case, Mr. Pawan is liable as a surety for the loss suffered by ABC Constructions company due to misappropriation of cash by Mr. Chetan during the first six months but not for misappropriations committed after the reduction in salary.

Hence, Mr. Pawan, will be liable as a surety for the act of Mr. Chetan before the change in the terms of the contract i.e., during the first six months. Variation in the terms of the contract (as to the reduction of salary) without consent of Mr. Pawan, will discharge Mr. Pawan from all the liabilities towards the act of the Mr. Chetan after such variation.

Question 8

A agrees to sell goods to B on the guarantee of C for the payment of the price of goods in default of B. Is the agreement of guarantee valid in each of the following alternate cases:

Case 1. If A is a Minor

Case 2: If B is a Minor

Case 3: If C is a minor.

Answer

Case 1: The agreement of guarantee is void because the creditor is incompetent to contract.

Case 2: The agreement of guarantee is valid because the capability of the principal debtor does not affect the validity of the agreement of the guarantee.

Case 3: The agreement of guarantee is void because the surety is incompetent to contract.

Question 9

S asks R to beat T and promises to indemnify R against the consequences. R beats T and is fined ₹ 50,000. Can R claim ₹ 50,000 from S.

Answer

R cannot claim ₹ 50,000 from S because the object of the agreement was unlawful. A contract of indemnity to be valid must fulfil all the **essentials of a valid contract** which includes:

a. Offer and acceptance

b. Intention to create legal obligation

c. Consideration

d. Competency to contract

e. Free consent

f. Lawful object

g. The agreement must not be expressly declared to be void- eg: an agreement in restraint of trade/ marriage etc.

h. The terms of the agreement must not be vague or uncertain

i. The agreement must be capable of performance- An agreement to do an impossible act is void.

j. Legal formalities

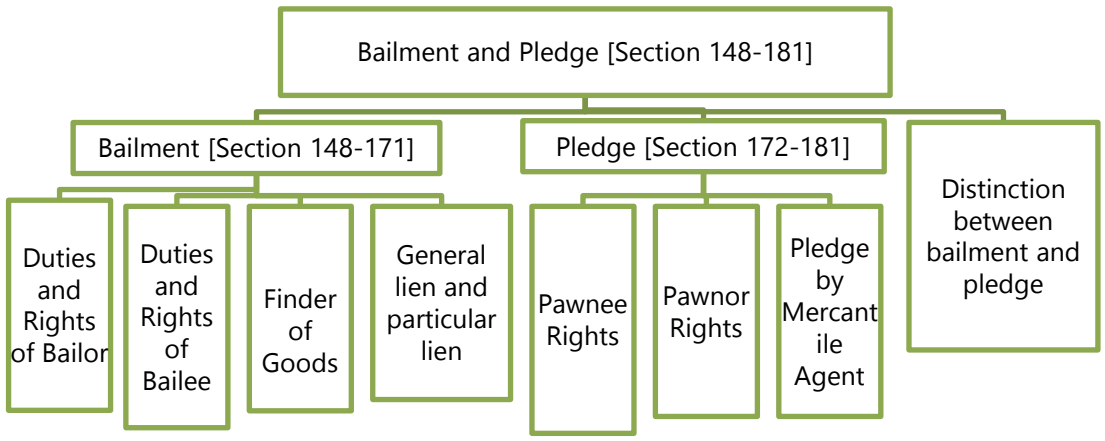
UNIT–2 : BAILMENT AND PLEDGE

LEARNING OUTCOMES

After studying this unit, you would be able to:

- Understand the general principles underlying contracts of bailment and pledge.
- Know duties and rights of the parties to the contracts.

UNIT OVERVIEW



1. WHAT IS BAILMENT?

The word "Bailment" has been derived from the **French word "ballier**" which **means "to deliver**". Bailment etymologically means 'handing over' or 'change of possession'. As per **Section 148** of the Act, **bailment** is the delivery of goods by one person to another for some **purpose**, upon a **contract**, that the **goods** shall,

when the purpose is accomplished, be **returned** or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the **"bailor".** The person to whom they are delivered is called the **"bailee".**

Example: Where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.

Example: X delivers a piece of cloth to Y, a tailor, to be stitched into a suit. It is contract for bailment.

Analysis:

The **essential elements** of a contract of bailment are—

(a) **Contract:** Bailment is based upon a contract. The contract may be express or implied. No consideration is necessary to create a valid contract of bailment.

(b) **Delivery of goods** It involves the delivery of **goods** from one person to another for some purposes. **Bailment is only for moveable goods** and never for immovable goods or money. The delivery of the possession of goods is of the following kinds:

i. **Actual Delivery**: When goods are physically handed over to the bailee by the bailor. Eg: delivery of a car for repair to workshop

ii. **Constructive Delivery**: Where delivery is made by doing anything that has the effect of putting goods in the possession of the bailee or of any person authorized to hold them on his behalf. Eg: Delivery of the key of a car to a workshop dealer for repair of the car.

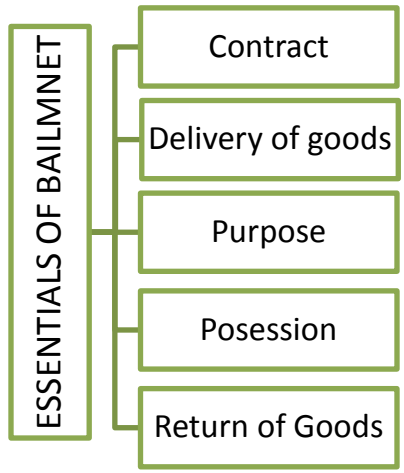
(c) **Purpose**: The goods are delivered for some purpose. The purpose may be express or implied.

(d) **Possession:** In bailment, possession of goods changes. Change of possession can happen by physical delivery or by any action which has the effect of placing the goods in the possession of bailee. The change of possession does not lead to change of ownership. In bailment, bailor continues to be the owner of goods as there is no change of ownership. Where a person is in custody without possession he does not became a bailee.

For **example**, servants of a master who are in custody of goods of the master do not become bailees.

Similarly, depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank. The ornaments are in possession of the owner though kept in a locker at the bank.

(e) **Return of goods:** Bailee is obliged to **return the goods** physically to the bailor. The goods should be returned in the same form as given or may be altered as per bailor's direction. It should be noted that exchange of goods should not be allowed. The bailee cannot deliver some other goods, even not those of higher value. Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.



Different forms of Bailment: Following are the popular forms of bailment

(1) Delivery of goods by one person to another to be held for the bailor's use.

(2) Goods given to a friend for his own use without any charge.

(3) Hiring of goods.

(4) Delivering goods to a creditor to serve as security for a loan.

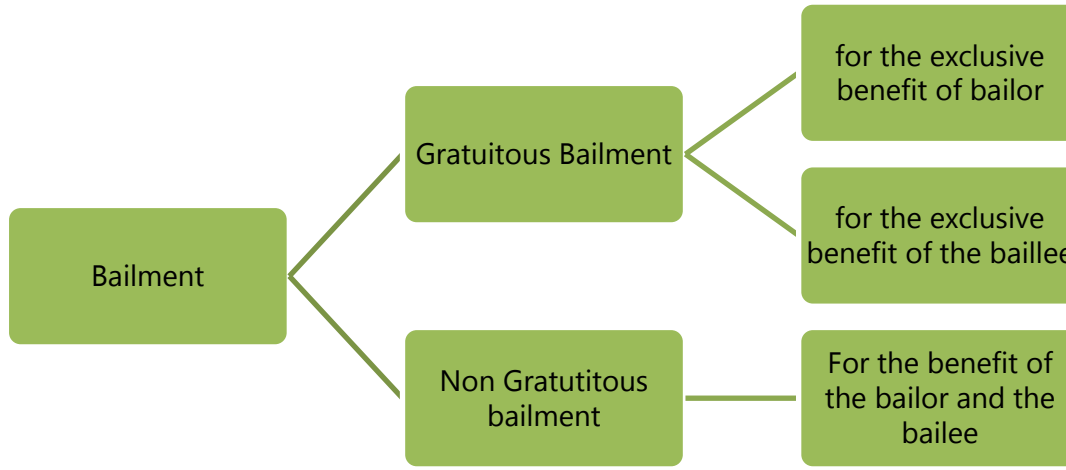
(5) Delivering goods for repair with or without remuneration.

(6) Delivering goods for carriage.

Note: On the basis of reward, bailment can be classified into two types:

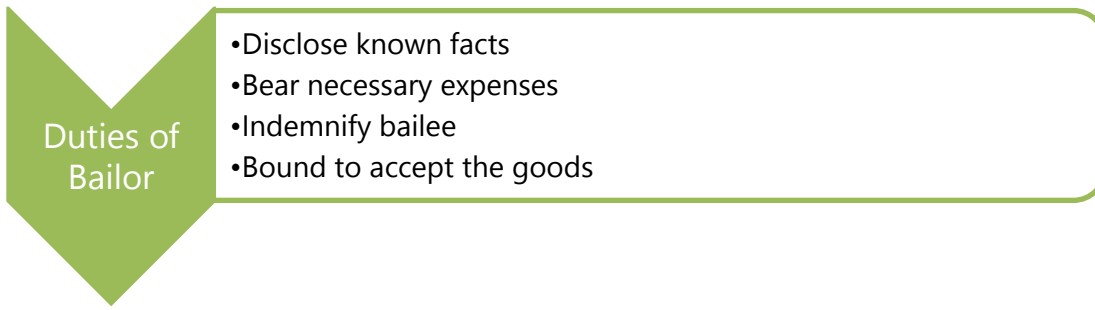
a. Gratuitous Bailment: The word gratuitous means free of charge. So a gratuitous bailment is one when the provider of service does it gratuitously i.e. free of charge such bailment would be either for the exclusive benefits of bailor or bailee.

b. Non-Gratuitous Bailment: Non gratuitous bailment means where both the parties get some benefit i.e. bailment for the benefit of both bailor & bailee



2. DUTIES OF A BAILOR

Duties of Bailor: The duties of bailor are spelt out in a number of Sections [Section 150, 158, 159, 164]. These are categorized under the following headings:



These are enumerated hereunder:

(i) Bailor's duty to disclose faults in goods bailed [Section 150]: The bailor is **bound to disclose** to the bailee **faults in the goods bailed**, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed.

Example 1: A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

Example 2: A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

The condition for the liability of the bailor are:

a. The bailor should have the knowledge of the defect and the bailee should not be aware

b. The defect in the goods must be such as exposes the bailee to extraordinary risks or materially interferes with the use of goods.

In *Hyman & Wife v. Nye & Sons (1881)*, A hired from B a carriage along with a pair of horses and a driver for a specific journey. During the journey a bolt in the under-part of the carriage broke away. As a result of this, the carriage became upset and A was injured. *It was held that B was liable to pay damages to A for the injury sustained by him. The court observed that it was the bailor's duty to supply a carriage fit for the purpose for which it was hired.*

Sometimes, the goods bailed are of dangerous nature (e.g., explosives). In such cases it is the duty of the bailor to disclose the nature of goods. *[Great Northern Ry'.case (1932)]*

(ii) Duty to pay necessary expenses [Section 158]: Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the **bailee is to receive no remuneration (gratuitous bailment)**, the **bailor shall repay** to the bailee the **necessary expenses** incurred by him and **any extraordinary expenses** incurred by him for the purpose of the bailment. However, in case of **non-gratuitous** bailment the bailor is liable to pay the extraordinary expenses.

Example: A hired a taxi from B for the purpose of going to Gurgaon from Noida, during the journey, a major defect occurred in the engine. A had to pay ₹ 5000 as repair charges. These are the extraordinary expenses and it is the bailor's duty to bear such expenses. However, the usual and ordinary expenses for petrol, toll tax etc are to be borne by the bailee itself.

(iii) Duty to indemnify the Bailee for premature termination [Section 159]: The bailor must compensate the bailee for the loss or damage suffered by the bailee that is in excess of the benefit received, where he had lent the

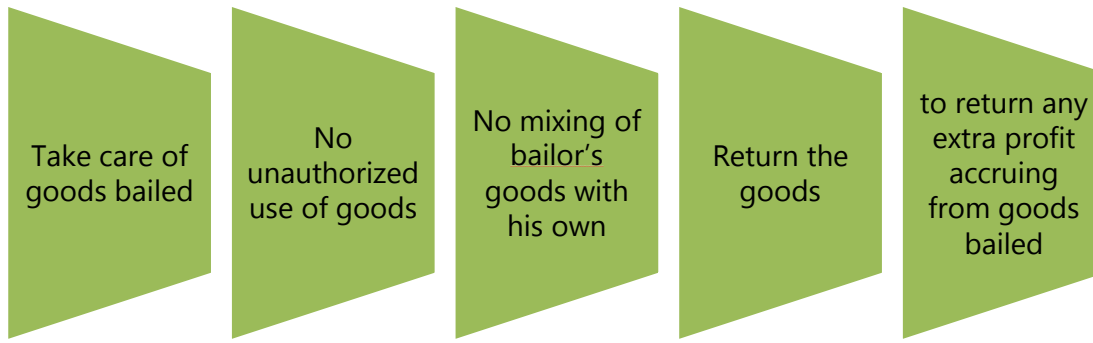
goods gratuitously and decides to terminate the bailment before the expiry of the period of bailment.

(iv) Bailor's responsibility to bailee [Section 164]: The bailor is responsible to the bailee for the following:

a. **Indemnify for any loss** which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods or to give directions, respecting them (defective title in goods).

b. It is the duty of the bailor **to receive back the goods** when the bailee returns them after the time of bailment has expired or the purpose of bailment has been accomplished. If the bailor refuses to take delivery of goods when it is offered at the proper time the bailee can claim compensation for all necessary expenses incurred for the safe custody. **Example**: X delivered his car to S for five days for safe keeping. However, X did not take back the car for one month. In this case, S can claim the necessary expenses incurred by him for the custody of the car.

3. DUTIES OF A BAILEE



1. Take reasonable Care of the goods (Section 151 & 152): In all cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

Example 1: If X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank,

but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss [caused on account of riot].

Example 2: A deposited his goods in B's godown. On account of unprecedented floods, a part of the goods were damaged. It was held that, B is not liable for the loss *(Shanti Lal V. Takechand)*.

Exception: Bailee when not liable for loss, etc., of thing bailed [Section 152]: The bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in section 151.

2. **Not to make inconsistent use of goods (section 153 & 154):** As per Section 154, if the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

Example 1: A lends a horse to B for his own riding only. B allows C, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury done to the horse.

Example 2: 'A' hires a horse in Kolkata from B expressly to march to Varanasi. 'A' rides with due care, but marches to Cuttack instead. The horse accidentally falls and is injured. 'A' is liable to make compensation to B for the injury to the horse.

As per Section 153, a contract of bailment is **voidable** at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

Example: A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. This is, at the option of A, a termination of the bailment.

3. **Not to mix the goods (Section 155, 156 and 157):** Bailee is not entitled to mix up the goods bailed with his own goods except with the consent of the bailor. If he, **with the consent of the bailor**, mixes the goods bailed with his own goods, both the parties shall have an interest in proportion to their respective shares in the mixture thus produced (**Sec. 155**).

If the bailee, **without the consent of the bailor**, mixes the goods bailed with his own goods and the **goods can be separated or divided**, the property in the goods remains in the parties respectively bailee is bound to

bear the expenses of separation and division and any damage arising from the mixture (**Sec. 156**).

Example: A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark; A is entitled to have his 100 bales returned, and B is bound to bear all the expenses incurred in the separation of the bales, and any other incidental damage.

If the bailee, **without the consent of the bailor** mixes the goods of the bailor with his own goods in such a manner that it is **impossible to separate the goods bailed** from the other goods and to deliver them back, the bailor is entitled to compensation by the bailee for loss of the goods **(Sec. 157).**

Example: A bails a barrel of Cape flour worth ₹ 4500 to B. B, without A's consent, mixes the flour with country flour of his own, worth only ₹ 2500 a barrel. B must compensate A for the loss of his flour.

4. **Return the goods (Section 160 & 161):** It is the **duty of bailee to return**, or deliver according to the bailor's directions, **the goods bailed without demand**, as soon as the time for which they were bailed, has expired, or the purpo.se for which they were bailed has been accomplished. [Section 160]

   If, by the **default of the bailee**, the **goods are not returned**, delivered or tendered at the proper time**, he is responsible to the bailor for any loss**, destruction or deterioration of the goods from that time. [Section 161]

   Example – X delivered books to Y to be bound. Y promised to return the books within a reasonable time. X pressed for the return of the book. But Y, failed to deliver them back even after the expiry of reasonable time. Subsequently the books were burnt in an accidental fire at the premises of Y. In this case Y was held liable for the loss.

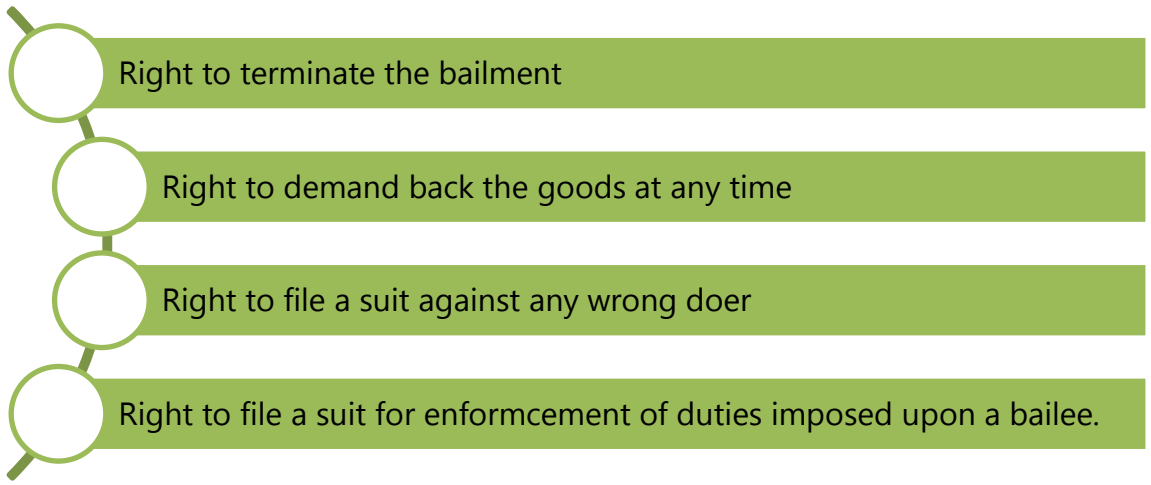
5. **Return an accretion from the Goods [Section 163]:** In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

   Example: A leaves a cow in the custody of B. The cow gives birth a calf. B is bound to deliver the calf as well as the cow to A.

6. **Not to setup Adverse Title**: Bailee must not set up a title adverse to that of the bailor. He must hold the goods on behalf of and for the bailor. He cannot deny the title of the bailor.

4. RIGHTS OF A BAILOR

Rights of Bailor: Broadly rights of bailor are also the duty of the bailee can be categorized as under:



The following are the rights of bailor:

(i) **Right to terminate the bailment [Section 153]:** A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

Example: A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. This is, at the option of A, a termination of the bailment.

Termination of bailment may take place in the following circumstances:

(ii) **Premature Termination (Section 159)**: When the goods are lent gratuitously, the bailor can demand back the goods at any time even before the expiry of the time fixed or the achievement of the object.

Example: A, while going out of station delivered his ornaments to B for safe custody for one month. But A returned to station after one week. He may demand the return of his ornaments even though the time of one month has not expired.

However, due to the premature return of the goods, if the bailee suffers any loss, which is more than the benefit actually obtained by him from the use of the goods bailed, the bailor has to compensate the bailee.

(iii) Right to file a suit against a wrong doer [Section 180 and section 181] (discussed in detail on next page)

(iv) Right to sue the bailee: The bailor has a right to sue the bailee for enforcing all the liabilities and duties of him. It includes:

a. Right to claim compensation for loss caused to the goods by the negligence of the bailee.

b. Right to claim compensation for unauthorized mixing of goods

c. Right to claim damages for unauthorized use of the goods

d. Right to demand back goods.

e. Right to any accretion to the goods bailed.

5. RIGHTS OF A BAILEE

Rights of bailee: As a matter of fact, all the duties of the bailor are the rights of the bailee. In addition to that, the bailee has the following other rights also.

1. Right to Deliver the Goods to any one of the Joint Bailors [Section 165]

If several joint owners bailed the goods, the bailee has a right to deliver them to any one of the joint owners unless there was a contract to the contrary.

Example: A, B and C are the joint owners of a harvesting combine. They delivered it on hire to D for one month. After the expiry of one month, D may return the "combine" to any one of the joint owners namely, A, B or C.

2. Right to indemnity (Sec. 166): Bailee is entitled to be indemnified by the bailor for any loss arising to him by reasons that the bailor was not entitled to make the bailment or to receive back the goods or to give directions in respect to them. If the bailor has no title to the goods, and the bailee in good faith, delivers them back to, or according to the directions of the bailor, the bailee shall not be responsible to the owner in respect of such delivery. Bailee can also claim all the necessary expenses incurred by him for the purpose of gratuitous bailment.

3. **Right to claim compensation in case of faulty goods (Sec. 150):** A bailee is entitled to receive compensation from the bailor or any loss caused to him due to the failure of the bailor to disclose any faults in the goods known to him. If the bailment is for hire, the bailor will be liable to compensate even though he was not aware of the existence of such faults.

4. **Right to claim extraordinary expenses (Sec. 158)**: A bailee is expected to take reasonable care of the gods bailed. In case he is required to incur any extraordinary expenses, he can hold the bailor liable for such expenses.

5. **Right to Apply to Court to Decide the Title to the Goods [Section 167]:** If the goods bailed are claimed by the person other than the bailor, the bailee may apply to the court to stop its delivery and to decide the title to the goods.

   Example: A, a dealer in T.V. delivered a T.V. to B for using in summer vacation. Subsequently, C claimed that the T.V. belonged to him as it was delivered only for repairs, to A and thus, B should deliver it to him. In this case, B may apply to the Court to decide the question of ownership of the T.V. so that he may deliver it to the right owner.

6. **Right of particular lien for payment of services [Section 170]:** Where the bailee has (a) in accordance with the purpose of bailment, (b) rendered any service involving the exercise of labour of skill, (c) in respect of the goods, he shall have (d) in the absence of a contract to the contrary, right to retain such goods, until he receives due remuneration for the services he has rendered in respect of them. Bailee has, however, only a right to retain the article and not to sell it. The service must have entirely been formed within the time agreed or a reasonable time and the remuneration must have become due.

   This right of particular lien shall be available only against the property in respect of which skill and labour has been used.

7. **Right of general lien (Sec. 171):** Bankers, factors, wharfingers, attorneys of a High Court and policy brokers will be entitled to retain, as a security for a general balance of amount, any goods bailed to them in the absence of a contract to the contrary. By agreement other types of bailees excepting the above given five (Bankers, factors, wharfingers, attorneys of a High Court and policy brokers) may also be given this right of general lien.

6. RIGHTS OF BAILOR AND BAILEE AGAINST ANY WRONG DOER (THIRD PARTY)

Suit by bailor & bailee against wrong doers [Section 180]: If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

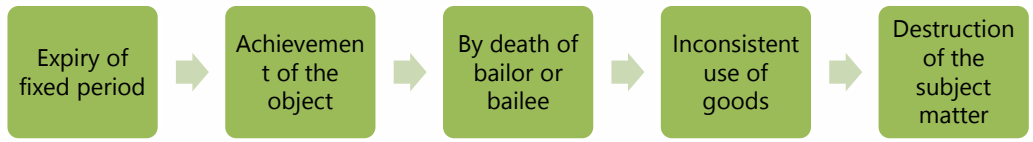
Apportionment of relief or compensation obtained by such suits [Section181]: Whatever is obtained by way of relief or compensation in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests

7. TERMINATION OF BAILMENT

A contract of bailment shall terminate in the following circumstances:

1. **On expiry of stipulated period**: If the goods were given for a stipulated period, the contract of bailment shall terminate after the expiry of such period.
2. **On fulfillment of the purpose**: If the goods were delivered for a specific purpose, a bailment shall terminate on the fulfillment of that purpose.
3. **By Notice:**
   (a) Where the bailee acts in a manner which is inconsistent with the terms of the bailment, the bailor can always terminate the contract of bailment by giving a notice to the bailee.
   (b) A gratuitous bailment can be terminated by the bailor at any time by giving a notice to the bailee. However, the termination should not cause loss to the bailee in excess of the benefit derived by him. In case the loss exceeds the benefit derived by the bailee, the bailor must compensate the bailee for such a loss (Sec. 159)
4. **By death**: A gratuitous bailment terminates upon the death of either the bailor or the bailee.
5. **Destruction of the subject matter**: If the original condition of the bailed goods does not exist or is destroyed, the contract of bailment is

automatically terminated, because the purpose will not be fulfilled or the performance of the contract is impossible



8. FINDER OF LOST GOODS

Right of finder of lost goods; may sue for specific reward offered [Section 168]: The finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner; but he may retain the goods against the owner until he receives such compensation; and, where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

Analysis: The 'finder of lost goods' can ask for reimbursement for expenditure incurred for preserving the goods but also for searching the true owner. If the real owner refuses to pay compensation, the 'finder' cannot sue but retain the goods so found.

Further where the real owner has announced any reward, the finder is entitled to receive the reward. The right to collect the reward is a primary and a superior right even more than the right to seek reimbursement of expenditure.

When finder of thing commonly on sale may sell it [Section 169]: When a thing which is commonly the subject of sale if lost, if the owner cannot with reasonable diligence be found, or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it—

(1) when the thing is in danger of perishing or of losing the greater part of its value, or

(2) when the lawful charges of the finder in respect of the thing found amount to two-thirds of its value.

Analysis: The finder though has no right to sell the goods found in the normal course, he may sell the goods if the real owner cannot be found with reasonable efforts or if the owner refuses to pay the lawful charges subject to the following conditions:

(a) when the article is in danger of perishing and losing the greater part of the value or

(b) when the lawful charges of the finder amounts to two-third or more of the value of the article found.

9. GENERAL LIEN AND PARTICULAR LIEN

Bailee's particular lien [Section 170]: Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them.

Example 1: A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

Example 2: A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a three months' credit for the price. B is not entitled to retain the coat until he is paid.

Analysis: In accordance with the purpose of bailment if the bailee by his skill or labour improves the goods bailed, he is entitled for remuneration for such services. Towards such remuneration, the bailee can retain the goods bailed if the bailor refuses to pay the remuneration. Such a right to retain the goods bailed is the right of particular lien. He however does not have the right to sue.

Where the bailee delivers the goods without receiving his remuneration, he has a right to sue the bailor. In such a case the particular lien may be waived. The particular lien is also lost if the bailee does not complete the work within the time agreed.

General lien of bankers, factors, wharfingers, attorneys and policy brokers [Section 171]: Bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to the effect.

Analysis: Bankers, factors, wharfingers, policy brokers and attorneys of law have a general lien in respect of goods which come into their possession during the course of their profession.

For instance, a banker enjoys the right of a general lien on cash, cheques, bills of exchange and securities deposited with him for any amounts due to him. For instance, 'A' borrows ₹ 500/- from the bank without security and subsequently again borrows another ₹ 1000/- but with security of say certain jewellery. In this illustration, even where 'A' has returned ₹ 1000/- being the second loan, the banker can retain the jewellery given as security to the second loan towards the first loan which is yet to be repaid.

Under the right of general lien the goods cannot be sold but can only be retained for dues. The right of lien can be waived through a contract.

Difference between Bailee's General and Particular Lien

General lien	Particular lien
Section **171** of the Indian Contract Act,1872 confer on Bailee the right of General Lien.	Section **170** of the Indian Contract Act, 1872 confers on the Bailee, the right of particular lien.
General lien alludes to the right to keep possession of goods belonging to other against general balance of account.	Particular lien implies a right of the bailee to **retain specific goods** bailed for non-payment of amount.
A general lien is not automatic but is recognized through on agreement. It is exercised by the bailee only by name	It is **automatic**
It can be exercised against goods even without involvement of labour or skill.	It comes into play only when some **labour or skill is involved** has been expended on the goods, resulting in an increase in value of goods.
Only such persons as are specified under **section 171**, eg, Bankers, factors, wharfingers, policy brokers etc. are entitled to general lien	Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc are entitled to particular lien

10. PLEDGE

"Pledge", "pawnor" and "pawnee" defined [Section 172]: The *bailment of goods as security for payment of a debt* or *performance of a promise* is called **"pledge".** The bailor is in this case called the **"pawnor".** The bailee is called the **"pawnee".**

Analysis: Pledge is a variety or specie of bailment. It is bailment of goods as security for payment of debt or performance of a promise. The person who pledges [or bails] is known as pledgor or also as pawnor, the bailee is known as pledgee or also as pawnee. In pledge, there is no change in ownership of the property. Under exceptional circumstances, the pledgee has a right to sell the property pledged. Section 172 to 182 of the Indian Contract Act,1872 deal specifically with the bailment of pledge.

Example: A lends money to B against the security of jewellery deposited by B with him i.e. A. This bailment of jewellery is a pledge as security for lending the money. B is a pawnor and A is a pawnee.

ESSENTIALS OF PLEDGE: Since Pledge is a special kind of bailment, therefore all the essentials of bailment are also the essentials of the pledge. Apart from that, the other essentials of the pledge are:

a. There shall be a bailment for security against payment or performance of the promise,

b. The subject matter of pledge is goods,

c. Goods pledged for shall be in existence,

d. There shall be the delivery of goods from pledger to pledgee,

Essentials of contract of pledge:

- There must be bailment for security for payment of debt/ performance of a promise.
- Goods must be the subject matter of the contract of pledge.
- The goods pledged must be in existence.
- There must be a delivery of goods from pawnor to pawnee

Pawnee's rights: Rights of Pawnee can be classified as under the following headings:

(a) Right to retain the pledged goods [Section 173]: The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Example: Where 'M' pledges stock of goods for certain loan from a bank, the bank has a right to retain the stock not only for adjustment of the loan but also for payment of interest.

(b) **Right to retention of subsequent debts [Section 174]:** The Pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the Pawnee.

(c) **Pawnee's right to extraordinary expenses Incurred [Section 175]:** The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. For such expenses, however, he does not have the right to retain the goods.

(d) **Pawnee's right where pawnor makes default [Section 176]:** If the pawnor makes default in payment of the debt, or performance, at the stipulated time of the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged on giving the pawnor reasonable notice of the sale.

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

Rights of a pawnor

As the bailor of goods pawnor has all the rights of the bailor. Along with that he also has the right **of redemption to the pledged goods which is enumerated under Section 177 of the Act.**

Right to redeem [Section 177]: If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them; but he must, in that case, pay, in addition, any expenses which have arisen from his default.

Duties of the Pawnee

Pawnee has the following duties:

a. Duty to take reasonable care of the pledged goods

b. Duty not to make unauthorized use of pledged goods

c. Duty to return the goods when the debt has been repaid or the promise has been performed

d. Duty not to mix his own goods with goods pledged

e. Duty not to do any act which is inconsistent with the terms of the pledge

f. Duty to return accretion to the goods, if any.

Duties of a Pawnor

Pawnor has the following duties:

a. The pawnor is liable to pay the debt or perform the promise as the case may be.

b. It is the duty of the pawnor to compensate the pawnee for any extraordinary expenses incurred by him for preserving the goods pawned.

c. It is the duty of the pawnor to disclose all the faults which may put the pawnee under extraordinary risks.

d. If loss occurs to the pawnee due to defect in pawnors title to the goods, the pawnor must indemnify the pawnee.

e. If the pawnee sells the good due to default by the pawnor, the pawnor must pay the deficit.

11. PLEDGE BY NON-OWNERS

Ordinarily, it is the owner of the goods, or any person authorized by him in that behalf, who can pledge the goods. But in order to facilitate mercantile transactions, the law has recognised certain exceptions. These exceptions are for bonafide pledges made by those persons who are not the actual owners of the goods, but in whose possession the goods have been left.

a. Pledge by mercantile agent [Section 178]: Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the Pawnor has no authority to pledge.

Explanation: In this section, the expressions 'mercantile agent and documents of title' shall have the meanings assigned to them in the Sale of Goods Act, 1930.

Analysis: Though generally only a owner of goods can pledge, the Act recognizes the right of certain mercantile agents to pledge provided it is done with the consent of the owner of the goods. Such a pledge done in the ordinary course of business is valid. Pledge in this case can be effected through pledge of documents like a bill of lading or a railway receipt etc.

The necessary conditions of validity under the section 178 are as follows:

(i) The person pledging the goods must be a mercantile agent,

(ii) Mercantile agent must be in possession either of the goods or the documents of title to goods,

(iii) Such possession must be with the consent of the owner. If possession has been obtained dishonestly or by a trick, a valid pledge cannot be effected,

(iv) Pledge must have been made by the mercantile agent, when acting in the ordinary course of business of a mercantile agent,

(v) The pledgee must act in good faith;

(vi) The pledgee should have no notice of the pledger's defect of title. If the pledgee knows that the pledger has a defective title, the pledge will not be valid.

b. Pledge by person in possession under voidable contract [Section 178A]: When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

c. Pledge where pawnor has only a limited interest [Section 179]: Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest.

d. Pledge by a co-owner in possession: Where the goods are owned by many person and with the consent of other owners, the goods are left in the possession of one of the co-owners. Such a co-owner may make a valid pledge of the goods in his possession.

e. **Pledge by seller or buyer in possession**: A seller, in whose possession, the goods have been left after sale or a buyer who with the consent of the seller, obtains possession of the goods, before sale, can make a valid pledge, provided the pawnee acts in good faith and he has no knowledge of the defect in title of the pawnor.

For example, A buys a cycle from B. But leaves the cycle with the seller. B then pledges the cycle with C, who does not know of sale to B, and acted in good faith. This is valid pledge.

12. DISTINCTION BETWEEN BAILMENT AND PLEDGE

S.no	Basis of Distinction	Bailment	Pledge
1	*Meaning*	Transfer of goods by one person to another for some specific purpose is known as bailment	Transfer of goods from one person to another as security for repayment of debt is known as the pledge.
2	*Terms Applicable*	The person delivering the goods under a contract of bailment is called as "Bailor". The person to whom the goods are delivered under a contract of bailment is called as "Bailee"	The person who delivers the good as security is called the "Pawnor". The person to whom the goods are delivered as security is called the "pawnee"
3	*Purpose*	Bailment may be made for any purpose (as specified in the contract of bailment, eg: for safe custody, for repairs, for processing of goods)	Pledge is made for the purpose of delivering the goods as security for payment of a debt, or performance of a promise.
4	*Consideration*	The bailment may be made for consideration or without consideration	Pledge is always made for a consideration.
5	*Right to sell the goods*	The bailee has no right to sell the goods even if the charges	The pawnee has right to sell the goods if the

		of bailment are not paid to him. The bailee's rights are limited to suing the bailor for his dues or to exercise lien on the goods bailed	pawnor fails to redeem the goods.
6.	*Right to use of goods*	Bailee can use the goods only for a purpose specified in the contract of bailment and not otherwise.	Pledgee or Pawnee cannot use the goods pledged.

SUMMARY

- Bailment-Delivery of goods by one person to another for some purpose upon a contract that they shall be returned after the purpose is over or disposed off according to the directions of the person delivering them.
- Bailor- Person who delivers goods for bailment.
- Bailee- Person to whom goods are delivered under the contract of bailment.
- Depositing currency notes in a bank- It is not a bailment as currency notes or moneys are not goods as per the definition of goods given under the Sale of Goods Act,1930 and also no same notes are returned to the depositor by the bank.
- Keeping of ornaments/valuables in a bank locker- It's not a bailment as there is no transfer of possession of ornaments or valuables.
- Gratuitous bailment- No consideration passes between the bailor and the bailee and the bailor is not responsible for the damages in respect of the faults which were not known to him.
- Pledge- Bailment of goods as security for payment of a debt/performance of a promise.
- Pawnor- Person who pledges goods as security.
- Pawnee- Person who receives the goods as security.
- Some non-owners may also create a valid pledge of goods, such as- Mercantile agents, co-owner, by person having a limited interest, by person having a possession of goods under voidable contract.
- Basic distinction between bailment and pledge- All the pledges are bailments but all the bailments are not pledges.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. A bailee has
   (a) a right of particular lien over the goods bailed
   (b) a right of generation
   (c) a right of both particular and general lien
   (d) no lien at all over the goods bailed.

2. The delivery of goods by one person to another as security for the payment of a debt is called
   (a) Bailment
   (b) Pledge
   (c) Mortgage
   (d) Hypothecation

3. The position of a finder of lost goods is that of a
   (a) bailor
   (b) bailee
   (c) surety
   (d) principal debtor

4. The delivery of goods by one person to another for some specific purpose and time is known as:
   (a) Mortgage
   (b) Pledge
   (c) Bailment
   (d) Charge

Answer to MCQs

1. (c) **2.** (b) **3.** (b) **4.** (c)

Question and Answer

Question 1

Examine whether the following constitute a contract of 'Bailment' under the provisions of the Indian Contract Act, 1872:

(i) V parks his car at a parking lot, locks it, and keeps the keys with himself.

(ii) Seizure of goods by customs authorities.

Answer

(i) No. Mere custody of goods does not mean possession. For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it, Section 148, of the Indian Contract Act, 1872 is not applicable.

(ii) Yes, the possession of the goods is transferred to the custom authorities. Therefore, bailment exists and section 148 is applicable.

Question 2

A hires a carriage from B and agrees to pay ₹ 500 as hire charges. The carriage is unsafe, though B is unaware of it. A is injured and claims compensation for injuries suffered by him. B refuses to pay. Discuss the liability of B.

Answer

Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed. Accordingly, applying the above provisions in the given case B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.

Question 3

A bails his jewellery with B on the condition to safeguard it in a bank's safe locker. However, B kept it in safe locker at his residence, where he usually keeps his own jewellery. After a month all jewellery was lost in a religious riot. A filed a suit against B for recovery. Referring to provisions of the Indian Contract Act, 1872, state whether A will succeed.

Answer

Referring to the Section 152 of the Indian Contract Act, 1872, B is liable to compensate A for his negligence to keep jewellery at his resident. Here, A and B

agreed to keep the jewellery at the Bank's safe locker and not at the latter's residence.

Question 4

R gives his umbrella to M during raining season to be used for two days during Examinations. M keeps the umbrella for a week. While going to R's house to return the umbrella, M accidently slips and the umbrella is badly damaged. Who bear the loss and why?

Answer

M shall have to bear the loss since he failed to return the umbrella within the stipulated time and Section 161 clearly says that where a bailee fails to return the goods within the agreed time, he shall be responsible to the bailor for any loss, destruction or deterioration of the goods from that time notwithstanding the exercise of reasonable care on his part.

Question 5

State the essential elements of a contract of bailment. Distinguish between the 'contract of bailment' and 'contract of pledge'.

Answer

Essential elements of a contract of bailment: Section 148 of the Indian Contract Act, 1872 defines the term 'Bailment'. A 'bailment' is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The essential elements of the contract of the bailment are:

1. Delivery of goods—The essence of bailment is delivery of goods by one person to another.
2. Bailment is a contract—In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, the goods shall be returned to the bailor.
3. Return of goods in specific—The goods are delivered for some purpose and it is agreed that the specific goods shall be returned.
4. Ownership of goods—In a bailment, it is only the possession of goods which is transferred and the bailor continues to be the owner of the goods.

5. Property must be movable—Bailment is only for movable goods and never for immovable goods or money.

Difference between contract of bailment and contract of pledge:

1. Right of sale—In case of pledge, the pawnee (pledgee) can sell the goods and recover his debt, if pawnor (pledger) does not pay while in bailment the bailee can retain the goods and sue for damages, but he has no authority to sell the goods.
2. Purpose—Pledge is specifically for securing a debt, while bailment may be for any purpose e.g. for repairs, safe custody etc.
3. Right to use the goods—In case of pledge, pawnee cannot use the goods pledged but bailee can use the bailed goods if contract so provides.

Question 6

Give four differences between Bailment and Pledge.

Answer

Distinction between bailment and pledge: The following are the distinction between bailment and pledge:

(a) **As to purpose:** Pledge is a variety of bailment. Under pledge goods are bailed as a security for a loan or a performance of a promise. In regular bailment the goods are bailed for other purpose than the two referred above. The bailee takes them for repairs, safe custody etc.

(b) **As to right of sale:** The pledgee enjoys the right to sell only on default by the pledgor to repay the debt or perform his promise, that too only after giving due notice. In bailment the bailee, generally, cannot sell the goods. He can either retain or sue for non-payment of dues.

(c) **As to right of using goods:** Pledgee has no right to use goods. A bailee can, if the terms so provide, use the goods.

(d) **Consideration:** In pledge there is always a consideration whereas in a bailment there may or may not be consideration.

(e) **Discharge of contract:** Pledge is discharged on the payment of debt or performance of promise whereas bailment is discharged as the purpose is accomplished or after specified time.

Question 7

Amar bailed 50 kg of high quality sugar to Srijith, who owned a kirana shop, promising to give ₹ 200 at the time of taking back the bailed goods. Srijith's

employee, unaware of this, mixed the 50 kg of sugar belonging to Amar with the sugar in the shop and packaged it for sale when Srijith was away. This came to light only when Amar came asking for the sugar he had bailed with Srijith, as the price of the specific quality of sugar had trebled. What is the remedy available to Amar?

Answer

According to section 157 of the Contract Act, 1872, if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

In the given question, Srijith's employee mixed high quality sugar bailed by Amar and then packaged it for sale. The sugars when mixed cannot be separated. As Srijith's employee has mixed the two kinds of sugar, he (Srijith) must compensate Amar for the loss of his sugar.

Question 8

Mrs. A delivered her old silver jewellery to Mr. Y a Goldsmith, for the purpose of making new a silver bowl out of it. Every evening she used to receive the unfinished good (silver bowl) to put it into box kept at Mr. Y's Shop. She kept the key of that box with herself. One night, the silver bowl was stolen from that box. Was there a contract of bailment? Whether the possession of the goods (actual or constructive) delivered, constitute contract of bailment or not?

Answer

Section 148 of Indian Contract Act 1872 defines 'Bailment' as the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them.

According to Section 149 of the Indian Contract Act, 1872, the delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf. Thus, delivery is necessary to constitute bailment.

Thus, the mere keeping of the box at Y's shop, when A herself took away the key cannot amount to delivery as per the meaning of delivery given in the provision in section 149. Therefore, in this case there is no contract of bailment as Mrs. A did not deliver the complete possession of the good by keeping the keys with herself.

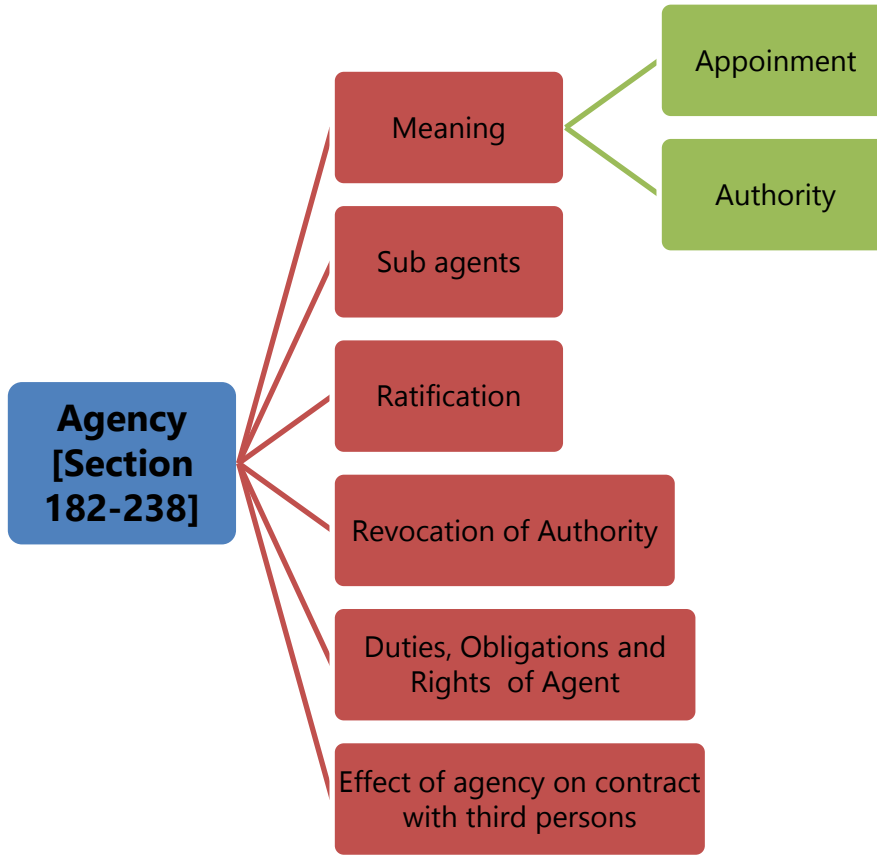
UNIT–3: AGENCY

LEARNING OUTCOMES

After studying this unit, you would be able to:

- Understand the relationship between agent and principal and the intention behind adoption of such course of agency.
- Know that consideration is not at all necessary for validity of agency contracts.
- Understand rights and obligations of an agent as well as the circumstances when the agent is personally liable for the acts done by him on behalf of the principal and the legal position of the agent, the principal and the third parties involved.
- Identify with the terms 'sub-agent' and 'substituted agent' and to distinguish between the two.

UNIT OVERVIEW



INTRODUCTION

An agency relationship is established when one party (agent) is authorized by another party (principal) to act on his/ her behalf. Such relationships are initiated when one party desires to extend his/her activities beyond his/her present limits or capacity. In modern life, it would be virtually impossible for a business to function efficiently without agents; for **example**, corporations must hire agents to work for them since a corporation is an artificial person. Agency relationships occur frequently in the course of business and include hiring employees or retaining the services of other parties such as an attorney or a design professional. An agent has the potential to form contracts on behalf of the

principal and in doing so, will bind the principal. As a result, the agency relationship is one of trust and confidence and an agent must perform his/her activities in a capable and conscientious manner. The law of agency is contained in sections 182 to 238 of the Indian Contract Act, 1872

1. WHAT IS AGENCY?

The Indian Contract Act,1872 does not define the word 'Agency'. However the word **'Agent'** is defined as "a person employed to do any act for another or to represent another in dealings with third persons". The person for whom the act is done or who is so represented is called **"Principal"**. [Section 182].

Test of Agency

(a) Whether the person has the capacity to bind the principal and make him answerable to the third party.

(b) Whether he can establish Privity of Contract between the principal and third parties.

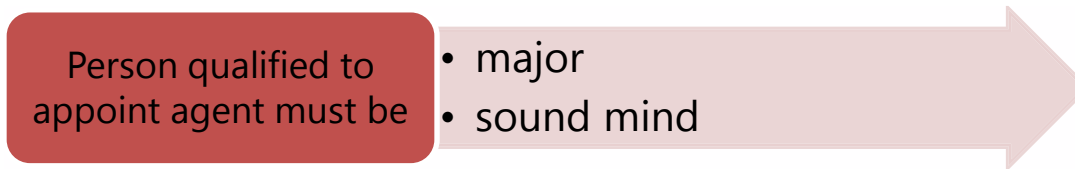
If the answer to these questions is in affirmative (Yes), then there is a relationship of agency.

Thus, 'Agency' is a comprehensive word used to describe the relationship between one person and another, where the first mentioned person brings the second mentioned person into legal relation with others.

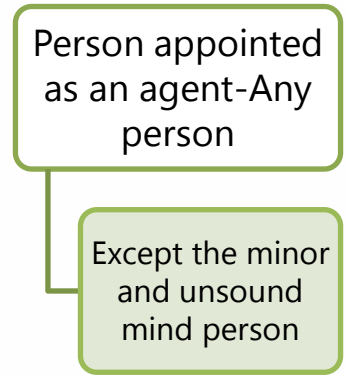
The Rule of Agency is based on the maxim *"Qui facit per alium, facit per se"* i.e., he who acts through an agent is himself acting.

2. APPOINTMENT AND AUTHORITY OF AGENTS

Who may employ an agent: According to Section 183, "any person who is of the **age of majority** according to the law to which he is subject, and who is **of sound mind**, may employ an agent." Thus a minor or a person of unsound mind cannot appoint an agent.



Who may be an agent: Section 184 provides that "as between the principal and third persons any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf herein contained.



Section 184 of the Contract Act provides that any person may become an agent. In other words, even a **minor** can become an agent and the principal can be bound by his acts.

Since, agent is a mere connecting link between the principal and the third party, it is immaterial whether or not the agent is legally competent to contract. Thus, there is no bar to the appointment of a minor as an agent. However, in considering the contract of agency itself (i.e. the relation between principal and agent), the contractual capacity of the agent becomes important.

Thus, if the agent happens to be a person incapable of contracting, then the principal cannot hold the agent liable, in case of his misconduct or where the agent has been negligent in performance of his duties.

Example:

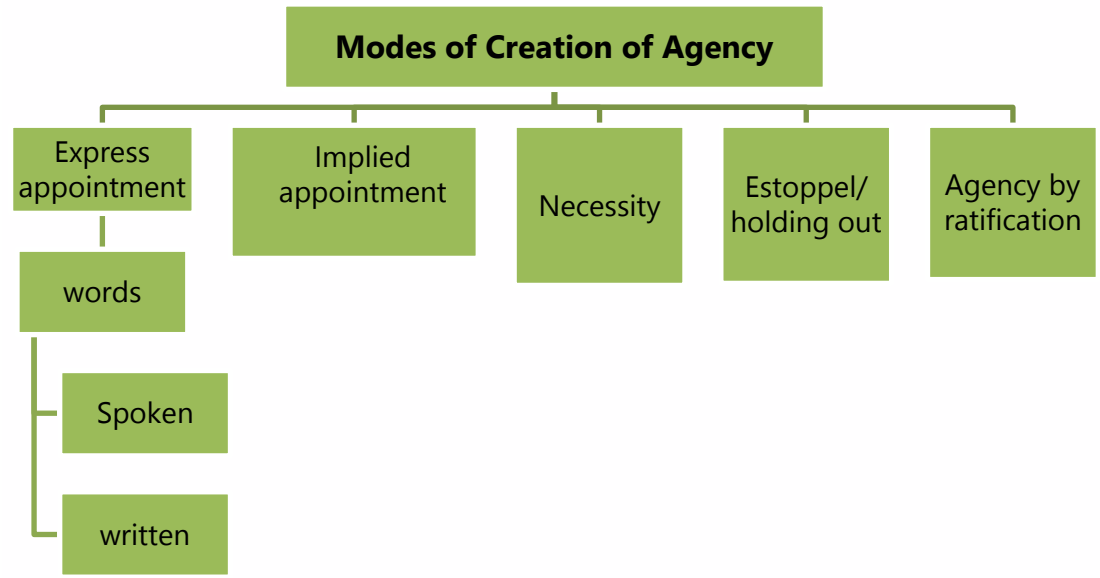
P appoints Q, a minor, to sell his car for not less than ₹ 2,50,000. Q sells it for ₹ 2,00,000. P will be held bound by the transaction and further shall have no right against Q for claiming the compensation for having not obeyed the instructions, since Q is a minor and a contract with a minor is 'void-ab-initio'.

Consideration not necessary: According to Section 185, no consideration is necessary to create an agency. The acceptance of the office of an agent is regarded as a sufficient consideration for the appointment.

3. CREATION OF AGENCY

In the words of Desai J, of the Supreme Court of India "The relation of agency arises whenever one person called the agent has the authority to act on behalf of another called the principal and consents to act. The relationship has genesis in a contract"

The relationship of the principal and the agent may be created in any of the following ways —



The authority may be express or implied: According to Section 186, the authority of an agent may be express or implied.

1. **Definitions of express and implied authority [Section 187]**

   Express Authority: An authority is said to be express when it is given by words, spoken or written.

Example: A is residing in Delhi and he has a house in Kolkata. A appoints B by a deed called the power of attorney, as a caretaker of his house. Agency is created by express agreement.

Example: If a customer of a bank wishes to transact his banking business through an agent, the bank will require written evidence of the appointment of the agent and will normally ask to see the registered power of attorney appointing the agent.

2. **Implied Authority:** An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or in the ordinary course of dealing, may be accounted from the circumstances of the case.

Example 1: If a person realises rent and gives it to the landlord, he impliedly acts for the landlord as an agent**.**

Example 2: A owns a shop in Selampur, living himself in Kolkata and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

3. **Agency by Estoppel [Section 237]:** An agency by estoppel is based on the principle of estoppel. The principle of estoppel lays down that when one person by declaration (representation), act or omission has intentionally caused or permitted another person to believe a thing to be true and to act upon such belief, he shall not be allowed to deny his previous statement or he shall be stopped to deny his previous statement or conduct. This agency is implicit under section 237 of the Indian Contract Act. Section 237 of the Contract Act says: "When an agent has without authority done acts or incurred obligations to third persons on behalf of his principal the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority".

According to section 237 of the Contract Act, an agency by estoppel may be created when following essentials are fulfilled:

1. the principal must have made a representation;
2. the representation may be express or implied;

3. The representation must state that the agent has an authority to do certain act although really he has no authority;

4. The principal must have induced the third person by such representation; and

5. The third person must have believed the representation and made the contract on the belief of such representation.

Example: A consigns goods to B for sale and gives him instructions not to sell below a fixed price. C being ignorant of B's instruction enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract. A cannot plead that he had given to B instructions not to sell the goods below certain price. An agency by estoppel is, consequently, deemed between A and B.

Example: If Piyal (the principal) has for several moths permitted Sunil to buy goods on credit from Prasad and has paid for the goods bought by Sunil, Piyal cannot later refuse to pay Prasad who had supplied goods on credit to Sunil in the belief that he was Piyal's agent and was buying the goods on behalf of Piyal. Piyal is stopped from now asserting that Sunil is not his agent because on earlier occasions he permitted Prasad to believe that Sunil was his agent and Prasad had acted in that belief.

4. **Necessity:** An agency of necessity arises due to some emergent circumstances. In emergency a person is authorised to do what he cannot do in ordinary circumstances. Thus, where an agent is authorised to do certain act, and while doing such an act, an emergency arises, he acquires an extra-ordinary or special authority to prevent his principal from loss**.**

Example: Raja has a large farm on which Shyam is the caretaker. When Raja is in Canada, there is a huge fire on the farm. Shyam becomes an agent of necessity for Raja so as to save the property from being destroyed by fire. Raja (the principal) will be liable for any expenses, Shyam (his agent of necessity) incurred to put out the fire and save the farm from destruction during Raja's absence from the country.

5. **Ratification: Rights of person as to acts done for him without his authority, Effect of ratification [Section 196]:** Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority. In simple words, "Ratification" means approving a previous act or transaction.

Ratification may be express or implied by the conduct of the person on whose behalf the act was done.

Example: X who is Y's agent has on 10th January 2019 purchases goods from Z on credit without Y's permission. After the purchase, on 20th January 2019, Y tells X that he will accept responsibility to pay for the purchases although at the time of purchase the agent had no authority to buy on credit. Y's subsequent statement on 20th January 2019 amounts to a ratification of the agent's (X's) purchase of goods on 10th January 2019.

Essentials of a valid Ratification

a. **Ratification may be expressed or Implied [Section 197]:** Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.

Example 1: A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A.

Example 2: A, without B's authority, lends B's money to C. Afterwards B accepts interests on the money from C. B's conduct implies a ratification of the loan.

b. **Knowledge requisite for valid ratification [Section 198]:** No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.

Example: A has an authority from P to buy certain goods at the market rate. He buys at a higher rate but P accepts the purchase. Afterwards P comes to know that the goods purchased by A for P belonged to A himself. The ratification is not binding on P.

If, however the alleged principal is prepared to take the risk of what the purported agent has done, he can choose to ratify without full knowledge of facts.

c. **Effect of ratifying unauthorized act forming part of a transaction [Section 199]:** A person ratifying any unauthorized act done on his behalf ratifies the whole of the transaction of which such act formed a part. There can be ratification of an act in entirely or its rejection in entirely. The principal cannot ratify a part of the transaction which is beneficial to him and reject the rest.

d. **Ratification of unauthorized act cannot injure third person [Section 200]:** An act done by one person on behalf of another, without such other person's authority, which, if done with authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to have such effect. In other words, when the interest of third parties is affected, the principle of ratification does not apply. Ratification cannot relate back to the date of contract if third party has in the intervening time acquired rights.

Example 1: A, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

Example 2: A holds a lease from B, terminable on three months' notice. C, an unauthorized person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

e. **Ratification within reasonable time:** Ratification must be made within a reasonable period of time.

f. **Communication of Ratification:** Ratification must be communicated to the other party.

g. **Act to be ratified must be valid:** Act to be ratified should not be void or illegal, for e.g. payment of dividend out of capital is void and cannot be ratified.

4. EXTENT OF AGENT'S AUTHORITY

The authority of an agent means his capacity to bind the principal to third parties. The agent can bind the principal only if he acts within the scope of his authority. The extent of an agent's authority, whether expressed or implied is determined by:

(a) the nature of the act or the business he is appointed to do

(b) things which are incidental to the business or are usually done in the course of such business,

(c) the usage of trade or business.

Whatever be the nature or extent of the agent's authority, it will always include the authority to do:

(1) every lawful thing necessary for the purpose of carrying it out,

(2) every lawful thing justified by various customs of trades,

(3) in an emergency, all such acts for the purpose of protecting the principal from loss as will be done by a person of ordinary prudence in his own case under similar circumstances.

The agent's authority is governed by two principles, namely (a) in normal circumstances and (b) in emergency.

(a) Agent's authority in normal circumstances [Section 188]: An agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act.

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

Example 1: A is employed by B, residing in London, to recover at Mumbai a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt, and may give a valid discharge for the same.

Example 2: A constitutes B as his agent to carry on his business of a shipbuilder. B may purchase timber and other materials, and hire workmen, for the purposes of carrying on the business.

(b) Agent's authority in an emergency [Section 189]: An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

To constitute a valid agency in an emergency, following conditions must be satisfied.

(i) Agent should not be a in a position or have any opportunity to communicate with his principal within the time available.

(ii) There should have been actual and definite commercial necessity for the agent to act promptly.

(iii) the agent should have acted bonafide and for the benefit of the principal.

(iv) the agent should have adopted the most reasonable and practicable course under the circumstances, and

(v) the agent must have been in possession of the goods belonging to his principal and which are the subject of contract.

Example 1: An agent for sale may have goods repaired if it be necessary.

Example 2: A consigns provisions to B at Kolkata, with directions to send them immediately to C at Cuttack. B may send the provisions at Kolkata, if they will not bear the journey to Cuttack without spoiling.

5. SUB-AGENTS

When agent cannot delegate [Section 190]: An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally, unless by the ordinary custom of trade a sub-agent may, or from the nature of the agency, a sub-agent must, be employed.

"Sub-agent" defined [Section 191]: A "Sub-agent" is a person employed by, and acting under the control of, the original agent in the business of the agency.

Analysis: Sub agency refers to case where an agent appoints another agent. The appointment of sub agent is not lawful, because the agent is a delegatee and a delegatee cannot further delegate. This is based on the Latin principle **"delegatus non potest delegare".**

A contract of agency is of a fiduciary character. It is based on the confidence reposed by the principal in the agent and that is why a delegatee cannot further delegate.

Exception where an agent can appoint Sub-agent:

(1) The appointment of a sub agent would be valid if the terms of appointment originally contemplated it.

(2) Sometimes **customs of the trade** may provide for appointment of sub agents.

In both these cases the sub agent would be treated as the agent of the principal.

(3) Where in the course of the agent's employment, **unforeseen emergency** arise which make it necessary for him to delegate authority.

Representation of principal by sub-agent properly appointed [Section 192]: Where a sub-agent is properly appointed,

(1) the principal is, so far as regards third persons, represented by the sub-agent, and is bound by and responsible for his acts as if he were an agent originally appointed by the principal.

(2) **Agents responsibility for sub agents:** The agent is responsible to the principal for the acts of the sub-agent.

(3) **Sub-agents liability to principal:** The sub-agent is responsible for his acts to the agent, but not to the principal, except in case of fraud or willful wrong.

Agent's responsibility for sub-agent appointed without authority [Section 193]: Where an agent, without having authority to do so, has appointed a person to act as a sub-agent,

(1) the agent stands towards such person in the relation of a principal to an agent, and is responsible for his acts both to the principal and to third persons;

(2) the principal is not represented by or responsible for the acts of the sub agent, the sub agent is not responsible to the principal at all. He is answerable only to the agent.

Analysis:

(a) Where the sub-agent is properly appointed: Where a sub agent is properly appointed, the principal is bound by his acts and is therefore responsible to third parties as if he were an agent originally appointed by the principal.

Example: A, a carrier, agreed to carry 60 bags of cotton waste from Morvi to Bhavnagar by a truck. A asked B, another carrier, to carry the goods. The goods were damaged in transit. Held, A was liable even though it was proved that B was the carrier.

(b) In the case of appointment without authority: In case where the appointment of sub agent takes place without authority, the principal is not bound by the acts of sub agent and sub agent is not bound to the principal. It is the agent who is the principal of sub agent. Where the sub-agent purportedly acts in the name of first principal, that first principal may ratify the act of sub agent. However if the sub agent acts in his own name or in the name of the agent who has without authority delegated to the sub agent the business which is in fact of the principal, the principal cannot ratify such acts of sub agent.

6. SUBSTITUTED AGENT

Substituted Agent is a person appointed by the agent to act for the principal, in the business of agency, with the knowledge and consent of the principal.

Substituted agents are not sub agents. They are agents of the principal. Where the principal appoints an agent and if that agent identifies another person to carry out the acts ordered by principal, then the second person is not to be treated as a sub agent but only as an agent of the original principal.

Relation between principal and person duly appointed by agent to act in business of agency [Section 194]: Where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted to him.

Example 1: A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub-agent, but is A's agent for the conduct of the sale.

Example 2: A authorizes B, a merchant in Kolkata, to recover the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C &Co. for the recovery of the money. D is not a sub-agent, but is a solicitor for A.

Agent's duty in naming such person [Section 195]: In selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.

Analysis

While selecting a "substituted agent" the agent is bound to exercise same amount of diligence as a man of ordinary prudence and if he does so he will not be responsible for acts or negligence of the substituted agent.

Example 1: A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

Example 2: A consigns goods to B, a merchant, for sale B, in due course, employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to

receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.

7. DIFFERENCE BETWEEN A SUB-AGENT AND A SUBSTITUTED AGENT

Both a sub-agent and a substituted agent are appointed by the agent. But, however, the following are the points of distinction between the two.

S.no	Sub Agent	Substituted Agent
1.	A sub-agent does his work under the control and directions of agent	a substituted agent works under the instructions of the principal
2.	The agent not only appoints a sub-agent but also delegates to him a part of his own duties	The agent does not delegate any part of his task to a substituted agent.
3.	There is no privity of contract between the principal and the sub-agent.	Privity of contract is established between a principal and a substituted agent
4.	The sub-agent is responsible to the agent alone and is not generally responsible to the principal	a substituted agent is responsible to the principal and not to the original agent who appointed him
5.	The agent is responsible to the principal for the acts of the sub-agent	The agent is not responsible to the principal for the acts of the substituted agent.
6.	The sub-agent has no right of action against the principal for remuneration due to him	The substituted agent can sue the principal for remuneration due to him
7.	Sub-agents may be improperly appointed	Substituted agents can never be improperly appointed.
8.	The agent remains liable for the acts of the sub-agent as long as the sub-agency continues.	The agent's duty ends once he has named the substituted agent.

8. DUTIES AND OBLIGATIONS OF AN AGENT

- Duty to execute Mandate
- Conduct business in accordance with the directions given by the principal
- Duty of resonable care and skill
- Duty to communicate with the principal
- Duty to avoid conflict of interest
- Duty not to make secret profit
- Duty to remit sums
- Duty to maintain acounts
- Duty not to delegate

(i) **Duty to execute mandate:** The first and foremost duty of every agent is to carry out the mandate of his principal. He should perform the work which he has been appointed to do. Any failure in this respect would make the agent absolutely responsible for the principal's loss. In *Pannalal Jankidas V Mohanlal*, a commission agent purchased goods for his principal and stored them in a godown pending their dispatch. The agent was under instruction to insure them. He actually charged the premium for insurance but failed to insure the goods. The goods were lost in an explosion in Bombay harbor. The agent was held liable to compensate the principal for his loss minus the amount received under the Bombay explosion (compensation) ordinance, 1944.

(ii) **Duty to follow instructions or customs:** According to **Section 211** an agent is bound to conduct the business of his principal according to the direction given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

Example 1: A, an agent engaged in carrying on for B a business, in which it is the custom to invest from time to time, at interest, the moneys which may be in hand, omits to make such investment. A must make good to B the interest usually obtained by such investment.

Example 2: B, a broker, in whose business it is not the custom to sell on credit, sells goods of A on credit to C, whose credit at the time was very high. C, before payment, becomes insolvent. B must make good the loss to A.

(iii) **Duty of Reasonable care and skill:** According to section 212, an agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business, unless the principal has notice of his want of skill.

The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct, but not in respect of loss of damage which are indirectly or remotely caused by such neglect, want of skill or misconduct.

Example 1: A, a merchant in Kolkata, has an agent, B, in London, to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent. B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss- as, e.g. by variation of rate of exchange-but not further.

Example 2: A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B, at the time of such sale is insolvent. A must make compensation to his principal in respect of any loss thereby sustained.

Example 3: A, an insurance-broker, employed by B to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good the loss to B.

Example 4: A, a merchant in England, directs B, his agent at Mumbai, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

(iv) Agent' duty to communicate with principal [Section 214]: It is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions.

(v) Duty to Avoid Conflict of interest (Duty not to deal on his own account):

Right of principal when agent deals, on his own account, in business of agency without principals consent: According to **Section 215,** If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him.

Example 1: A directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale if he can show that B has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

Example 2: A directs B to sell A's estate. B, on looking over the estate before selling it, finds a mine on the estate which is unknown to A. B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A allow B to buy, in ignorance of the existence of the

mine. A, on discovering that B know of the mine at the time he bought the estate, may either repudiate or adopt the sale at his option.

Principals right to benefit gained by agent dealing on his account in business of agency- According to section 216 If an agent, without the knowledge of his principal deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction.

Example: A directs B, his agent, to buy a certain house for him. B tells A it cannot be bought, and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he gave for it.

(vi) **Duty not to make secret profits**: It is the duty of an agent not to make any secret profit in the business of agency. His relationship with the principal is of fiduciary nature and this requires absolute good faith in the conduct of agency**.**

Secret Profit means any advantage obtained by the agent over and above his agreed remuneration and which he would not have been able to make but for his position as agent.

(vii) **Duty to render proper accounts [Section 213]:** An agent is bound to render proper accounts to his principal on demand. Rendering accounts does not mean showing the accounts but the accounts supported by vouchers. *(Anandprasad vs. Dwarkanath)*

(viii) **Duty not to Delegate:** According to section 190, An agent cannot lawfully employ to perform acts which he has expressly or impliedly undertaken to perform personally, unless by the ordinary custom of trade a sub-agent may, or, from the nature of agency, a sub- agent, must be employed.

(ix) **Agent's duty to pay sums received for principal [Section 218]:** Subject to such deductions, the agent is bound to pay to his principal all sums received on his account.

(x) **Duty not to use any confidential information received in the course of agency against the principal.**

9. RIGHTS OF AN AGENT

(i) Right of retain out of sums received on principal's account [Section 217]: This section empowers the agent to retain, out of any sums received on account of the principal in the business of the agency for the following payments:

(a) all moneys due to himself in respect of advances made

(b) in respect of expenses properly incurred by him in conducting such business

(c) such remuneration as may be payable to him for acting as agent.

The right can be exercised on any sums received on account of the principal in the business of agency.

(ii) Right to remuneration [Section 219]: The agent in the normal course is entitled for remuneration as per the contract. In the absence of any agreed amount of remuneration, he is entitled for usual remuneration which is customary in the business. However an agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the business which he has misconducted [Section 220].

Example 1: A employs B to recover ₹ 1,00,000 from C, and to lay it out on good security. B recovers the ₹ 1,00,000 and lays out ₹ 90,000 on good security, but lays out ₹ 10,000 on security which he ought to have known to be bad, whereby A loses ₹ 2,000. B is entitled to remuneration for recovering the ₹ 1,00,000 and for investing the ₹ 90,000. He is not entitled to any remuneration for investing the ₹ 10,000, and he must make good the ₹ 2,000 to B.

Example 2: A employs B to recover ₹ 1,00,000 from C. Through B's misconduct the money is not recovered. B is entitled to no remuneration for his services, and must make good the loss.

(iii) Agent's lien on principal's property [Section 221]: In the absence of any contract to the contrary**,** an agent is entitled to retain the goods, papers and other property, whether movable or immovable, of the principal received by him, until the amount due to himself for commission, disbursement and services in respect of the same has been paid or accounted for him.

The conditions of this right are:

a. The agent should be lawfully entitled to receive from the principal a sum of money by way of commission earned or disbursement made or services rendered in the proper execution of the business of agency

b. The property over which the lien is to be exercised should belong to the principal and it should have been received by the agent in his capacity and during the course of his ordinary duties as agent.

c. The agent has only a particular lien.

The agent's right to lien is lost in the following cases:

a. When the possession of the property is lost.

b. When the agent waives his right. Waiver may arise out of agreement express or implied.

c. The agent's lien is subject to a contract to the contrary.

(iv) Right to indemnity:

a. Right of indemnification for lawful acts [Section 222]: The principal is bound to indemnify the agent against all consequences of lawful acts done in exercise of his authority.

Example: 'A' of Delhi appoints 'B' of Mumbai as agent to sell his merchandise. As a result 'B' contracts to deliver the merchandise to various parties. But A fails to send the merchandise to B and B faces litigations for non- performance. Here, A is bound to protect B against the litigations and all costs, expenses arising of that.

The right to indemnity extends to all losses and expenses incurred by the agent in the conduct of the business. Where, for example, a stockbroker, on the instructions of a solicitor, contracted to sell certain shares and had to incur liability to the purchaser by reason of the owners refusal to complete the sale, the stockbroker was held to be entitled to recover indemnity from the principal.

b. **Right of indemnification against acts done in good faith [Section 223]:** Where the agent acts in good faith on the instruction of principal, agent is entitled for indemnification of any loss or damage from the principal.

Example: Where P appoints A as his agent and directs him to sell certain goods which in fact turned out to be not those belonging to P and if third parties sue A for this act, A is entitled for reimbursement and indemnification for such act done in good faith.

However, the agent cannot claim any reimbursement or indemnification for any loss etc. arising out of acts done by him in violation of any penal laws of the country.

c. **Non-liability of employer of agent to do a criminal act:** According to section 224, where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon an express or an implied promise, to indemnify him against the consequences of that act.

Example 1: A employs B to beat C, and agrees to indemnify him against all consequences of the act. B thereupon beats C, and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.

Example 2: B, the proprietor of a newspaper, publishes, at A's request, a libel upon C in the paper, and A agrees to indemnify B against the consequences of the publication, and all costs and damages of any action in respect thereof. B is sued by C and has to pay damages, and also incurs expenses. A is not liable to B upon the indemnity.

(v) Right to compensation for injury caused by principal's neglect [Section 225]: Section 225 provides that the principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill. Thus, every principal owes to his agent the duty of care not to expose him to unreasonable risks.

Example: A employs B as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskillfully put up, and B is in consequence hurt. A must make compensation to B.

10. AGENT'S LIABILITY TO THIRD PARTIES

An agent does all acts on behalf of the principal but incurs no personal liability. The liability remains that of the principal unless there is a contract to the contrary. This is because there is no privity of contract and passing of consideration between the agent and third party. An agent also cannot personally enforce contracts entered into by him on behalf of the principal.

(i) Principal's liability for the Acts of the Agent [Section 226]: Principal liable for the acts of agents which are within the scope of his authority. Contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner, and will have the same legal consequences, as if the contracts had been entered into and the acts done by the principal in person.

Example 1: A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a suit by the principal, set off against that claim a debt due to himself from B.

Example 2: A, being B's agent with authority to receive money on his behalf, receives from C, a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

(ii) Principal not bound, when agent exceeds authority [Section 227]: When an agent does more than he is authorised to do, and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority is binding as between him and his principal.

Example: A, being owner of a ship and cargo, authorizes B to procure an insurance for ₹ 4,00,000 on the ship. B procures a policy for ₹ 4,00,000 on the ship, and another for the like sum on the cargo. A is bound to pay the

premium for the policy on the ship, but not the premium for the policy on the cargo.

(iii) Principal not bound when excess of agent's authority is not separable [Section 228]: Where an agent does more than he is authorised to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognise the transaction.

Example: A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of ₹ 6,00,000. A may repudiate the whole transaction.

(iv) Consequences of notice given to agent [Section 229]: Any notice given to or information obtained by the agent, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the same legal consequence as if it had been given to or obtained by the principal.

Example 1: A is employed by B to buy from C certain goods of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set off a debt owing to him from C against the price of the goods.

Example 2: A is employed by B to buy from C goods of which C is the apparent owner. A was, before he was so employed, a servant of C, and then learnt that the goods really belonged to D, but B is ignorant of that fact. In spite of the knowledge of his agent, B may set off against the price of the goods a debt owing to him from C.

(v) Agent cannot personally enforce, nor be bound by, contracts on behalf of principal [Section 230]: In the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them. He can neither sue nor be sued on contracts made by him on his principal's behalf.

Presumption of contract to the contrary: Such a contract shall be presumed to exist in the following cases:

(1) Where the contract is made by an agent for the sale or purchase of goods for a **merchant resident abroad/foreign principal**;

(2) Where the agent **does not disclose the name of his principal or undisclosed principal**; (Principal unnamed)

(3) **Non-existent or incompetent principal:** Where the principal, though disclosed, cannot be sued. Example: An agent who contracts for a minor, the minor being not liable, the agent becomes personally liable. This result, may not, however, follow where the other party already knows that the principal is a minor.

(vi) Rights of parties to a contract made by agent not disclosed [Section 231]: If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has, as against the principal, the same right as he would have had as against the agent if the agent had been the principal.

If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfill the contract, if he can show that, if he had known who was the principal in the contract, or if he had known that the agent was not a principal, he would not have entered into the contract.

(vii) Performance of contract with agent supposed to be principal [Section 232]: Where one man makes a contract with another, neither knowing nor having reasonable ground to suspect that the other is an agent, the principal, if he requires the performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example: A, who owes 50,000 rupees to B, sells 1,00,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

(viii) Right of person dealing with agent personally liable [Section 233]: In cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them, liable.

Example: A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

(ix) Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable [Section 234]: When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, or induces the

principal to act upon the belief that the agent only will be held liable, he cannot afterwards hold liable the agent or principal respectively.

(x) Liability of pretended agent [Section 235]: A pretended agent is a person who represents himself to be an agent of another, when infact he has no authority from him, whatsoever if the principal ratifies his acts as agent, he has no liability. But if the principal refuses to ratify his acts, he becomes personally liable to third party for any loss or damage caused to him. It is to be noted that where agent is personally liable, the third party can sue the principal or the agent or both the principal and the agent, as the liability of the principal and agent is joint and several.

(xi) Person falsely contracting agent not entitled to performance [Section 236]: A person with whom a contract has been entered into in the character of agent, is not entitled to require the performance of it if he was in reality acting, not as agent, but on his own account.

(xii) Liability of principal inducing belief that agent's unauthorized acts were authorized [Section 237]: When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority.

Example 1: A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

Example 2: A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private orders from A. The sale is good.

(xiii) Effect, on agreement, of misrepresentation or fraud by agent [Section 238]: Misrepresentations made, or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by such agents as if such misrepresentations or frauds had been made, or committed, by the principals; but misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

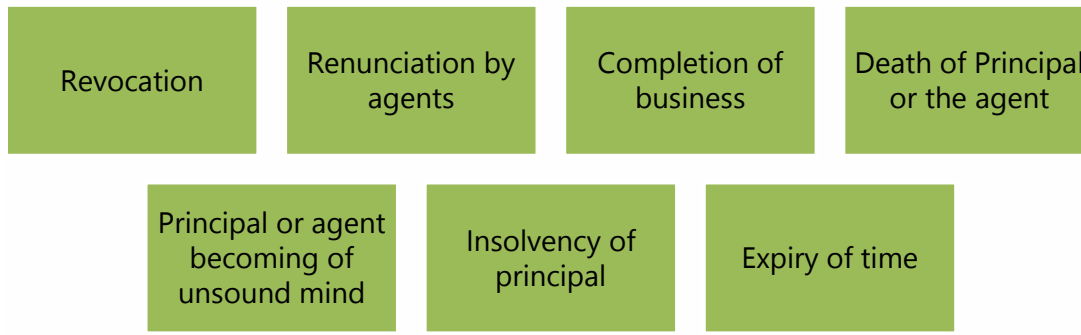
Example 1: A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

Example 2: A, the captain of B's ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended consignor.

11. REVOCATION OF AUTHORITY

Termination of agency [Section 201]

This section provides for the following modes of termination:



a. **Revocation:** An agency may be terminated by the principal revoking the authority of the agent. Principal may revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal [Section 203]. However, the principal cannot revoke the authority given to his agent after the authority has been partly exercised so far as regards such acts and obligations as arise for acts already done in the agency. [Section 204]

Example 1: A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

Example 2: A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in A's name, and so as not to render himself personally liable for the price. A can revoke B's authority to pay for the cotton.

Compensation for revocation by principal, or renunciation by agent [Section 205]: Where there is an express or implied contract that the agency should be continued for any period of time, the principal must make compensation to the agent, or the agent to the principal, as the case may be, for any previous revocation or renunciation of the agency without sufficient cause.

Notice of revocation or renunciation [Section 206]: Reasonable notice must be given of such revocation or renunciation; otherwise the damage thereby resulting to the principal or the agent, as the case may be, must be made good to the one by the other.

Revocation and renunciation may be expressed or implied [Section 207]: Revocation and renunciation may be expressed or may be implied in the conduct of the principal or agent respectively.

Example: A empowers B to let A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

b. **Renunciation by agent [Section 206]:** An agent may renounce the business of agency in the same manner in which the principal has the right of revocation. In the first place, if the agency is for a fixed period, the agent would have to compensate the principal for any premature renunciation without sufficient cause. [S. 205] Secondly, a reasonable notice of renunciation is necessary. Length of notice is to be determined by the same principles which apply to revocation by the principal. If the agent renounces without proper notice, he shall have to make good any damage thereby resulting to the principal. [S. 206]

3. **Completion of business:** An agency is automatically and by operation of law determined when its business is completed. Thus, for example, the authority of an agent appointed to sell goods ceases to be exercisable when the sale is completed.

4. **Death or insanity:** An agency is determined automatically on the death or insanity of the principal or the agent. Winding up of a company or dissolution of partnership has the same effect. Act done by agent before death would remain binding.

5. **Principal's insolvency:** An agency ends on the principal being adjudicated insolvent.

6. **On expiry of time:** Where an agent has been appointed for a fixed term, the expiration of the term puts an end to the agency, whether the purpose

of agency has been accomplished or not. An agency comes to an automatic end on expiry of its term

When the agency is irrevocable?

When the agent is personally interested in the subject matter of agency the agency becomes irrevocable**. Section 202** states that where the agent has himself an interest in the property which forms the subject matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

Example: A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

Example: A consigns 1000 bales of cotton to B, who has made advances to him on such cotton, and desires B to sell the cotton, and to repay himself, out of the price, the amount of his own advances. A cannot revoke this authority, nor it is terminated by his insanity or death.

Effects of Termination [Section 208]

When termination of agent's authority takes effect as to agent, and as to third persons [Section 208]: The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.

Example 1: A directs B to sell goods for him, and agrees to give B five per cent commission on the price fetched by the goods. A afterwards, by letter, revokes B's authority. B, after the letter is sent, but before he receives it sells the goods for ₹ 1,00,000. The sale is binding on A, and B is entitled to ₹ 5,000 as his commission.

Example 2: A, at Chennai, by letter directs B to sell for him some cotton lying in a warehouse in Mumbai, and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second, for the sale to him of the cotton. C pays B the money, with which B absconds. C's payment is good as against A.

Example 3: A directs B, his agent, to pay certain money to C. A dies, and D takes out probate to his will. B, after A's death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

Agent's duty on termination of agency by principal's death or insanity [Section 209]: When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him.

Termination of sub-agent's authority [Section 210]

The termination of the authority of an agent causes the termination (subject to the rules herein contained regarding the termination of an agent's authority) of the authority of all sub-agents appointed by him.

SUMMARY

- **Agency:** Relation between an agent and his principal created by an express/ implied agreement authorising an agent by his principal to create contractual relations with third parties. Person so appointed to represent the principal is called as agent whereas a person who appoints an agent to represent him as per his directions and authority is called as principal.
- Agency can be either expressed or implied.
- **Sub-agent:** Person appointed by the original agent in the business of agency under his direction and control and being responsible to the principal for acts of a sub-agent.
- **Substituted agent:** Person is named by the agent expressly or impliedly to act for the principal in the business of agency.
- **Ratification:** Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority. Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.
- **Revocation of authority:** An Agency is terminated (a) by the principal revoking his authority; or (b) by the agent renouncing the business of the agency; or (c) by the business of the agency being completed; or (d) by either the principal or agent dying or becoming of unsound mind; or (e) by either the principal or agent dying or becoming of unsound mind
- **Duties and obligations of an Agent:** (a) Conduct the business according to principal's directions (b) Conduct the business with the skill and diligence (c) Render proper accounts (d) Communicate with principal in cases of difficulty

(e) Repudiation of the transaction by principal (f) Not to deal on his own account (g) Agent's duty to pay sums received for principal

- **Rights of an Agent:** (a) Right of retain out of sums received on principal's account (b) Right to remuneration (c) Agent's lien on principal's property (d) Right of indemnification for lawful acts (e) Right of indemnification against acts done in good faith.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. _____ is one who represents to be an agent of another when in reality he has no such authority from the other agent at all.
   (a) Substituted agent
   (b) Subordinate agent
   (c) Pretended agent
   (d) Both (a) & (b)
2. Out of the following, who can appoint an Agent?
   (a) Minor
   (b) Person of sound mind
   (c) Person of unsound mind
   (d) None of the above
3. When an authority of agent is said to be implied:
   (a) given by words
   (b) spoken
   (c) inferred from the circumstances of the case
   (d) written
4. Substituted Agent is agent of the ___:
   (a) Agent
   (b) Principal
   (c) Sub-agent
   (d) Third party

5. L made an offer to MD of a company. MD accepted the offer though he had no authority to do so. Subsequently L withdrew the offer but the company ratified the MD's acceptance. State which of the statement given hereunder is correct:

   (a) L was bound with the offer

   (b) An offer once accepted cannot be withdrawn

   (c) Both option (a) & (b) is correct

   (d) L is not bound to an offer.

6. A is residing in Delhi and has a house in Mumbai. A appoints B by a power of attorney to take care of his house. State the nature of agency created between A and B:

   (a) Implied agency

   (b) Agency by ratification

   (c) Agency by necessity

   (d) Express agency

7. An agent is not liable to the principal if

   (a) He is a minor

   (b) He is of unsound mind

   (c) a and b both

   (d) None of these

Answer to MCQs

1. (c) **2.** (b) **3.** (c) **4.** (b) **5.** (c) **6.** (d) **7.** (c)

QUESTION AND ANSWER

Question 1

A appoints M, a minor, as his agent to sell his watch for cash at a price not less than ₹ 700. M sells it to D for ₹ 350. Is the sale valid? Explain the legal position of M and D, referring to the provisions of the Indian Contract Act, 1872.

Answer

According to the provisions of Section 184 of the Indian Contract Act, 1872, as between the principal and a third person, any person, even a minor may become an agent. But no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal. Thus, if a person who is not competent to contract is appointed as an agent, the principal is liable to the third party for the acts of the agent. Thus, in the given case, D gets a good title to the watch. M is not liable to A for his negligence in the performance of his duties.

Question 2

State with reason whether the following statement is correct or incorrect Ratification of agency is valid even if knowledge of the principal is materially defective.

Answer

Incorrect: Section 198 of the Indian Contract Act, 1872 provides that for a valid ratification, the person who ratifies the already performed act must be without defect and have clear knowledge of the facts of the case. If the principal's knowledge is materially defective, the ratification is not valid and hence no agency.

Question 3

Rahul, a transporter was entrusted with the duty of transporting tomatoes from a rural farm to a city by Aswin. Due to heavy rains, Rahul was stranded for more than two days. Rahul sold the tomatoes below the market rate in the nearby market where he was stranded fearing that the tomatoes may perish. Can Aswin recover the loss from Rahul on the ground that Rahul had acted beyond his authority?

Answer

Agent's authority in an emergency (Section 189 of the Indian Contract Act, 1872): An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

In the instant case, Rahul, the agent, was handling perishable goods like 'tomatoes' and can decide the time, date and place of sale, not necessarily as per instructions of the Aswin, the principal, with the intention of protecting Aswin from losses.

Here, Rahul acts in an emergency as a man of ordinary prudence, so Aswin will not succeed against him for recovering the loss.

Question 4

Mr. Ahuja of Delhi engaged Mr. Singh as his agent to buy a house in West Extension area. Mr. Singh bought a house for ₹ 20 lakhs in the name of a nominee and then purchased it himself for ₹ 24 lakhs. He then sold the same house to Mr. Ahuja for ₹ 26 lakhs. Mr. Ahuja later comes to know the mischief of Mr. Singh and tries to recover the excess amount paid to Mr. Singh. Is he entitled to recover any amount from Mr. Singh? If so, how much? Explain.

Answer

The problem in this case, is based on the provisions of the Indian Contract Act, 1872 as contained in Section 215 read with Section 216. The two sections provide that where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:

(1) repudiate the transaction, if the case shows, either that the agent has dishonestly concealed any material fact from him, or that the dealings of the agent have been disadvantageous to him.

(2) claim from the agent any benefit, which may have resulted to him from the transaction.

Therefore, based on the above provisions, Mr. Ahuja is entitled to recover ₹ 6 lakhs from Mr. Singh being the amount of profit earned by Mr. Singh out of the transaction.

Question 5

Comment on the 'Principal is not always bound by the acts of a sub-agent '.

Answer

The statement is correct. Normally, a sub-agent is not appointed, since it is a delegation of power by an agent given to him by his principal. The governing principle is, a delegate cannot delegate'. (Latin version of this principle is, "***delegates non potest delegare***"). However, there are certain circumstances where an agent can appoint sub-agent.

In case of proper appointment of a sub-agent, by virtue of Section 192 of the Indian Contract Act, 1872 the principal is bound by and is held responsible for the acts of the sub-agent. Their relationship is treated to be as if the sub-agent is appointed by the principal himself.

However, if a sub-agent is not properly appointed, the principal shall not be bound by the acts of the sub-agent. Under the circumstances the agent

appointing the sub-agent shall be bound by these acts and he (the agent) shall be bound to the principal for the acts of the sub-agent.

Question 6

ABC Ltd. sells its products through some agents and it is not the custom in their business to sell the products on credit. Mr. Pintu, one of the agents sold goods of ABC Ltd. to M/s. Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale. ABC Ltd. sued Mr. Pintu for compensation towards the loss caused due to sale of products to M/s. Parul Pvt. Ltd. Will ABC Ltd. succeed in its claim?

Answer

To conduct the business of agency according to the principal's directions (Section 211 of the Indian Contract Act, 1872): An agent is bound to conduct the business of his principal according to the direction given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

In the present case, Mr. Pintu, one of the agents, sold goods of ABC Ltd. to M/s Parul Pvt. Ltd. (on credit) which was insolvent at the time of such sale. Also, it is not the custom in ABC Ltd. to sell the products on credit.

Hence, Mr. Pintu must make good the loss to ABC Ltd.

Question 7

Azar consigned electronic goods for sale to Aziz. Aziz employed Rahim a reputed auctioneer to sell the goods consigned to him through auction. Aziz authorized Rahim to receive the proceeds and transfer those proceeds once in 45 days. Rahim sold goods on auction for ₹ 2,00,000 but before transferring the proceeds of the auction, became insolvent. Assess the liability of Aziz according to the provisions of the Indian Contract Act, 1872.

Answer

According to section 195 of the Contract Act, 1872, in selecting an agent (substituted) for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.

Thus, while selecting a "substituted agent" the agent is bound to exercise same amount of diligence as a man of ordinary prudence and if he does so he will not be responsible for acts or negligence of the substituted agent.

Hence, if Aziz has exercised same amount of diligence as a man of ordinary prudence would, he shall not be responsible to Azar for the proceeds of the auction.

Question 8

R is the wife of P. She purchased sarees on credit from Nalli. Nalli demanded the amount from P. P refused. Nalli filed a suit against P for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether Nalli would succeed.

Answer

The position of husband and wife is special and significant case of implied authority. According to the Indian contract Act 1872, Where the husband and wife are living together in a domestic establishment of their own, the wife shall have an implied authority to pledge the credit of her husband for necessaries. However, the implied authority can be challenged by the husband only in the following circumstances.

(1) The husband has expressly forbidden the wife from borrowing money or buying goods on credit

(2) The articles purchased did not constitute necessities.

(3) Husband had given sufficient funds to the wife for purchasing the articles she needed to the knowledge of the seller

(4) The creditor had been expressly told not to give credit to the wife

Further, where the wife lives apart from husband without any of her fault, she shall have an implied authority to bind the husband for necessaries, if he does not provide for her maintenance.

Since, none of the above criteria is being fulfilled; Nalli would be successful in recovering its money.

CHAPTER 2

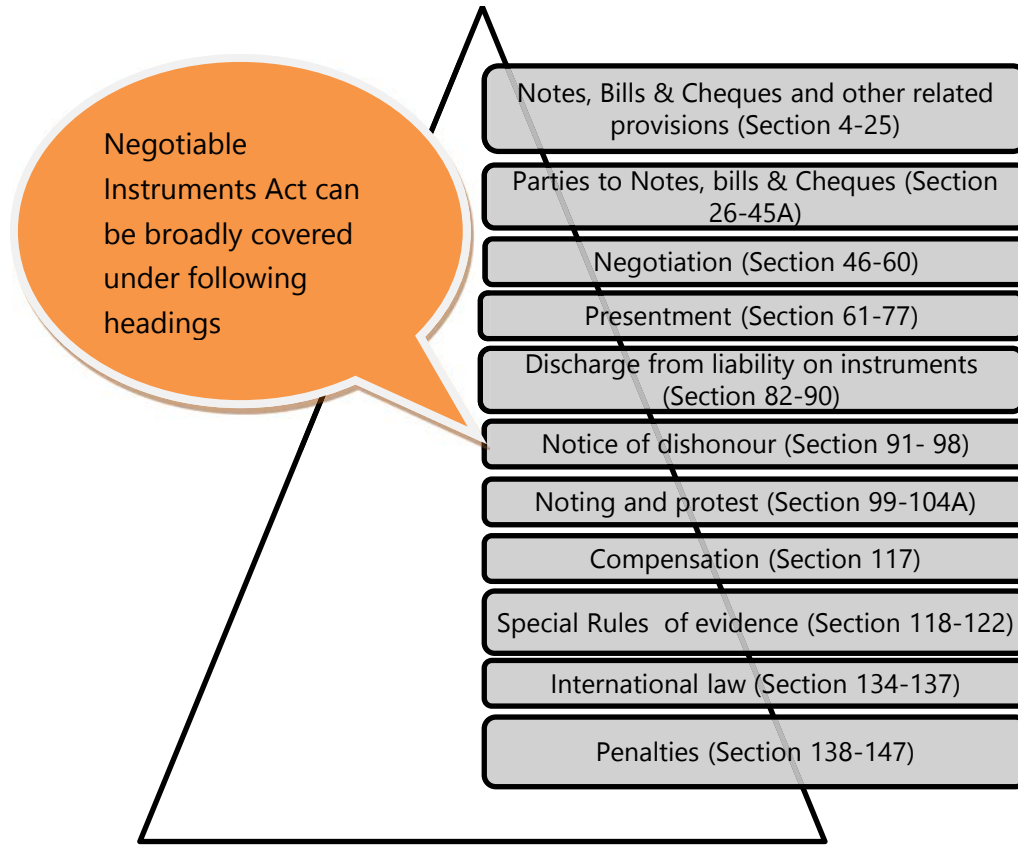
THE NEGOTIABLE INSTRUMENTS ACT,1881

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Understand the meaning, characteristics and elements of different kinds of negotiable instruments
- Know the parties to notes, bills and cheques, various ways of negotiation of the instruments and their presentment.
- Know the concepts of Noting and Protest, and of dishonour of instrument

CHAPTER OVERVIEW



1. INTRODUCTION

The law relating to negotiable instruments is the law of the commercial world which was *enacted to facilitate the activities in trade and commerce* making provision of giving sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, the trade and commerce activities were likely to be adversely affected as it was not practicable for the trading community to carry on with it the bulk of the currency in force. The source of Indian law relating to such instruments is admittedly the English Common Law. The **main objective** of the Act is to legalise the system by which instruments contemplated by it could pass from hand to hand by negotiation like any other goods.

The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. This is an Act to define and amend the law relating to Promissory Notes, Bills of Exchange and Cheques. ***The Act applies to the whole of India*****,** but nothing herein contained affects the Reserve Bank of India Act, 1934, (section 21 which provides the Bank to have the right to transact Government business in India), or affects any local usage relating to any instrument in an oriental language.

Provided that such usages may be excluded by any words in the body of the instrument, which indicate an intention that the legal relations of the parties thereto shall be governed by this Act; and it shall come into force on the first day of March, 1882.

The provisions of this Act are also applicable to Hundis, unless there is a local usage to the contrary. Other native instruments like Treasury Bills, Bearer debentures etc. are also considered as negotiable instruments either by mercantile custom or under other enactments.

Recent developments: The Act was amended several times. Recent three amendments made in the N.I. Act were the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 and the Negotiable Instruments (Amendment) Act, 2015 and Negotiable Instruments (Amendment) Act, 2018.

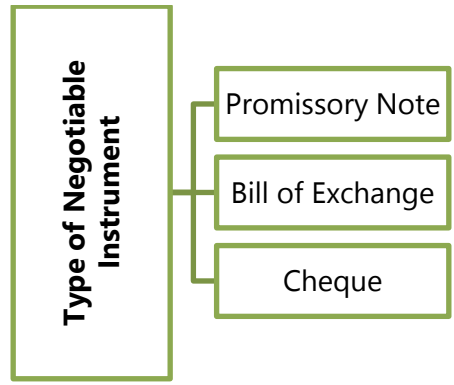
The Negotiable Instruments (Amendment) Act, 2018 received the assent of the President and was notified in the official gazette on 2nd August, 2018 and came into effect from September 1, 2018.

The Amendment Act 2018 contains two significant changes – the introduction of Section 143A and Section 148. These sections provide interim compensation during the pendency of the criminal complaint and the criminal appeal.

2. MEANING OF NEGOTIABLE INSTRUMENTS

Negotiable Instruments is an instrument (the word instrument means a document) which is **freely transferable** (by customs of trade) from one person to another by mere delivery or by **endorsement** and **delivery**. The property in such an instrument passes to a *bonafide* transferee for value.

The Act does not define the term 'Negotiable Instruments'. However**, Section 13** of the Act provides for only **three kinds of negotiable instruments** namely**, bills of exchange, promissory notes and cheques, payable either to order or bearer.**



A negotiable instrument is **payable to order** when

a. It is expressed to be so payable

b. When it is expressed to be payable to a specified person and does not contain words prohibiting its transfer. (i.e. it is transferrable by endorsement and delivery)

A negotiable instrument **is payable to bearer** when

a. When it is expressed to be so payable e.g. pay bearer

b. When the only or last endorsement (endorsement means signing of the instrument) on the instrument is an endorsement in blank

Essential Characteristics of Negotiable Instruments

1. It is necessarily in writing
2. It should be signed
3. It is free transferable from one person to another
4. Holders title is free from defects
5. It can be transferred any number of times till its satisfaction
6. Every negotiable instrument must contain either a promise or order to pay money. Also, the promise or order must be unconditional.
7. The promise or order to pay must consist of money only. Nothing should be payable, whether in addition or in substitution of money. Also, the sum payable must be certain.

Presumptions as to Negotiable Instruments [Section 118]

Presumptions made in relation	Presumptions drawn
Until the contrary is proved, the following presumption shall be made:	
of **consideration**	every negotiable instrument was made or drawn for consideration
as to **date**	every negotiable instrument bearing a date was made or drawn on such date
as to **time of acceptance**	every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity
as to **time of transfer**	every transfer of a negotiable instrument was made before its maturity;
as to **order of endorsements**	endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon
as to **stamps**	lost promissory note, bill of exchange or cheque was duly stamped
as to **holder**	the holder of a negotiable instrument is a holder in due course

The above presumptions are rebuttable by evidence to the contrary.

3. PROMISSORY NOTE

Meaning

According to section 4 of the NI Act, 1881, "A **"promissory note"** is an **instrument in writing** (not being a bank-note or a currency-note) containing an **unconditional undertaking** signed by the maker, **to pay a certain sum of money** only to, or **to the order of**, a certain person, or to the **bearer of** the instrument."

The person who makes the promise to pay is called the **Maker**. He is the debtor and must sign the instrument. The person who will get the money (the creditor) is called **Payee**.

Essential Characteristics of a Promissory Note

a. In **writing**- An oral promise to pay is not sufficient.

b. There must be **an express promise to pay.** Mere acknowledgment of debt is insufficient.

Example: I acknowledge myself to be indebted to B in ₹ 1,000, to be paid on demand, for value received. (Valid promissory note as the promise to pay is definite)

Example: "Mr. B I.O.U ₹ 1,000." – Invalid promissory note as there is no promise to pay. It is just an acknowledgement of debt.

c. The promise to pay should be **definite** and **unconditional**. Therefore, instruments payable on performance or non-performance of a particular act or on the happening or non-happening of an event, are not promissory notes. However, the promise to pay may be subject to a condition, which according to the ordinary experience of mankind, is bound to happen.

Example: I promise to pay B ₹ 500 seven days after my marriage with C. (the promissory note is invalid as marriage with C may or may not happen.)

Example: I promise to pay B ₹ 500 on D's death- as the death of D is certain, promise in unconditional. Thus, the promissory note is valid.

Example: I promise to pay B ₹ 500 on D's death, provided D leaves me enough to pay that sum. Invalid promissory note as promise is dependent on D leaving behind money which is not certain.

d. A promissory note must be **signed by the maker** otherwise it in incomplete and ineffective.

e. Promise **to pay money only**.

Example: I promise to pay B ₹ 500 and to deliver to him my black horse on 1st January next. – It is not a valid promissory note, as the promisor needs to deliver its black horse which is not money.

f. Promise to pay a **certain sum**

Example: "I promise to pay B ₹ 500 and all other sums which shall be due to him."- Promissory note invalid as the amount payable is not certain.

g. The **maker and payee must be certain**, **definite and different persons**. A promissory note cannot be made payable to the bearer (Sec. 31 of RBI Act).

Only the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.

h. **Stamping** A promissory note must be properly stamped in accordance with the provisions of the Indian Stamp Act and such stamp must be duly cancelled by maker's signatures or initials or otherwise.

4. BILLS OF EXCHANGE

A "bill of exchange" is an **instrument in writing** containing an **unconditional order**, **signed** by the maker, **directing a certain person** to **pay a certain sum** of **money only** to, or to **the order of**, a **certain person** or to **the bearer** of the instrument.

Parties to the Bill of exchange

a. **Drawer:** The maker of a bill of exchange.

b. **Drawee**: The person directed by the drawer to pay is called the 'drawee'. He is the person on whom the bill is drawn. On acceptance of the bill he is called an acceptor and is liable for the payment of the bill. His liability is primary and unconditional.

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

Essential characteristics of bill of exchange

a) It must be in writing

b) Must contain an express order to pay

c) The order to pay must be definite and unconditional

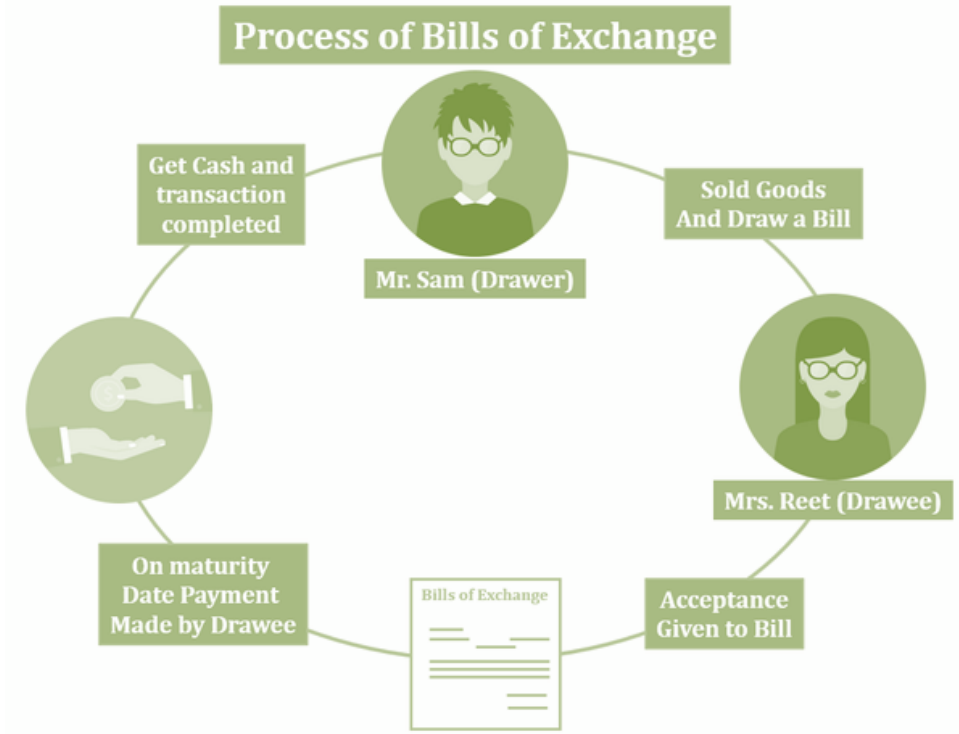
d) The drawer must sign the instrument

e) Drawer, drawee and payee must be certain. All these three parties may not necessarily be three different persons. One can play the role of two. But there must be two distinct persons in any case. As per Section 31 of RBI Act, 1934, a bill of exchange cannot be made payable to bearer on demand.

f) The sum must be certain

g) The order must be to pay money only

h) It must be stamped.



In above image, firstly seller sold goods to the buyer/customer and then draw a bill on him. Buyer received a bill and accepts it without any condition. On maturity of bill buyer will pay a sum of amount to the payee. (Payee may be a bank or Drawer himself)

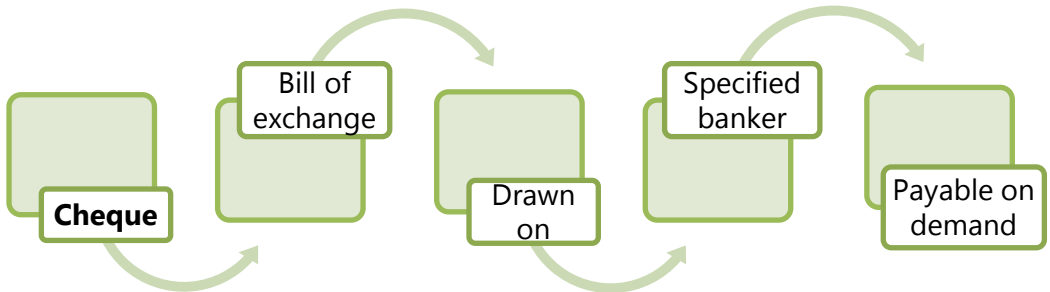
Difference between Promissory note and Bill of Exchange

S.no	Basis	Promissory Note	Bill of Exchange
1.	Definition	"A Promissory Note" is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.	"A bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.

2.	Nature of Instrument	In a promissory note there is a promise to pay money.	In a bill of exchange there is an order for making payment.
3.	Parties	In a promissory note there are only 2 parties namely: i. the maker and ii. the payee	In a bill of exchange, there are 3 parties which are follows i. the drawer ii. the drawee iii. the payee
4.	Acceptance	A promissory note does not require any acceptance, as it is signed by the person who is liable to pay.	The Bills of Exchange need a acceptance from the drawee.
5.	Payable to bearer	A promissory note cannot be made payable to bearer.	On the other hand a bill of exchange can be drawn payable to bearer. However, it cannot be payable to bearer on demand

5. CHEQUE [SECTION 6]

A "cheque" is a bill of exchange **drawn on a specified banker** and not expressed to **be payable** otherwise than **on demand** and it includes the electronic image of a truncated cheque and a cheque in the electronic form.



Payable on demand means- It should be payable whenever the holder chooses to present it to the drawee (the banker).

The expression "Banker" includes any person acting as a banker and any post office saving bank **[Section 3]**

Explanation I: For the purposes of this section, the expressions-

(a) **Cheque in the electronic form-**means a cheque **drawn in electronic form** by using any **computer resource,** and **signed in a secure system** with a digital signature (with/without biometric signature) and **asymmetric crypto system** or electronic signature, as the case may be;

Note- For the purposes of this section, the expressions "asymmetric crypto system", "computer resource", "digital signature", "electronic form" and "electronic signature" shall have the same meanings respectively assigned to them in the Information Technology Act, 2000

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

Explanation II: For the purposes of this section, the expression "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognized as such by the Reserve Bank of India.

Explanation III: For the purposes of this section, the expressions "asymmetric crypto system", "computer resource", "digital signature", "electronic form" and "electronic signature" shall have the same meanings respectively assigned to them in the Information Technology Act, 2000.

A combined reading of section 5 and 6 tells us that a bill of exchange is a negotiable instrument in writing containing an instruction to a third party to pay a stated sum of money at a designated future date or on demand. Whereas, a cheque is also a bill of exchange but is drawn on a banker and payable on demand.

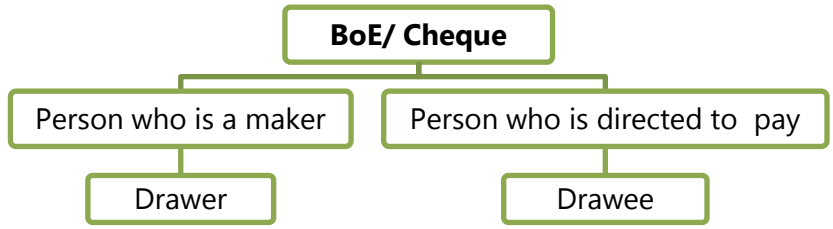
Parties to Cheque

1. **Drawer:** The person who draws a cheque i.e. makes the cheque. (Debtor) **His** liability is primary and conditional.

2. **Drawee:** The specific bank on whom cheque is drawn. He makes the payment of the cheque. In case of cheque, drawee is always banker.

"drawee in case of need"— When in the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need such person is called a "drawee in case of need

3. **Payee:** The person named in the instrument (i.e. the person in whose favour cheque is issued), to whom or to whose order the money is, by the instrument, directed to be paid, is called the payee. The payee may be the drawer himself or a third party.



Essential Characteristics of a cheque

According to the definition of cheque under section 6, a cheque is a species of bill of exchange. Thus, it should fulfill:

a. all the essential characteristics of a bill of exchange

b. Must be drawn on a specified banker

c. It must be payable on demand

Note: These two additional features distinguish a cheque from bill. Thus, all cheques are bills while all bills are not cheques.

Specimens of Promissory notes, bill of exchange and cheque

Specimen of Promissory notes

₹ 10,000 Lucknow

April 10, 2018

Three months after date, I promise to pay Shri Ramesh (Payee) or to his order the sum of Rupees Ten Thousand, for value received.

Stamp

Sd/-

Ram

To,

Shri Ramesh,

B-20, Green Park,

Mumbai.

(Maker)

Specimen of Bill of Exchange

Mr. A (Drawer)

48, MP Nagar, Bhopal (M.P.)

April 10, 2018

₹ 10,000/-

Four months after date, pay to Mr. B (Payee) a sum of Rupees Ten Thousand, for value received.

To,

Mr. C (Drawee)

576, Arera Colony, Bhopal (M.P.)

Signature

Mr. A

Specimen of Cheque

Date:.....

Pay .....

a sum of Rupees..... ₹

A/C No. 12345678910

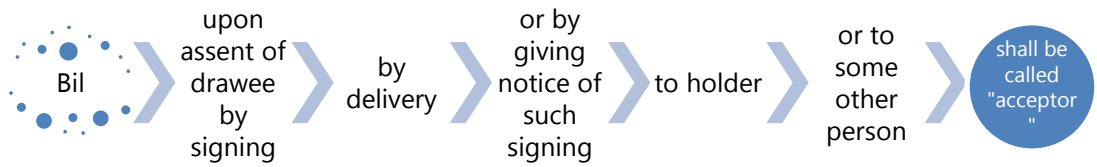
ABC Bank
622, Vijay Nagar, Indore (M. P.)

Signature

01212 1125864 000053 38

ACCEPTANCE:

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Section 7 states that an acceptance is the signature of the drawee of a bill who has signed his assent upon the bill and delivered it.



"**acceptor"** — After the drawee of a bill has signed his assent upon the bill, or, if there are more parts thereof than one, upon one of such parts, and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the "acceptor". **Thus, an acceptor is the drawee who has signed his assent upon the bill and delivered it to the holder.**

"Acceptor for honour" When a bill of exchange has been dishonoured by non-acceptance and any person accepts it for honour of the drawer or of any indorsers, such person is called "an Acceptor for honour". The payment which he makes is known as "payment for honour. In other words, it is an undertaking by a third party to accept and pay a bill of exchange that was dishonored, either by non-acceptance (see dishonor by non-acceptance) or by non-payment (see dishonor by non payment) by the party on whom it was drawn. It is also called acceptance supra protest.

How acceptance for honor must be made: A person desiring to accept for honor must, [by writing on the bill under his hand], declare that he accepts under protest the protested bill for the honor of the drawer or of a particular endorser whom he names, or generally for honor.

Essentials of valid acceptance for honor

1) The **holder must consent** to acceptance for honor. The holder cannot be compelled to assent to acceptance for honor.

2) The **bill must have been noted or protested** for the non-acceptance or for better security.

3) Acceptance for honor can be made by a person who is not already liable on the bill. Drawee of the bill when he refuses to accept the bill becomes a stranger. He may therefore accept the bill for honor of any party thereto.

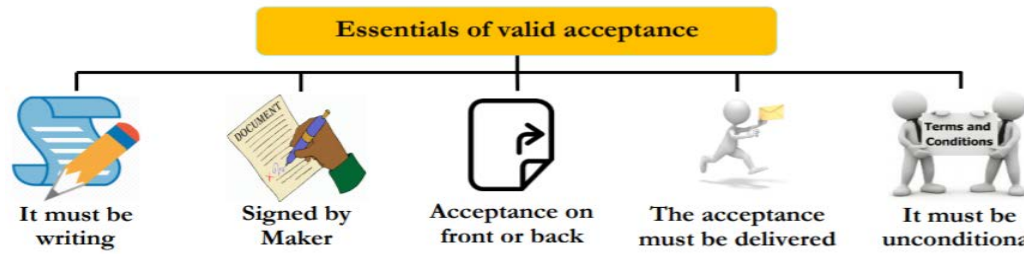
4) It must be made **by writing** on the bill.

5) It must be for the whole amount due on the bill

6) Acceptance must be for the honor of any party already liable on the bill.

7) Acceptance for honor must be made before to bill is overdue.

8) Stranger paying for honor must, before payment, declare before a Notary Public the party for whose honor he pays and the Notary Public must have recorded such a declaration.



A specimen of Acceptance for Honor

The acceptor for honor writes as below, across the bill as given under specimens of bills of exchange above: Accepted Supra Protest or Accepted for AB.

Rights and liabilities of an acceptor for honour (Sec 111& 112)

1) Acceptor for honor binds himself to all the subsequent parties to pay the amount of the bill if the drawee does not pay.

2) The party for whose honor he accepts to pay the amount and all price parties are liable to compensate the acceptor for honor for all loss or damage sustained by him in consequence of such acceptance. The liability of an acceptor or honor is conditional he is liable only if the drawee fails to pay the bill.

The bill of exchange should be presented at its maturity to the drawer for payment and it must be dishonored by the drawer and noted or protested for non-payment to charge an acceptor for honor (Sec 112). The bill must be presented or forwarded for presentment to the drawee not later than the day next after the day of its maturity.

HOLDER AND HOLDER IN DUE COURSE

"Holder" [Section 8]— The "holder" of a promissory note, bill of exchange or cheque means—

- any person
- entitled in his own name to the possession thereof, and
- to receive or recover the amount due thereon from the parties thereto.

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

Broadly speaking, a holder means the owner of a negotiable instrument. What is required is a right to possession. A person in possession of an instrument without having a right to possess can't be called a holder.

Example: A person who finds or steals a bearer instrument or takes an instrument under forged endorsement is not holder: The reason is that holder of a negotiable instrument must have right to receive or recover the money thereon from the parties thereto.

Example: An agent holding an instrument for his principal is not a holder: The reason being that, although agent can receive payment of the instrument, he has no right to sue on the instrument in his own name.

"Holder in due course" [Section 9]— "Holder in due course" means—

- any person
- who for consideration
- became the possessor of a promissory note, bill of exchange or cheque (if payable to bearer), or the payee or endorsee thereof, (if payable to order),
- before the amount mentioned in it became payable, and
- without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

Example 1: A draws a cheque for ₹ 5,000 and hands it over to B by way of gift. B is a holder but not a holder in due course as he does not get the cheque for value and consideration. His title is good and bonafide. As a holder he is entitled to receive ₹ 5000 from the bank on whom the cheque is drawn.

Example 2: On a Bill of Exchange for ₹ 1 lakh, X's acceptance to the Bill is forged. 'A' takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons whether 'A' can be considered as a 'Holder in due course' and whether he (A) can receive the amount of the Bill from 'X'.

Answer: According to section 9 of the Negotiable Instruments Act, 1881 'holder in due course' means any person who for consideration becomes the possessor of

a promissory note, bill of exchange or cheque if payable to bearer or the payee or endorsee thereof, if payable to order, before the amount in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

As 'A' in this case *prima facie* became a possessor of the bill for value and in good faith before the bill became payable, he can be considered as a holder in due course.

But where a signature on the negotiable instrument is forged, it becomes a nullity. The holder of a forged instrument cannot enforce payment thereon. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue on tort the person who had received. This principle is universal in character, by reason where of even a holder in due course is not exempt from it. A holder in due course is protected when there is defect in the title. But he derives no title when there is entire absence of title as in the case of forgery. Hence 'A' cannot receive the amount on the bill.

ESSENTIALS TO BECOME HOLDER IN DUE COURSE (HDC):

a) The holder must have paid **valuable consideration**:

   i) To become a holder in due course, a person must obtain a negotiable instrument by paying valuable and lawful consideration for it.

   ii) When given as a gift or has been inherited, the transferee cannot be a holder in due course.

b) A holder must **acquire the instrument before its maturity** in order to attain the status of holder in due course.

c) The holder must have **obtained the instrument in good faith**

d) The instrument must be **complete and regular** on the face of it.

e) He must have received the instrument as a holder- ie. A HDC may be either payee, or the possessor (if the instrument is payable to bearer), or the indorsee (if the instrument is payable to order).

PRIVILEGES OF BEING A HOLDER IN DUE COURSE:

(i) **In case of Inchoate Instrument**: A person signing and delivering to another a stamped but otherwise inchoate instrument (When you execute an unfilled up but duly signed negotiable instrument such as a cheque or a promissory note, it is an inchoate negotiable instrument) is debarred from asserting, as against a holder in due course, that the instrument has not

been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).

Example: A signs his name on a blank but stamped instrument which he gives to B with an authority to fill up as a note for a sum of ₹ 3 000 only. But B fills it for ₹ 5,000. B than transfers it to C for a consideration of 5000 who takes it in good faith. Here in the case, C is entitled to recover the full amount of the instrument because he is a holder in due course whereas B, being a holder cannot recover the amount because he filled in the amount in excess of his authority.

(ii) **In case of fictitious bill:** In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42).

(iii) **In case of conditional instrument or 'escrow'**: In case a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sections 46 and 47).

(iv) **In case of instrument obtained by unlawful means or for unlawful consideration;** The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or obtained from the former by means of an offence or fraud or for an unlawful consideration (Section 58). Thus, a holder in due course acquires a title free from all defects.

(v) **In case original validity of the instrument is denied**; No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120). In short, a holder in due course gets a good title to the bill.

(vi) **In case Payee's capacity to indorse is denied**: No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the date of the note or bill, to endorse the same (Section 121). In short, a holder in due course gets a good title to the bill.

"Payment in due course" [Section 10]—"Payment in due course" means payment in accordance with the apparent tenor of the instrument in good faith

and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

CLASSIFICATION OF NEGOTIABLE INSTRUMENTS

"Bearer instrument" and "order instrument"

Bearer Instrument: It is an instrument where the name of the payee is blank or Where the name of payee is specified with the words "or bearer" or Where the last indorsement is blank. Such instrument can be negotiated by mere delivery.

Order Instrument: It is an instrument which is payable to a person or Payable to a person or his order or Payable to order of a person or Where the last indorsement is fill Such instrument can be negotiated by indorsement and delivery.

"Inland instrument" and "Foreign instrument" [Sections 11 & 12]

A promissory note, bill of exchange or cheque drawn or made in India and made payable in, or drawn upon any person resident in India shall be deemed to be an inland instrument.

Example: (i) A promissory note made in Kolkata and payable in Mumbai.

(ii) A bill drawn in Varanasi on a person resident in Jodhpur (although it is stated to be payable in Singapore)

"Foreign instrument"

Any such instrument not so drawn, made or made payable shall be deemed to be foreign instrument. In other words,

(a) Bills drawn outside India and made payable in or drawn upon any person resident in any country outside India,

(b) Bills drawn outside India and made payable in India, or drawn upon any person resident in India;

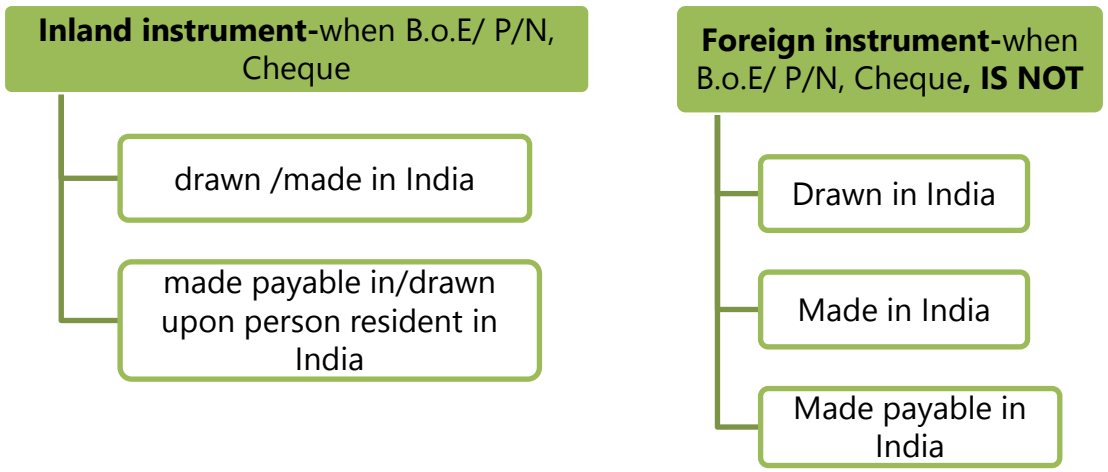
(c) Bills drawn in India made payable outside India or drawn upon any resident outside India, but not made payable in India.

are foreign bills.

In the absence of a contract to the country, the liability of the maker or drawer of a foreign promissory note or bill of exchange or cheque is regulated in all essential matters by the law of the place where he made the instrument, and the

respective liabilities of the acceptor and endorser by the law of the place where the instrument is made payable (Section 134).

For example, a bill of exchange is drawn by A in Berkley where the rate of interest is 15% and accepted by B payable in Washington where the rate of interest is 6%. The bill is endorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only. But if A is charged as drawer, he is liable to pay interest at 15%.



Inchoate and Ambiguous Instruments

Inchoate Instrument: According to section 20 where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount; provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder.

It means an Instrument that is incomplete in certain respects. (i) The person gives a blank instrument with authority to the holder to complete it with appropriate amount up to the stamp value of the instrument. (ii) Delivery of such a paper is essential. The words "when one person signs and delivers to another" in Section 20 are important. (iii) The person signing and delivering the inchoate instrument is liable both to a holder and holder in due course. However, there is a difference in their respective rights. The holder of such an instrument cannot recover the amount in excess of the amount intended to be paid by the signor. The holder in due course can, however, recover any amount on such instrument provided it is covered by the stamp affixed on the instrument.

Example, a person signed a blank acceptance and kept it in his drawer and some person stole it and filled it up for ₹ 20,000 and negotiated it to an innocent person for value, it was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument. Further, as a condition of liability, the signer as a maker, drawer, endorser or acceptor must deliver the instrument to another. In the absence of delivery, the signer is not liable. Furthermore, the paper so signed and delivered must be stamped in accordance with the law prevalent at the time of signing and on delivering otherwise the signer is not estopped from showing that the instrument was filled without his authority.

Ambiguous Instrument: According to section 17, where an instrument may be construed either as a promissory note or bill of exchange (**example,** a bill drawn by a person on himself in favour of a third person or where the drawee is a fictitious person), the holder may at his election treat it as either and the instrument shall be thenceforward treated accordingly.

An instrument which is vague and cannot be clearly identified either as a bill of exchange, or as a promissory note, is an Ambiguous instrument. In other words, such an instrument may be construed either as promissory note, or as a bill of exchange. Section 17 provides that the holder may, at his discretion, treat it as either and the instrument shall thereafter be treated accordingly. Thus, after exercising his option, the holder cannot change that it is the other kind of instrument.

Where amount is stated differently in figures and words [Section 18]

If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.

Demand and Time Instrument

Demand Instruments (Section 19): A promissory note or bill of exchange in which no time for payment is mentioned is payable on demand. Bills and notes are payable either on demand or at a fixed future time. Cheques are always payable on demand. A bill or promissory note is also payable on demand when it is expressed to be payable on demand, or "at sight" or "presentment" (Section 21). The expression "after sight" means, in a promissory note, after presentment for sight, and, in a bill of exchange after acceptance, or noting for non-acceptance, or protest for non-acceptance.

Time instrument (Section 22): A bill or note which is payable: a) After a fixed period or b) After sight or c) On a specified day or d) On the happening of an event which is certain to happen is known as time instrument.

"AT SIGHT", "ON PRESENTMENT", "AFTER SIGHT" [SECTION 21]

In a promissory note or bill of exchange the expressions "**at sight" and "on presentment"** means on demand.

The expression "**after sight"** means, in a promissory note, after presentment for sight, and, in a bill of exchange after acceptance, or noting for non-acceptance, or protest for non-acceptance.

"MATURITY OF NEGOTIABLE INSTRUMENT"

Where bill or note is payable at fixed period after sight, the question of maturity becomes important. The maturity of a note or bill is the date on which it falls due.

Days of grace: A note or bill, which is not expressed to be payable on demand, at sight or on presentment; is at maturity on the third day after the day on which it is expressed to be payable. Three days are allowed as days of grace **(Section 22).**

Calculation of maturity [Section 23]:

In calculating the date at which a promissory note or bill of exchange, made payable at stated number of months after date or after sight, or after a certain event, is at maturity, the period stated shall be held to terminate on the day of the month, which corresponds with the day on which the instrument is dated, or presented for acceptance or sight, or noted for non-acceptance, or protested for non-acceptance, or the event happens or, where the instrument is a bill of exchange made payable at stated number of months after sight and has been accepted for honor, with the day on which it was so accepted. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Sl. No.	Time at which instrument is payable	Maturity period
1.	When a note or bill is made payable, a stated number of months **after date**	when the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated
2.	When it is made payable after a stated number of months **after sight**	The period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance.
3.	When it is payable a stated number of months **after a certain event**	The period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance.
4.	When the instrument is a bill of exchange made payable **at stated number of months after sight and has been accepted for honor.**	Maturity will be with the day on which it was so accepted.

Examples:

(a) A negotiable instrument dated 29th January, 2017, is made payable at one month after date. The instrument is at maturity on the third day after the 28th February, 2017.

(b) A negotiable instrument, dated 30th August, 2019, is made payable three months after date. The instrument is at maturity on the 3rd December, 2019.

(c) A promissory note or bill of exchange, dated 31st August, 2019, is made payable three months after date. The instrument is at maturity on the 3rd December, 2019.

Calculating maturity of bill or note payable so many days after date or sight [Section 24]

In calculating the date at which a promissory note or bill of exchange made payable at certain number of days after date or after sight or after a certain event

is at maturity, the day of the date, or of presentment for acceptance or sight, or of protest for non-acceptance, or on which the event happens, **shall be excluded**.

Example: Bharat executed a promissory note in favour of Bhushan for ₹ 5 crores. The said amount was payable three days after sight. Bhushan, on maturity, presented the promissory note on 1st January, 2017 to Bharat. Bharat made the payments on 4th January, 2017. Bhushan wants to recover interest for one day from Bharat. Advise Bharat, in the light of provisions of the Negotiable Instruments Act, 1881, whether he is liable to pay the interest for one day?

Answer: Claim of Interest: Section 24 of the Negotiable Instruments Act, 1881 states that where a bill or note is payable after date or after sight or after happening of a specified event, the time of payment is determined by excluding the day from which the time begins to run.

Therefore, in the given case, Bharat will succeed in objecting to Bhushan's claim. Bharat paid rightly "three days after sight". Since the bill was presented on 1st January, Bharat was required to pay only on the 4th and not on 3rd January, as contended by Bhushan.

When day of maturity is a holiday [Section 25]

When the day on which a promissory note or bill of exchange is at maturity is a public holiday, the instrument shall be deemed to be due on the next preceding business day.

Explanation: The expression "Public Holiday" includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.

6. NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

One of the essential characteristics of a negotiable instrument is that it is freely transferable from one person to another. The rights in a negotiable instrument can be transferred from one person to another by

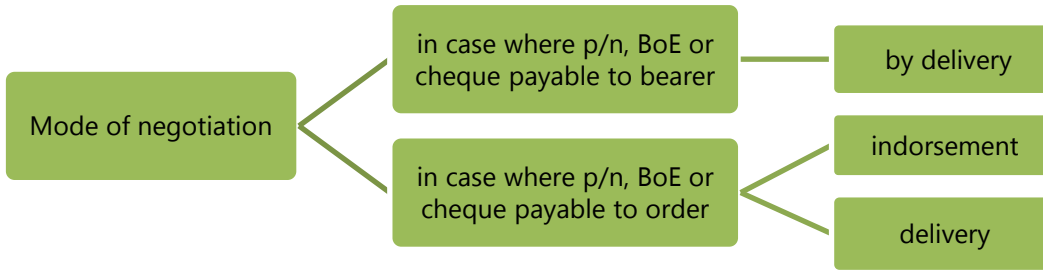
a. Negotiation under the N.I act

b. Assignment under Transfer of Property act

According to Section 14 of N.I act, when a negotiable instrument is transferred to any person with a view to constitute the person holder thereof, the instrument is deemed to have been negotiated. Thus, there is a transfer of ownership of the

instrument. Negotiable instruments may be negotiated either **by delivery** when these are payable to bearer or **by indorsement and delivery** when these are payable to order.

Modes of Negotiation



Modes of negotiation of instrument?

(i) A promissory note, bill of exchange or cheque **payable to bearer** is negotiable by the **delivery thereof.**

(ii) A promissory note, bill of exchange or cheque **payable to order** is negotiable by the holder by **endorsement and delivery thereof.**

Negotiation by delivery [Section 47]

Subject to the provisions of section 58, a promissory note, bill of exchange or cheque **payable to bearer** is negotiable by delivery thereof.

Exception: A promissory note, bill of exchange or cheque delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

Examples:

(1) A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.

(2) A, the holder of a negotiable instrument payable to bearer, which is in the hands of A's banker, who is at the time the banker of B, directs the banker to transfer the instrument to B's credit in the banker's account with B. The banker does so, and accordingly now possesses the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it.

Negotiation by endorsement [Section 48]

Subject to the provisions of section 58, a promissory note, bill of exchange or cheque **payable to order**, is negotiable by the holder by endorsement and delivery thereof.

Importance of Delivery in Negotiation [Section 46]

Delivery of an instrument is essential whether the instrument is payable to bearer or order for effecting the negotiation. The delivery must be voluntary and the object of delivery should be to pass the property in the instrument to the person to whom it is delivered. The delivery can be, actual or constructive. Actual delivery takes place when the instrument changes hand physically, constructive delivery take place when the instrument is delivered to the agent, clerk or servant of the endorsee on his behalf or when the endorser, after endorsement, holds the instrument as an agent of the endorsee.

Section 46 also lays down that when an instrument is conditionally or for a special purpose only, the property in it does not pass to the transferee, even though it is endorsed to him, unless the instrument is negotiated to a holder in due course.

The contract on a negotiable instrument **until delivery remains incomplete** and revocable. The delivery is essential not only at the time of negotiation but also at the time of making or drawing of negotiable instrument. The rights in the instrument are not transferred to the indorsee unless after the indorsement the same has been delivered. If a person makes the indorsement of instrument but before the same could be delivered to the indorsee the indorser dies, the legal representatives of the deceased person can't negotiate the same by mere delivery thereof. (Section 57)

Delivery when effective between the parties

Negotiation of instruments between the parties	How delivery is to be made
As between parties standing in immediate relation	Delivery to be effectual must be made by the party making, accepting or endorsing the instrument, or by a person authorized by him in that behalf.
As between such parties and any holder of the instrument other than a holder in due course	it may be shown that the instrument was delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein.

INDORSEMENT OF INSTRUMENT (Section 15)

Meaning: When the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto known as *allonge* (a French word meaning a slip of paper attached to the end of a BoE to give room for further indorsements)- he is said to indorse the same and called as the indorser. The person to whom the instrument is indorsed is called the indorsee. The indorsement, therefore, means, signatures of the person which are generally made at the back of the instrument, for the purpose of negotiation ie. transfer of rights to another person. The signature may also be on the face of the instrument. No particular form of words is necessary for an indorsement.

INDORSEMENT: When the maker or holder of a negotiable instrument signs the same (otherwise than as such maker)—

- for the purpose of negotiation
- on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument,
- he (maker/holder) is said to indorse the same, and is called the "indorser".

Example: X, who is the holder of a negotiable instrument writes on the back thereof: "pay to Y or order" and signs the instrument. In such a case, X is deemed to have en-dorsed the instrument to Y. If X delivers the instrument to Y, X ceases to be the holder and Y becomes the holder.

Indorsement "in blank" and "in full"-"endorsee" [Section 16]

(1) If the indorser signs his name only, the endorsement is said to be "in blank", and if he adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is said to be "in full", and the person so specified is called the "indorsee" of the instrument.

(2) The provisions of this Act relating to a payee shall apply with the necessary modifications to an indorsee.

Example 1: Blank (or general): No indorsee is specified in an indorsement in blank, it con-tains only the bare signature of the indorser. A bill so indorsed becomes payable to bearer.

Specimen

Motilal Poddar

Example 2: Special (or in full): In such an indorsement, in addition to the signature of the indorser the person to whom or to whose order the instrument is payable is specified.

Specimen

Pay to B, Batliwala or order.

S. Shroff

Various Kinds of Indorsement:

1. **Indorsement in Blank (only signature):** Where the indorser just puts his signature without specifying the indorsee, the indorsement is said to be in blank (Section 16). The effect of such an indorsement is to render the instrument payable to bearer even though originally payable to order (Section 54).

2. **Indorsement in Full (name and signature):** Where along with indorser's signature, the name of the indorsee is specified, the indorsement is called 'indorsement in full' (Section 16). Thus, where the instrument states, 'Pay X or order' and is signed by A, the payee, it constitutes 'indorsement in full'.

3. **Partial indorsement:** An indorsement which purports to transfer only a part of amount of the instrument is called as partial indorsement. As per section 56 such an indorsement is invalid under law.

   Example: A is a holder of a bill for ₹ 10000. A indorses it thus: "Pay B or order ₹ 5000". This is partial indorsement and invalid for the purpose of negotiation.

   Exception: Second part of section 56 states that if a bill has been paid in part, the fact of the part payment may be indorsed on the instrument and it may then be negotiated for the residue. **Example:** A bill may be indorsed: Pay A or order ₹ 5000 being the unpaid residue of the bill. It is a valid indorsement.

4. **Restrictive Indorsement:** An indorsement is restrictive when the indorser while making indorsement restricts or excludes the right of the indorsee to further transfer the instrument or constitutes the indorsee as an to indorse the instrument or to receive its content for the indorser or for some other specified person (Section 50). An indorsement is "restrictive" when it prohibits or restricts the further negotiability of the instrument. It merely entitles the holder of the instrument to receive the amount on the instrument for a specific purpose.

Example: D signs the following indorsements on different negotiable instruments payable to bearer:

(a) Pay the contents to G only

(b) Pay G for my use

(c) Pay G or order for the account of H

These indorsements exclude the right of further negotiation by G.

5. **Conditional indorsement:** Section 52 gives power to an indorser to insert in the indorsement by express words, a stipulation negating (excluding) or limiting his own liability to the holder by making such liability or the right of the indorsee to receive the amount due thereon upon the happening of a specified event although such event may never happen.

Condition indorsement can be achieved by an indorser in any of the following ways:

(1) **Sans recourse indorsement**- By excluding his liability e.g. the holder of a bill may indorse it thus: 'Pay A or order without recourse to me, or Pay A or order sans recourse, or Pay A or order at his own risk'. In these cases, the holder does not incur any liability on the bill as an indorser.

(2) **Liability dependent upon a contingency**- By making his liability dependent upon the happening of a specified event which may never happen, in such a case the liability of the holder as an indorser, arises only upon the happening of the event specified, and is extinguished if the event becomes impossible, or the conditions specified are not fulfilled. But, the indorsee can sue the prior parties before the happening of the event.

(3) **Facultative indorsement** – In it, an indorser by express words abandons some right or increases his liability under an instrument. For example, the holder may waive presentment of the instrument for acceptance or notice of dishonor by the holder. An indorsement, 'Pay A order. Notice of dishonor waived' is a facultative indorsement.

(4) **'Sans frais' indorsement** – Where the indorser does not want the indorsee or any subsequent holder to incur any expenses on his account on the instrument, the indorsement is 'sans frais'.

CONVERSION OF INDORSEMENT IN BLANK INTO ENDORSEMENT IN FULL [SECTION 49]

The holder of a negotiable instrument endorsed in blank may—

- without signing his own name, by writing above the indorser's signature a direction to pay to any other person as endorsee, convert the indorsement in blank into an indorsement in full; and the holder does not thereby incur the responsibility of an indorser.

  According to **Section 55**, if a negotiable instrument, after having been indorsed in bank, is indorsed in full, the amount of it cannot be claimed from the indorser in full, except by the person to whom it has been indorsed in full, or by one who derives title through such person.

  For example, A is the payee holder of a bill. A endorses it in blank and delivers it to B. B endorses it in full to c or order. C without endorsement transfers the bill to D. D as the bearer is entitled to receive payment or to sue drawer, acceptor, or A who endorsed the bill in blank, but he cannot sue B or C. C can sue B as he received the bill form by endorsement in full. If, however, C instead of passing the bill to D without endorsement passes it by a regular endorsement, D can claim against all prior parties.

Thus, if an endorsement in blank is followed by an endorsement in full, the instrument still remains payable to bearer and negotiable by delivery against all parties prior to the endorser in full, though the endorser is full is only liable to a holder who made title directly through his endorsement, and person deriving title through such holder.

Essentials of a valid indorsement

a. **Signature of indorser:** The indorsement must be signed. The indorsement may be made by the indorser either by merely signing his name on the instrument or by specifying in addition to his signature, the person to whom or to whose order the instrument is payable. When, in a bill payable to order, the indorsee's name is wrongly spelled, he should when he indorses it, sign the name as spelled in the instrument and write the correct spelling within brackets after his indorsement.

b. **Who may indorse or negotiate-** Every sole maker, drawer, payee or indorsee, or all of several joint makers, drawers, payees or indorsee's of a negotiable instrument may indorse and negotiate the same unless negotiability of such instrument has been restricted or excluded as mentioned in Sec. 50 and 51.

   Explanation: It is however, necessary that such maker or drawer who wants to indorse is in lawful possession of the instrument. (section 51)

Example: A bill is drawn payable to A or order. A endorses it to B, the endorsement not containing the words "or order" or any equivalent words. B may negotiate the instrument.

c. **Effect of indorsement:** The indorsement of a negotiable instrument followed by delivery transfers to the indorsee the property therein with the right of further negotiation, but the indorsement may by express words, restrict or exclude such right, or may merely constitute the indorsee an agent to indorse the instrument, or to receive its contents for the indorser, or for some other specified person.

Examples: B signs the following indorsements on different negotiable instruments payable to bearer,—

(a) "pay the contents to C only".

(b) "pay C for my use".

(c) "pay C on order for the account to B".

(d) "the within must be credited to C".

These indorsements exclude the right of further negotiation by C.

(a) "pay C".

(b) "pay C value in account with the Oriental Bank".

(c) "pay the contents to C, bring part of the consideration in a certain deed of assignment executed by C to endorser and others".

These indorsements do not exclude the right of further negotiation by C.

Indorser who excludes his own liability or makes it conditional [Section 52]

The indorser of a negotiable instrument may,

- by express words in the endorsement,
- exclude his own liability thereon, or
- make such liability or the right of the indorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.
- Where an indorser so excludes his liability and afterwards becomes the holder of the instrument all intermediates indorsers are liable to him.

Examples:

(1) The endorser of a negotiable instrument signs his name, adding the words "without recourse". Upon this endorsement he incurs no liability.

(2) A is the payee and holder of a negotiable instrument. Excluding personal liability by an endorsement, "without recourse", he transfers the instrument to B, and B endorses it to C, who endorses it to A. A is not only reinstated in his former rights, but has the rights of an endorsee against B and C.

INSTRUMENT OBTAINED BY UNLAWFUL MEANS OR FOR UNLAWFUL CONSIDERATION [SECTION 58]

- When a negotiable instrument has been lost, or
- has been obtained from any maker, acceptor or holder thereof by means of
  - an offence or
  - fraud, or
  - for an unlawful consideration,

no possessor or endorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder, unless such possessor or endorsee is, or some person through whom he claims was, a holder thereof in due course.

INSTRUMENT ACQUIRED AFTER DISHONOR OR WHEN OVERDUE [SECTION 59]

The holder of a negotiable instrument, who has acquired it after dishonour, whether by—

- non-acceptance
- or non-payment,
- with notice thereof, or
- after maturity,

has only, as against the other parties, the rights thereon of his transferor.

Accommodation note or bill: Provided that any person who, in good faith and for consideration, becomes the holder, after maturity, of a promissory note or bill of exchange made, drawn or accepted without consideration, for the purpose of enabling some party thereto to raise money thereon, may recover the amount of the note or bill from any prior party.

Example: The acceptor of a bill of exchange, when he accepted it, deposited with the drawer certain goods as a collateral security for the payment of the bill, with power to the drawer to sell the goods and apply the proceeds in discharge of the bill if it were not paid at maturity. The bill not having been paid at maturity, the drawer sold the goods and retained the proceeds, but endorsed the bill to A. A's title is subject to the same objection as the drawer's title.

Instrument negotiable till payment or satisfaction [Section 60]

A negotiable instrument may be negotiated (except by the maker, drawee or acceptor after maturity) until payment or satisfaction thereof by the maker, drawee or accepter at or after maturity, but not after such payment or satisfaction.

Cancellation of endorsement: Where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity (Sec.40).

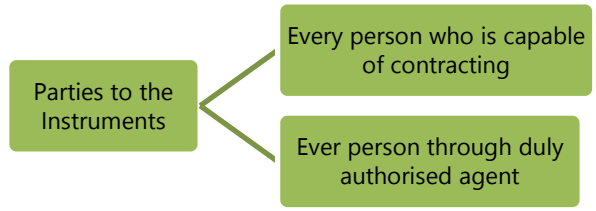
Example: A is the holder of a bill of exchange made payable to the order of B. which contains the following endorsements in blank: 1st endorsement - 'B', 2nd endorsement - C, 3rd endorsement - D, 4th endorsement – E. A puts this bill in suit against C and strikes out, without E's consent, the endorsements by C and D. A is not entitled to recover anything from E.

Negotiation Back ("taking up of a bill")

In the course of Negotiation, if a negotiable instrument is circulated/negotiated back by an Endorser to any of the prior party on the negotiable instruments it is termed as negotiation back. The person who becomes the holder in due course under this negotiation back cannot make any of the intermediate Endorsers liable on the instruments. But where an Endorser had excluded his liability, by the use of the words 'sans recourse' or 'without recourse to me' and after that becomes the holder of the instrument in his own right under the 'negotiation back' all intermediate Endorsers are liable to him and in case of dishonour, he can recover the amount from all or any one of them.

7. PARTIES TO NOTES, BILLS AND CHEQUES

(1) CAPACITY OF THE PARTIES



Capacity to make, draw, accepts etc. of instruments (Section 26): Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Minor: A minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself. A minors agreement is void and cannot be ratified when he attains the age of maturity. A minor cannot bind himself under a negotiable instrument as his contract is absolutely void.

Nothing herein contained shall be deemed to empower a corporation to make, endorse or accept such instruments except in cases in which, under the law for the time being in force, they are so empowered.

Example: A draws a cheque in favour of M, a minor. M endorses the same in favour of X. The cheque is dishonoured by the bank on grounds of inadequate funds. Here in this case, M being a minor may draw, endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, M is not liable. X can, thus, proceed against A.

Authority to sign i.e. through Agency [Sections 27]: Every person, capable of incurring liability, may bind himself or be bound by a duly authorized agent acting in his name.

Legal representative A legal representative of a deceased person, who sings his name on a promissory note, bill exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him **(Sec 29**) thus, in the absence of an express contract to the contrary, the liability of a legal representative is unlimited. However, a legal representative may, by an express agreement, limit his liability. Further, he may exclude his liability i.e. by adding the words "Sans recourse or without recourse."

Endorsement by legal representative: The legal representative of a deceased person cannot negotiate by delivery only, a promissory note, bill of exchange or cheque payable to order and endorsed by the deceased but not delivered (sec 57)

A legal representative is not an agent of the deceased. Therefore, a legal representative cannot complete the instrument if the instrument was executed by the deceased but could not be delivered because of his death.

For example, A, the holder of a bill to B, before delivering the bill died, the legal representative of A subsequently delivered the bill to B. The Indorsement is invalid and B cannot sue on the bill.

A general authority given to an agent to transact business and to receive and discharge debts does not empower him to accept or endorse bills of exchange so as to bind his principal.

An agent may have authority to draw bills of exchange, but not endorse them. An authority to draw does not, necessarily, imply an authority to endorse.

(2) LIABILITY OF THE PARTIES

- Liability of agent
- Liability of legal representative
- liability of drawer
- liability of drawee of cheque
- Liability of maker of note and acceptor of bill
- Liability of indorser
- liability of prioir parties to holder in due course
- Liability of prior parties as principal in respect to subsequent party

Liability of agent signing [Section 28]

An agent who signs his name to a promissory note, bill of exchange or cheque without indicating thereon that he signs as agent, or that he does not intend thereby to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable.

An agent can be sued by the holder in an action for falsely representing that he had authority.

Liability of legal representative signing [Section 29]

A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such.

Liability of drawer of a bill of exchange/ cheque [Section 30]

The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonor has been given to, or received by, the drawer as hereinafter provided.

The liability of the maker of promissory note is primary, while the liability of the drawer of a bill arises on dishonour by acceptance or non-acceptance by the drawee or acceptor respectively. The drawer of a bill, however, can exclude or limit his liability upon the bill

The liability of the drawer of a cheque is primary as in case of dishonour the holder of the cheque has no remedy against the banker. He can only sue the drawer.

Liability of drawee of cheque [Section 31]

The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default.

The drawee of cheque must always be a banker. The drawee bank is bound to honour the customer's cheque if he has sufficient funds of the drawer applicable to the payment of such cheque. If the drawee bank wrongfully dishonours the cheque it can be made liable for such default. The liability for such default is not towards the payee or the holder but towards the drawer. A bank is liable for dishonour of the cheque, to the drawer (his customer) only and not to the payee or the holder of the cheque as there is no privity of contract between the bank and the payee or the holder.

Liability of maker of note and acceptor of bill [Section 32]

In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

In default of such payment as aforesaid, such maker or acceptor is bound to compensate any party to the note or bill for any loss or damage sustained by him and caused by such default.

Liability of endorser [Section 35]

In the absence of a contract to the contrary, whoever endorses and delivers a negotiable instrument before maturity, without, in such endorsement, expressly excluding or making conditional his own liability, is bound thereby to every subsequent holder, in case of dishonour by the drawee, acceptor or maker, to compensate such holder for any loss or damage caused to him by such dishonour, provided due notice of dishonour has been given to, or received by, such endorser as hereinafter provided.

Every endorser after dishonour is liable as upon an instrument payable on demand.

Liability of prior parties to holder in due course [Section 36]

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.

Prior party a principal in respect of each subsequent party [Section 38]

As between the parties so liable as sureties, each prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party.

Example: A draws a bill payable to his own order on B, who accepts. A afterwards endorses the bill to C, C to D and D to E. As between E and B, B is the principal debtor, and A, C and D are his sureties. As between E and A, A is the principal debtor, and C and D are his sureties. As between E and C, C is the principal debtor and D is his surety.

(3) OTHER RELATED CONCEPTS TO THE PARTIES ON THE NEGOTIATION OF THE INSTRUMENTS

Discharge of endorser's liability [Section 40]

Where the holder of a negotiable instrument—

- without the consent of the endorser,
- destroys or impairs the endorser's remedy against a prior party,

The endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.

Example: A is the holder of a bill of exchange made payable to the order of B, which contains the following endorsements in blank-

First endorsement, "B".

Second endorsement, "Peter Williams".

Third endorsement, "Wright & Co.".

Fourth endorsement "John Rozario".

This bill A puts in suit against John Rozario and strikes out, without John Rozario's consent, the endorsements by Peter Williams and Wright & Co. A is not entitled to recover anything from John Rozario.

Acceptor bound, although endorsement forged [Section 41]

An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged, if he knows or had reason to believe the endorsement to be forged when he accepted the bill.

Acceptance of bill drawn in fictitious name [Section 42]

An acceptor of a bill of exchange—

- drawn in a fictitious name, and
- payable to the drawer's order

is not (by reason that such name is fictitious) relieved from liability to any holder in due course claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer.

Example: X draws a bill on Y but signs it in the fictitious name of Z. The bill is payable to the order of Z. The bill is duly accepted by Y. M obtains the bill from X thus, becoming its holder in due course. Can Y avoid payment of the bill? Decide in the light of the provisions of the Negotiable Instruments Act, 1881.

Answer: Bill drawn in fictitious name: The problem is based on the provision of Section 42 of the Negotiable Instruments Act, 1881. In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for the acceptor to allege as against the holder in due course that such name is fictitious. Accordingly, in the instant case, Y cannot avoid payment by raising the plea that the drawer (Z) is fictitious. The only condition is that the signature of Z as drawer and as endorser must be in the same handwriting.

Negotiable instrument made, etc. without consideration [Section 43]

A negotiable instrument—

- made, drawn, accepted, endorsed, or transferred without consideration, or
- for a consideration which fails,

creates no obligation of payment between the parties to the transaction.

But if any such party has transferred the instrument with or without endorsement to a holder for a consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

Exception I: No party for whose accommodation a negotiable instrument has been made, drawn, accepted or endorsed can, if he has paid the amount thereof, recover thereon such amount from any person who became a party to such instrument for his accommodation.

Exception II: No party to the instrument who has induced any other party to make draw, accept, endorse or transfer the same to him for a consideration which he has failed to pay or perform in full shall recover therein an amount exceeding the value of the consideration (if any) which he has actually paid or performed.

Partial absence or failure of money-consideration [Section 44]

When the consideration for which a person signed a promissory note, bill of exchange or cheque **consisted of money**—

- which was originally absent in part, or
- has subsequently failed in part,

the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

Explanation: The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note, bill of exchange or cheque stands in immediate relation with the payee, and the endorser with his endorsee. Other signers may by agreement stand in immediate relation with a holder.

Example 1: A draws a bill on B for ₹ 500 payable to the order of A. B accepts the bill, but subsequently dishonours it by non-payment. A sues B on the bill. B proves that it was accepted for value as to ₹ 400, and as an accommodation to the plaintiff as to the residue. A can only recover ₹ 400.

Example 2: A owes a certain sum of money to B. A does not know the exact amount and hence he makes out a blank cheque in favour of B, signs and delivers it to B with a request to fill up the amount due, payable by him. B fills up fraudulently the amount larger than the amount due, payable by A and endorses the cheque to C in full payment of dues of B. Cheque of A is dishonoured. Referring to the provisions of the Negotiable Instruments Act, 1881, discuss the rights of B and C.

Answer: Section 44 of the Negotiable Instruments Act, 1881 is applicable in this case. According to Section 44 of this Act, B who is a party in immediate relation with the drawer of the cheque is entitled to recover from A only the exact amount due from A and not the amount entered in the cheque. However, the right of C, who is a holder for value, is not adversely affected and he can claim the full amount of the cheque from B.

Partial failure of consideration not consisting of money [Section 45]

Where a part of the consideration for which a person signed a promissory note, bill of exchange or cheque, **though not consisting of money**, is ascertainable in money without collateral enquiry, and there has been a failure of that party, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

Sl. no.	Instruments with/without consideration	Liabilities of the parties
1.	Instrument made without consideration	creates no obligation of payment between the parties to the transaction
2.	Instrument made with consideration consisted of money, absent in part	a holder standing in immediate relation with such signer is entitled to receive from signerthe proportionally reduced sum.
3.	On partial failure of consideration not consisting of money	a holder standing in immediate relation with such signer is entitled to receive from him the proportionally reduced sum.

Holder's right to duplicate of lost bill [Section 45A]

Where a bill of exchange has been lost before it is overdue,

- the person who was the holder of it may apply

- to the drawer to give him another bill of the same tenor,
- giving security to the drawer, if required,
- to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again.

If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so.

8. PRESENTMENT OF NEGOTIABLE INSTRUMENTS

Presentation means showing the instrument the drawee, acceptor or maker for acceptance, sight or payment. There are three kinds of presentments:

1. Presentment of bills of exchange for acceptance.
2. Presentment of promissory notes for sight.
3. Presentment of negotiable instrument for payment.

Presentment for acceptance

The bill should be presented for acceptance by a person entitled to receive the payment. Thus, a bill must be presented by the holder or his duly authorised agent (Sec. 64)

It is only bills of exchange of certain types that need acceptance. A bill payable on demand or at sight or on a certain fixed date need not be presented for acceptance unless in such a case it is specially mentioned that such a bill is to be presented for acceptance. In case of a bill payable at sight or on demand as there is only one presentment if the bill is not paid, it is really dishonoured for non-acceptance.

"Acceptance" in regard to a bill of exchange is a technical term. It does not mean 'taking' or 'receiving'. Acceptance of a bill of exchange is the signification by the drawee of his assent to the order of the drawer. In other words, it is the drawee's signed engagement to honour the bill of exchange as presented.

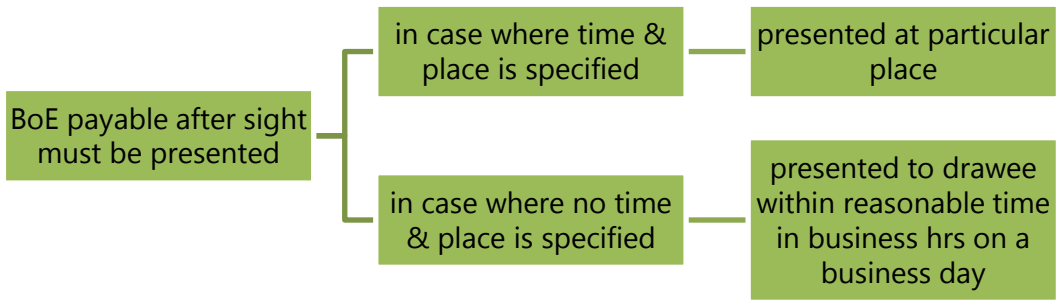
The following bills must be presented for acceptance in order to make the parties to the bill liable thereon:

(a) A bill payable after sight. Bills payable after sight mean bills payable after acceptance. Such bills of exchange must be presented for acceptance. In order to fix their date of maturity, but they may be negotiated even before acceptance.

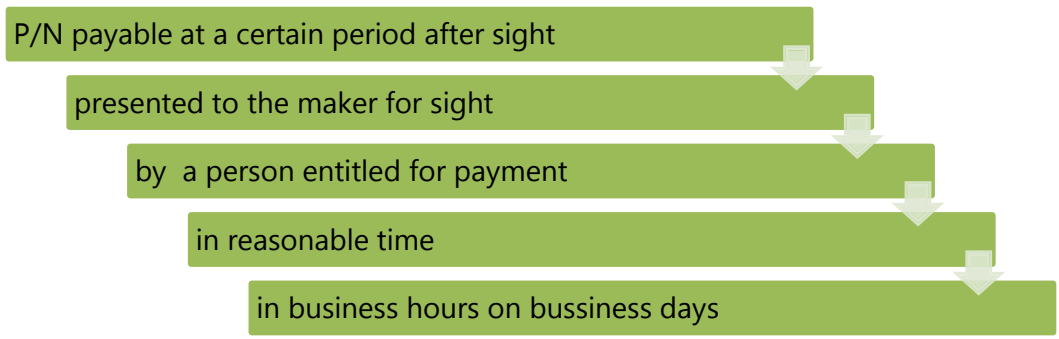
(b) A bill in which there is an express condition that is shall be presented for acceptance before it is presented for payment.

Unless otherwise provided, it is only a bill of exchange payable after sight which requires acceptance (Sec. 61). With respect to other bills there is no express provision in the Act requiring presentment of acceptance before presenting them for payment and there is nothing in the Act to prevent such bill being presented for acceptance. But whether the bill is payable after sight or at sight or on demand, acceptance by the drawee is necessary before he can be fixed with liability on it.

Sec. 63 provides that the holder of a bill must allow the drawee 48 hours (excluding of public holidays) to consider whether he will or will not accept the bill. It may be noted that as per Sec. 83 if the holder allows more time, all the previous parties not consenting to such allowance are discharged from liability to such holder.



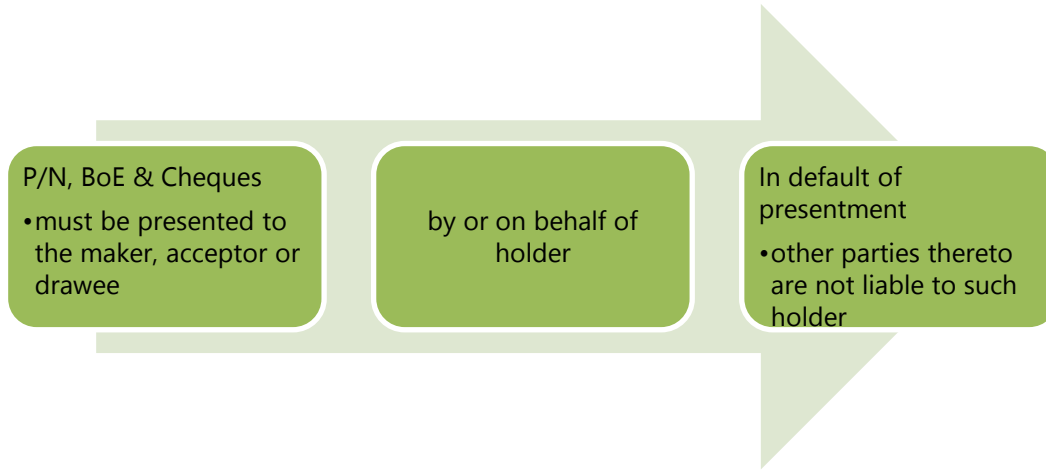
Presentment of promissory note for sight [Section 62]



A promissory note, payable at a certain period after sight, must be presented to the maker thereof for sight (if he can after reasonable search be found) by a person entitled to demand payment, within a reasonable time after it is made and

in business hours on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default.

Presentment for payment [Section 64]



Promissory notes, bill of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder as hereinafter provided.

In default of such presentment, the other parties thereto are not liable thereon to such holder.

Where authorized by agreement or usage, a presentment through the post office by means of a registered letter is sufficient.

Exception: Where a promissory note is payable on demand and is not payable at a specified place, no presentment is necessary in order to charge the maker thereof.

Time for presentment

As per sec. 65, presentment for payment must be made during usual (actual) hours of business of the maker of acceptor and in case of banker presentment must be made within banking hours. Thus, a presentment made during unusual hours of business, though valid for the purposes of acceptance and sight, is valid for purposes of acceptance and sight, is valid for purpose of payment.

Sec. 66 lays down that a promissory note or bill of exchange payable at a specified period after date or sight thereof, must be presented for payment at maturity. Presentment before maturity is not a valid presentment.

According to Sec. 67, a promissory note payable by instalments must be presented for payment on the third day after the date fixed for payment of each instalment (thus every instalment is entitled to three days of grace). Non-payment of single instalment has the same effect as non-payment of a note at maturity. Thus, if a single instalment is not paid the whole of the note can be treated as dishonoured by non-payment

Place of presentment

A promissory note, bill of exchange or cheque made, drawn or accepted payable at a specified place and not elsewhere must, in order to charge any party thereto, be presented for payment at that place (Sec. 68). Thus, acceptor will also be discharged in case an instrument is not presented at the specified place. "specified place" implies the precise address of the place; the mere mention of a big city like 'Madras' is not sufficient *[Sivaram v jayaram AIR 1996 Mad 297]*.

Sec. 69 provides for the presentment of a bill or note made payable at a specified place in order to charge the drawer or the maker. Sec 70 provides that where no place is specified, the note or bill must be presented for payment at the place of business (if any) or at usual place of residence, of the maker drawee or acceptor thereof, as the case may be.

It has been held that if the place of business is closed or abandoned, and there is some other place where his business is conducted which can be ascertained from reasonable inquiries, presentment at the former place is not sufficient.

Sec. 71 provides for cases when maker, etc. has no known place of business or residence. If the maker, drawee or acceptor of a negotiable instrument has no known place of business of fixed residence, and no place is specified in the instrument, presentment for acceptance for payment may be made to him in person wherever he can be found

Presentment of cheque to charge drawer

Subject to the provisions of section 84, a cheque must, in order to charge the drawer, be presented at the bank on which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer.

Presentment of instrument payable at demand

Subject to the provisions of section 31, a negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.

Excuse for delay in presentment for acceptance or payment [Section 75A]

Delay in presentment for acceptance or payment is excused if the delay is caused by circumstances beyond the control of holder and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, presentment must be made within reasonable time.

When presentment unnecessary

No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases:

(a)
- if the maker, drawee or acceptor **intentionally prevents the presentment** of the instrument, or
- If the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or
- If the instrument being payable at some other specified place, neither he nor any person authorized to pay it attends at such place during the usual business hours, or
- If the instrument not being payable at any specified place, he cannot after due search be found;

(b) as against any party sought to be charged therewith, if he has **engaged to pay notwithstanding non-presentment**;

(c) as against any party if, after maturity, with knowledge that the **instrument has not been presented**—
- he makes a part payment on account of the amount due on the instrument, or
- promises to pay the amount due therein whole or in part, or
- otherwise waives his right to take advantage of any default in presentment for payment;

(d) as against the drawer, if the **drawer could not suffer damage from the want of such presentment.**

Liability of banker for negligently dealing with bill presented for payment [Section 77]

When a bill of exchange, accepted payable at a specified bank, has been duly presented there for payment and dishonored, if the banker so negligently or

improperly keeps, deals with or delivers back such bill as to cause loss to the holder, he must compensate the holder for such loss.

9. PAYMENT AND INTEREST

To whom payment should be made [Section 78]

Subject to the provisions of section 82, clause (c), payment of the amount due on a promissory note, bill of exchange or cheque must, in order to discharge the maker or acceptor, be made to the holder of the instrument.

Section 82(c) of the Act provides that the maker, acceptor, or endorser respectively of a negotiable instrument is discharged from liability thereon by payment to all parties thereto, if the instrument is payable to bearer, or has been endorsed in blank, and such maker, acceptor or endorser makes payment in due course of the amount due thereon.

Interest when rate specified	Interest when no rate specified
Where interest rate is expressly made payable on P/N, BoE—Interest shall be calculated at the rate specified on the amount of the principal money due thereon, from the date of the instrument, until tender or realization of such amount, or until such date after the institution of a suit to recover such amount as the court directs.	**When no rate of interest is specified in the instrument**—Interest on the amount due thereon shall be calculated at the rate of 18% per annum, from the date at which the same ought to have been paid by the party charged, until tender or realization of the amount due thereon, or until such date after the institution of a suit to recover such amount as the court directs. **Explanation:** When the party charged is the indorser of an instrument dishonoured by non-payment- he is liable to pay interest only from the time that he receives notice of the dishonour.

10. DISCHARGE FROM LIABILITY ON NOTES, BILLS AND CHEQUES

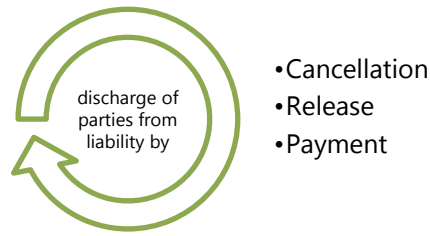
When a party, who is liable on a negotiable instrument, ceases to be liable he is said to be discharge from liability. Discharge from liability of a party to an instrument is different from the discharge of negotiable instrument itself. When only some of the parties to an instrument are discharged from liability but others continue to be liable thereon, it is only discharge of some of the parties from liability.

When the rights against all the parties on an instrument come to an end, the instrument is discharged. After the instrument is discharged no person, even a holder in due course, can claim the amount of the instrument from any party thereto.

Thus, when the maker of a promissory note or the acceptor of a bill is discharged, all the other parties liable on the instrument are automatically discharged and in that case the instrument itself is deemed to be discharged. So long as the instrument is discharged it can continue to be negotiated.

Chapter VII (Sections 82 to 90) of the N.I Act deal with the discharge of the parties on a negotiable instrument.

Modes of discharge from liability on Instruments



As per section 82 the maker, acceptor or indorser of a negotiable instrument is discharged from liability thereon by cancellation, release or payment. Further, there are other modes of discharge of liability that co-exist (along with section 82) as prescribed under various sections of the Negotiable Act.

Thus, the parties to the negotiable instrument may be discharged in the following ways—

(a) **By cancellation [S. 82 (a)]**— When the holder of a negotiable instrument or his agent cancels the name of a party on the instrument with an intention to discharge him, such party and all subsequent parties, who have a right of recourse against the party whose name is cancelled, are discharged from liability to the holder.

(b) **By release [S. 82 (b)]**— Where the holder of a negotiable instrument releases any party to the instrument by any method other than cancellation, the party so released is discharged from liability.

For **example** discharge by an agreement between the parties, and includes waiver, release, accord and satisfaction.

The party so released and all parties subsequent to him who have a right of action against the party so released are discharged from liability. Thus, the effect of release is the same as that of cancelling a party's name.

(c) **By payment**— When payment on an instrument is made in due course, both the instrument and the parties to it are discharged subject to the provision of Sec. 82 (c)[Sec. 78]. The payment on an instrument may be made by any party to the instrument. It may even be made by a stranger provided it is made on account of the party liable to pay

(d) **By the holder allowing the drawee of a bill more than 48 hours to accept-** If the holder of a bill of exchange allows the drawee more than forty eight hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder. [Section 83]

(e) **By the holder agreeing to a qualified or limited acceptance of bill of exchange [Section 86]:** If the holder of a bill agrees to a qualified acceptance all prior parties whose consent is not obtained to such an acceptance are discharged from liability. Acceptance of a bill is deemed to be qualified, for example, when the acceptance is conditional, declaring the payment to be dependent on the happening of an event therein stated, or wherein alters the payment of the sum ordered to be paid, or when the acceptor accepts to pay at a specified place only and not elsewhere.

(f) **By the drawer not duly presenting a cheque for payment** [Section 84]: If a holder does not present a cheque within reasonable time after its issue, and the bank fails causing damage to the drawer, the drawer is discharged as against the holder to the extent of the actual damage suffered by him.

Example: "A draws a cheque for ₹ 1000 and, when the cheque ought to be presented, has funds at the bank to meet it. The bank fails before the cheque is presented. The drawer is discharged, but the holder can prove against the bank for the amount of the cheque"

Example: "A draws a cheque at Ambala on a bank in Kolkata. The bank fails before the cheque could be presented in ordinary course. A is not

discharged, for he has not suffered actual damage through any delay in presenting the cheque".

(g) **By the bill coming to the acceptor's hands after maturity**

If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished (Sec. 90). This rule is based on the general principle that a **present right and liability united in the same person cancel each other.**

(h) **Discharge by material alteration**

"Any material alteration of negotiable instruments renders the same void as against anyone who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties" (First para, Sec. 87)

The second para of sec. 87 provides that "if a material alteration is made by an indorsee, the indorser will be discharged from his liability even in respect of the consideration thereof." If the holder of a negotiable instrument makes a material alteration of instrument he loses his right of action against those parties who would otherwise have been liable towards him.

The provisions of Sec. 87 are subject to those of sections 20, 49, 86 and 125. It is generally an accepted rule of law that a material alteration of an instrument by a party to it, without the consent of the other party, renders it void.

By material alteration the identity of original instrument is destroyed and those parties who had agreed to be liable on the original instrument can't be made liable on the new contract contained in the altered instrument to which they never consented (*Gour Chandra vs Prasanna Kumar 33 Cal 812*). It makes no difference whether the alteration is made by a party who is in possession of the same, or by a stranger while the instrument was in the custody of a party, because the party in custody of instrument is bound to preserve it in its integrity. The rule is defended on the ground that no man shall be permitted to take the chance of committing a fraud without running any risk of loss by the event when it is detected.

The party who consents to the alteration as well as the party who makes the alteration are disentitled to complain against such alteration e.g. the drawer of the cheque himself altered the date of the cheque for validating or re-validating the same instrument, he cannot take advantage of it by saying

that the cheque becomes void as there was a material alteration thereto. It is always open to a drawer to voluntarily re- validate a negotiable instrument including a cheque *[Veera Exports v T. Kalavathy (2002) 1 SCC97*].

Alteration must be material: An alteration is **material** which in any way alters the operation of the instrument and affects the liability of parties thereto. **Any alteration is material (a) which alters the business effect of the instrument if used for any business purpose; (b) which causes it to speak a different language in legal effect form that which it originally spoke or which changes the legal identity or character of the instrument.**

By material alteration, the liability of the parties is avoided, whether the change be prejudicial or beneficial to the parties. A material alteration is one which varies the rights, liabilities or legal position of the parties as ascertained by the original instrument [*Loonkaran sethiya v Ivan E. John (1977) SCC*].

"The following alteration are specifically declared to be material: any alteration of (i) the date, (ii) the sum payable, (iii) the time of payment, (iv) the place of payment, or the addition of a place of payment."

Following are the examples of material alteration:-

a. Alteration of date e.g. time of payment accelerated or postponed, or where date in the instrument inserted subsequent to the execution of instrument *(A. Subba Reddy v Neelapa Reddy AIR 1966 A.P. 267).*

b. Alteration of rate of interest (if specified) [*Seth Tulsidas Lalchand v Rajagopal (1967) 2 MLJ 66*].

c. Alteration of the sum payable, e.g. a bill for ₹ 5000 altered into a bill for ₹ 500.

d. Alteration in the time of payment, e.g. a bill payable 3 months after date is altered to be payable 1 month after date.

e. Alteration of the place of payment e.g. change of bank at which the bill is payable [*Tidamarsh v Grover (1813) 23 LJ QB 261*]. Likewise, alteration by addition of place for payment e.g. where a place of payment is not given but is subsequently added without the acceptor's consent.

f. Alteration by addition of parties (from one maker/payee to two makers/payees).

g. Alteration by tearing material part of the instrument.

h. Alteration by increasing or affixing stamps (*Challamma v Padmanabhan Nair 1970 KLR 682).*

i. Alteration by erasure of an "account payee" crossing *(J. Ladies Beauty v State Bank of Indian AIR 1984 Guj33].*

j. Alteration of an order cheque to a bearer cheque, except by or with consent of the drawer.

The following alterations do not affect the liability of parties thereto

(a) If the alteration is unintentional and due to pure accident (e.g. accidental disfigurement of document).

(b) Alteration made by a stranger without the consent of holder and without any fraud and negligence on his part

(c) An alteration made to correct a clerical error or a mistake, thus, if instead of 1823, the date entered was 1832, the agent of drawer held entitled to correct mistake [*Brutt v pikard (1824) Ry & M 37*]. Such correction is deemed to be giving effect to the original intention of the parties.

(d) Alteration made to carry out common intention of original parties is permitted by Sec. 87. For example, where the words "or order" after the name of payee, inserted subsequently [*Byrom v Thomson (1839) 11 A&E 31*]

(e) Alteration with the consent of the parties liable thereto.

(f) An alteration made before the completion or the issue of negotiable Instrument.

(g) A material alteration doesn't affect the liability of those parties who become liable after the alteration is made. Sec. 88 provides that the acceptor or indorser is bound by his acceptance or indorsement notwithstanding any previous alteration of the instrument.

(h) An alteration which is not material e.g. when a bill payable to bearer is converted to bill payable to order/or an incomplete name of a person converted into the complete name of same person.

(i) **Alterations permitted by Sec. 87 (Exceptions to Sec. 87)**

(a) **Sec. 20** – Incomplete instrument (e.g. column of sum left blank) can be filled up by the holder.

(b) **Sec. 49** – It enables the holder of an instrument indorsed in blank to convert it into indorsement in full (BY writing above the indorser's signature a direction to pay to any other person as indorsee). Thus, addition of parties allowed here.

(c) **Sec. 125**- the holder of an uncrossed cheque may cross it, or may convert general into special crossing or may make it 'not negotiable'.

(d) **Apparent alteration –** The alteration should be apparent on the face of the instrument otherwise it remains a valid security in the hands of a HDC. Sec. 89 provides that where a an instrument has been materially altered but doesn't appear to have been so altered, the party paying it will be discharged by payment in due course.

But in such case, the acceptor is liable only for the original tenor of the instrument and not for its altered tenor.

Similarly, where a cheque at the time of presentment is crossed but the crossing is not apparent, the banker will be discharged by payment in due course.

Example 1: A promissory note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. As per the above provision of the Negotiable Instruments Act, 1881 this is not a material alteration as a promissory note where no date of payment is specified will be treated as payable on demand. Hence adding the words "on demand" does not alter the business effect of the instrument.

Example 2: State whether the following alterations are material alterations under the Negotiable Instruments Act, 1881?

(i) The holder of the bill inserts the word "or order" in the bill,

(ii) The holder of the bearer cheque converts it into account payee cheque,

Answer: The following materials alterations have been authorised by the Act and do not require any authentication:

(a) filling blanks of inchoate instruments [Section 20]

(b) Conversion of a blank endorsement into an endorsement in full [Section 49]

11. DISHONOR OF NEGOTIABLE INSTRUMENTS

Dishonour of a bill

A bill may be dishonoured by:

(a) Non-acceptance, or

(b) Non- payment.

Dishonour by Non-acceptance

A bill of exchange is said to be dishonoured by non-acceptance is any one of the following ways (Sec. 91):

(a) When a bill is duly presented for acceptance, and the drawee, or one of several drawees not being partners, refuse acceptance within forty eight hours form the time of presentment, the bill is dishonoured. In other words, when the drawee makes default in acceptance upon being duly required to acceptance upon being duly required to accept the bill.

(b) Where the drawee is incompetent to contract, the bill may be treated as dishonoured.

(c) When a drawee gives a qualified acceptance, the holder may treat the instrument dishonoured.

(d) When presentment for acceptance is excused, and the bill is not accepted, it said to be dishonoured.

Also, when the drawee is a fictitious person or after reasonably search cannot be found, the bill may be treated as dishonoured

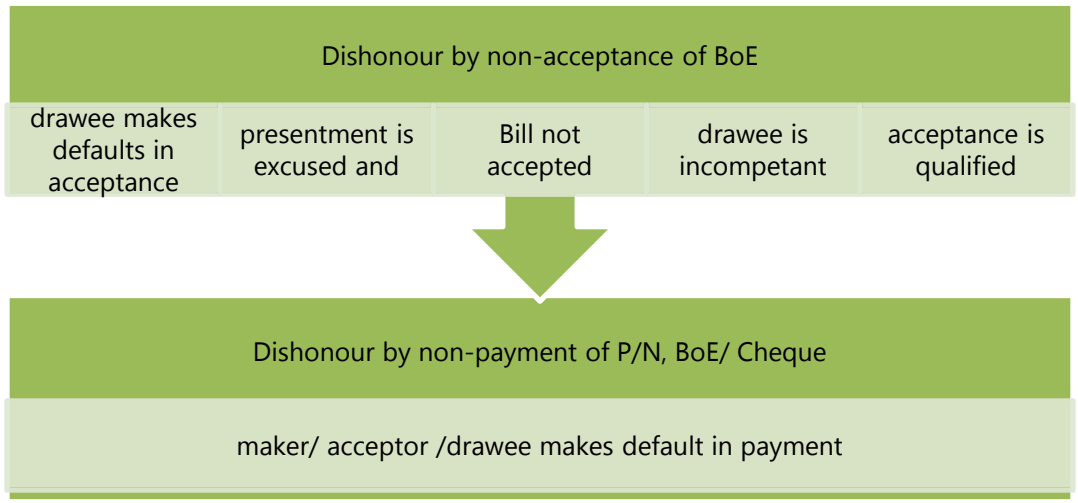
The effect of dishonoured by non-acceptance is that the holder of the bill can start an action against the drawer and the indorsers and need not wait for maturity of the bill.

Dishonour by non-payment

A promissory note, bill of exchange and cheque is said to be dishonoured by **non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same (Sec. 92).**

Again, a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid (Sec. 76).

Where a promissory note was sent by registered post and the party liable refused to receive the post, the bill was held to be dishonoured [*K. Venkatasubbayya v P.R. Rao Tobacco Co. AIR 1972 A.P.72*]



Notice of Dishonor

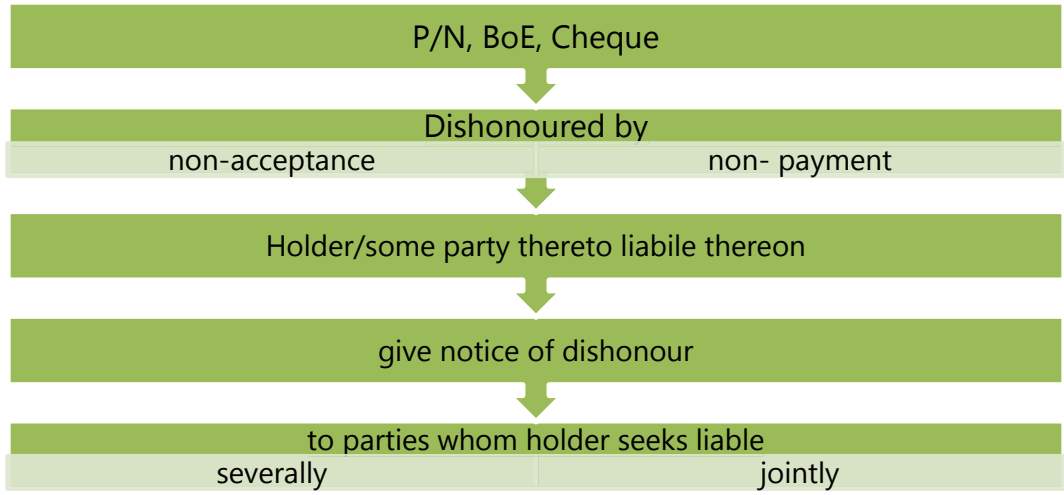
When negotiable instrument is dishonoured either by non-acceptance or by non payment, **the holder must give a notice of dishonour to the drawer or his previous holder** in order to make them liable on the instrument. If he fails to do so, except in cases when notice of dishonour maybe excused, he will forfeit his right of action against prior parties entitled to the notice of dishonour.

Object of notice of Dishonour

The object of notice of dishonour is **to inform (or warn) the party** or the person who is liable on instrument about the dishonour of the instrument. Also, in the case of drawer to enable him to protect himself as against the drawee or acceptor who has dishonoured his bill. The notice is necessary whatever the nature of the instrument i.e. whether it is payable at sight or on demand or whether it is an accommodation bill.

In order to make the drawer liable, on the dishonour by the drawee or the acceptor, it is necessary that a 'notice of dishonour' must have been given to him. The omission on the part of holder to give due notice of dishonour would discharge the drawer not only from his liability upon the cheque, but also upon the original debtor consideration. The doctrine of notice of dishonour is based upon the principle of just and equity.

By and to whom notice should be given [Section 93]



Notice by whom: Notice of dishonour must be given by the holder, or by a person liable on the instrument. But it is not necessary that the notice should always emanate from the holder, for he is entitled to avail himself of a notice given by any party liable on the instrument. Notice of dishonour given by the stranger is of no effect. Even a notice given by a party to the instrument is not valid, if at the time of giving such notice he is not liable thereon.

Notice to whom: Notice of dishonour must be given to all parties other than the maker or the acceptor or the drawee whom the holder seeks to make liable. Notice of dishonour to the acceptor of a bill or to the maker of a note or the drawee of cheque is not necessary. They are the parties primarily liable upon the instrument, on the due date and at the proper place. It is they who dishonour the instrument by no-acceptance or non-payment, and notice to them will merely be notice of fact already known to them.

Modes of giving notice

Notice of dishonour may be given to a duly authorized agent of the person to whom it is required to be given, or, where he has died, to his legal representative or, where he has been declared insolvent, to his assignee; may be oral or written; may, if written, be sent by post; and may be in any form; but it must inform the party to whom it is given, either in express term or by reasonable in intendment, that the instrument has been dishonoured, and in what way, and that he will be held liable thereon; and it must be given within reasonable time after dishonour, at the place of business or (in case such party has no place of business) at the residence of the party for whom it is intended.

If the notice is duly directed and sent by post and miscarries, such miscarriage does not render the notice invalid (Sec. 94).

Party receiving must transmit notice of dishonour

Any party receiving notice of dishonour must, in order to render any prior party liable to himself, give notice of dishonour to such party within reasonable time, unless such party otherwise receives due notice as provided by Sec. 93 (Sec. 95).

Thus, a person receiving notice must transmit it to prior parties whom he wishes to make liable to himself because the holder may have omitted to give notice to some of the prior parties.

Agent of presentment

When instrument is deposited with an agent for presentment, the agent is entitled to the same time to give notice to his principal as if he were the holder giving notice of dishonour, and the principal is entitled to a further like period to give notice of dishonour (Sec. 96).

When party to whom notice given is dead

When the party to whom notice of dishonour is dispatched is dead, but the party dispatching the notice is ignorant of his death, the notice is sufficient (Sec. 97).

When notice of dishonor is unnecessary [Section 98]

No notice of dishonour is necessary,-

(a) **waiver:** when it is dispensed with by the party entitled thereto; A waiver of notice may be made at the time of drawing or indorsing the instrument, or before or after the time for giving notice has arrived. A waiver by a party to receive notice ensures for the benefit of all the parties coming after him.

(b) in order to charge the drawer, when he has **countermanded payment**;

(c) **No damage**: when the party charged could not suffer damages for want of notice;

(d) when the **party** entitled to notice **cannot** after due search **be found**; or the party bound to give notice is, for any other reason, unable without any fault of his own to give it;

(e) to charge the drawers, when **the acceptor is also a drawer**;

(f) in the case of a promissory note which is not negotiable;

(g) **Promise to pay**: when the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

Examples: Is notice of dishonour necessary in the following cases:

(1) X having a balance of ₹ 1,000 with his bankers and having no authority to over draw, drew a cheque for ₹ 5,000/-. The cheque was dishonored when duly presented for repayment.

(2) X, drawer of a Bill informs Y, the holder of the bill that the bill would be dishonored on the presentment for payment.

Answer: Notice of dishonour is not necessary in both the cases. [Section 98 of the Negotiable Instruments Act, 1881].

12. NOTING AND PROTEST

Noting [Section 99]

When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument, or upon a paper attached thereto, or partly upon each.

Such note must be made within a reasonable time after dishonour, and must specify the date of dishonour, the reason, if any assigned for such dishonour, or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary's charges.

'Noting' must contain the following particulars (Sec. 90):

(1) The fact of dishonour

(2) The date of dishonour,

(3) The reasons, if any, assigned for such dishonour,

(4) If the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured; and

(5) The notary's charges.

'Noting' must be made by the notary within a reasonable time after dishonour (Sec. 99).

Noting is not compulsory in the case of an inland bill or note. The omission to get the instrument noted does not in any way affect the rights of the holder thereon. Noting is, however, compulsory in case of foreign bills.

Protest [Section 100]

When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest.

Contents of protest

Protest is based upon noting. A protest, in order to be valid, must contain all the following particulars:

1. The instrument itself or a literal transcript of the instrument and of everything written or printed thereupon.
2. The name of the person for whom and against whom the instrument has been protested.
3. The fact and reasons for dishonour (a statement that payment or acceptance, or better security, as the case may be, has been demanded of such person by the notary public; the terms of his answer, if any, or a statement that he gave no answer, or that he could not be found). A notary public may make the demand either in person or by his clerk or, where authorized by agreement or usage, by registered letter.
4. The place and time of dishonour (and, when better security has been refused, the place and time of refusal).
5. The subscription (signature) of the notary public.
6. In case of acceptance for honor or payment for honor, the name of the person accepting or paying and the name of the person for whose honor it is accepted or paid (sec. 101)

Protest for better security: When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand better security of the acceptor, and on its being refused may, with a reasonable time, cause such facts to be noted and certified as aforesaid. Such certificate is called a protest for better security.

Noting	Protest
P/N, BoE, Cheque has been dishonoured by non-acceptance or non-payment— the holder may cause such dishonour to be noted by a notary public upon- • the instrument, or • upon a paper attached thereto, or • partly upon each	P/N or BoE has been dishonoured by non-acceptance or non-payment— the holder may, cause such dishonour to be • noted, and • certified by a notary public

Notice of protest

When a promissory note or bill of exchange is required by law to be protested, notice of such protest must be given instead of notice of dishonour, in the same manner and subject to the same conditions; but the notice may be given by the notary public who makes the protest (Sec. 102).

Protest for Non-payment after dishonour by Non-acceptance

All bills of exchange drawn payable at some other place than the place mentioned as the residence of the drawee, and which are dishonoured by non-acceptance, may, without further presentment to the drawee, be protested for non-payment, in the place specified for payment, unless paid before or at maturity (Sec. 103).

Protest of Foreign Bills

Foreign bills of exchange must be protested for dishonour when such protest is required by law of the place where they are drawn (Sec. 104)

Thus, foreign bills must be protested as the law of most countries has made protest compulsory in case of dishonour of a bill.

REASONABLE TIME

In determining what is reasonable time of presentment for acceptance or payment, for giving notice of dishonour and for noting, regards shall be had to the nature of the instrument and the usual course of dealing with respect to similar instrument; and, in calculating such time, public holidays shall be excluded (Sec. 105).

Reasonable time of giving notice of dishonour

If the holder and the party to whom notice of dishonour is given carry on business or live (as the case may be) in different place, such notice is given within

a reasonable time if it is dispatched by the next post or on the day next after the day of dishonour

If the said parties carry on business or live in the same place, such notice is given within a reasonable time if it is dispatched in time to reach its destination on the date next after the day of dishonour (Sec. 106).

Reasonable time for transmitting such notice

A party receiving notice of dishonour, who seeks to enforce his right against a prior party, transmits the notice within a reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder (Sec. 107).

13. CROSSING OF CHEQUES [SECTION 123 – 131]

There are two types of cheques**, open cheques** and **crossed cheques**. A cheque which can be presented to the banker and can be paid at the counter of the bank is called an open cheque. If the drawer loses an open cheque, the finder of it may go to the bank and get payment unless its payment has been stopped. The finder may also transfer it to a holder in due course who is entitled to the money represented by the cheque. It was to prevent the losses incurred by open cheques getting into the hands of wrong person.

When a cheque bears across its face two parallel transverse lines, the cheque is said to be crossed. The lines are usually drawn on the left hand top corner, but may be drawn anywhere.

Meaning of crossing: Crossing of a cheque means an instruction to the drawee i.e. the paying bank that the payment is not to be made at the counter but through a bank.

Objects of Crossing: A crossing is a warning to the bank not to make payment of the crosses cheque over the counter. Crossing operates as a caution to the paying banker.

i) ***Crossing affects the mode of payment of cheque-*** An open or uncrossed cheque is payable to the payee or holder at the counter of the bank. In such a case, if a wrong person takes away the payment of cheque, it is difficult to trace him.

The payment of a cross cheque can be obtained only through a banker. Thus, crossing is a mode of assuring that only the rightful holder (i.e. the person entitled to receive money) gets payment.

ii) ***Crossing does not affect the transferability or negotiability of cheque-***a crossed cheque can be negotiated just the same way as an open cheque. A person acquiring a crossed cheque in good faith becomes its holder in due course just as in case of open cheque**.**

iii) ***Crossing is a material alteration*** but crossing of cheque by the holder does not in any way affect his rights in respect of cheques (section 125).

TYPES OF CROSSING:

(a) ***General Crossing:*** Where a cheque bears across its face two parallel, transverse lines without any words or with words 'and company' or/and 'not negotiable' written in between these two parallel lines, it is called general crossing. Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker (Sec. 126)

(b) ***Special Crossing:*** where the lines of crossing bear the name of a banker either with or without any additional words. The effect is that its payment can be obtained only through particular banker whose name appears between the lines.

According to Sec. 127, where a cheque is crossed specially to more than one banker, the banker on whom it is drawn shall refuse payment thereof except where the banker to whom it is crossed may cross it specially to another banker, his agent for collection.

(c) ***A/c payee crossing:*** When the words "A/C payee" or "A/C payee only" are added to a general or special crossing, it is called restrictive crossing. The effect of "Account payee" crossing is that the banker is supposed to collect the cheque on behalf of that payee only whose name appears on the face of the cheque. If banker collects this cheque from an endorsee (i.e. person other than named payee), he can be held responsible in case that endorsee turns out to be a wrongful holder of cheque. Thus liability of a banker enhances to a great extent. Such type of crossing is not statutorily recognised.

(d) ***Not negotiable Crossing:*** This requires writing of words "not negotiable" in addition to the two parallel lines. These words may be written inside or outside these lines. According to Section 130, a person taking a cheque crossed generally or specially, bearing in either case the word "not negotiable" shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it. It is a statutory crossing. A cheque with such crossing is not negotiable, but

continues to be transferable as before. Ordinarily, in a negotiable instrument, if the title of the transferor is defective, the transferee, if he is a HDC, will have a good title. When the words "not negotiable" are written, even a HDC will get the same title as that of transferor. Thus, if the title of the transferor is defective, the title of transferee will also be so.

Thus, the addition of the words not negotiable does not restrict the further transferability of the cheque, but it entirely takes away the main feature of negotiability, which is that a holder with a defective title can give a good title to the subsequent holder in due course.

Who may cross? [Section 125]

A cheque may be crossed by the following parties:

(a) *By Drawer:* A drawer may cross it generally or specially.

(b) *By Holder:* A holder may cross an uncrossed cheque generally or specially. If the cheque is crossed generally, the holder may cross specially. If cheque crossed generally or specially, he may add words "not negotiable".

(c) *By Banker:* A banker may cross an uncrossed cheque, or if a cheque is crossed generally he may cross it specially to himself. Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker, his agent, for collection.

PROTECTION OF LIABILITY OF THE PAYING BANKER:

The banker who makes the payment of a crossed cheque is called the paying banker.

(a) **Cheque payable to order [Section 85(1)]:** Where a cheque payable to order **purports to be endorsed by or on behalf of the payee**, the banker is discharged by payment in due course. The banker, in other words, can debit his customers account even though the endorsement by the payee might turn out to be forgery or the endorsement might have been placed by the payee's agent without his authority.

(b) **Cheque payable to bearer [Section 85(2)]:** As regards bearer cheque the rule is "once a bearer always a bearer". A banker gets a good discharge by payment in due course of the amount on a bearer cheque to the holder of the cheque. It does not matter whether the apparent holder is the owner of the cheque or not.

(c) **Payment of cheque crossed generally:** Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker.

(d) **Payment of cheque crossed specially**: Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection.

(e) **Payment in due course of crossed cheque [Section 128]**: Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque, and (in case such cheque has come to the hands of the payee) the drawer thereof, shall respectively be entitled to the same rights, and be placed in the same position in all respects, as they would respectively be entitled to and placed in if the amount of the cheque had been paid to and received by the true owner thereof

(f) **Payment of crossed cheque out of due course [Section 129]**: Any banker paying a cheque crossed generally otherwise than to a banker, or a cheque crossed specially otherwise than to the banker to whom the same is crossed, or his agent for collection, being a banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.

EXCEPTION: Payment of a cheque on which drawer signatures were forged: If any drawee banks made the payment on a cheque on **which drawer signatures were forged** then such bank shall be liable to the true owner. Thus, the paying banker shall be liable if it makes the payment of the cheque on **which drawers signature was forged.**

PROTECTION OF LIABILITY OF THE COLLECTING BANKER

The bank which receives the payment of a crossed cheque on behalf of its customer is known as the **collecting banker.**

Section 131- Non liability of banker receiving payment of cheque: A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title of the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment.

In order to avail such a protection, the banker needs to prove the following:

(a) That the banker had received the payment of crossed cheque

(b) That the collection was made by the bank on behalf of the customer

(c) That the collecting bank must have acted in good faith and without negligence.

14. DISHOUNOUR OF CHEQUES FOR INSUFFICIENCY OF FUNDS IN THE ACCOUNTS [SECTION 138 TO 142]

DISHONOR OF CHEQUE FOR INSUFFICIENCY, ETC., OF FUNDS IN THE ACCOUNTS [SECTION 138]

Where any cheque drawn by a person on an account maintained by him with a banker—

- For payment of any amount of money
- to another person from out of that account
- For the discharge, in whole or in part, of any debt or other liability, [A cheque given as gift or donation, or as a security or in discharge of a mere moral obligation, or for an illegal consideration, would be outside the purview of this section]
- is returned by the bank unpaid,
- either because of the—
    - amount of money standing to the credit of that account is insufficient to honor the cheque, or
    - that it exceeds the amount arranged to be paid from that account by an agreement made with that bank,

Such person shall be deemed to have committed an offence and shall, be punished with imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of the cheque, or with both:

Provided that this section shall not apply, unless—

(a) Cheque presented within validity period: The cheque has been presented to the bank within a period of three months from the date on which it is drawn or within the period of its validity, whichever is earlier.

(b) Demand for the payment through the notice: the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer of the

cheque, within 30 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid, and

(c) Failure of drawer to make payment: the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

Explanation: For the purpose of this section, "debt or other liability" means a legally enforceable debt or other liability.

Example: X issued a post- dated cheque to Y on the account of discharge of its liability. Further, X instructed to the bank to make the stop payment due to unavailability of the adequate amount in the account. Here, in this instance section 138 of the Act is attracted as when a cheque is dishonoured on account of stop payment instructions sent by the drawer to his banker in respect of a post-dated cheque irrespective of insufficiency of funds in the account. A post-dated cheque is deemed to have been drawn on the date it bears and the three months period for the purposes of section 138 is to be counted from that date. So, X will be liable for dishonour of cheque. Once a cheque is issued by the drawer a presumption under section 139 must follow.

Penalty: According to Section 138 of the Act, the dishonour of cheque is a criminal offence and is punishable with imprisonment upto 2 years or fine upto twice the amount of cheque or both.

PRESUMPTION IN FAVOR OF HOLDER [SECTION 139]

When a cheque is dishonoured, it shall be presumed, unless the contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, or any debt or other liability.

Presumption prescribed here is a "rebuttable presumption" as the provisions clearly provides that the person issuing the cheque is at liberty to prove to the contrary. The effect of this presumption is to place the evidential burden on the accused.

DEFENCE WHICH MAY NOT BE ALLOWED IN ANY PROSECUTION UNDER SECTION 138 [SECTION 140]

It shall not be a defence in a prosecution of an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.

OFFENCES BY COMPANIES [SECTION 141]

(1) If the person committing an offence under section 138 is a company, every person who, at the time the offence was committed—

- was in charge of, and
- as responsible to the company for the conduct of the business of the company,

as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Exception: Provided that nothing contained in this sub-section shall render any person liable to punishment if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence.

Where a person is nominated as a director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or State Government, as the case may be, he shall not be liable for prosecution under the chapter.

(2) Where any offence under this Act, has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation: For the purpose of this section

(a) "company" means anybody corporate and includes a firm or other association of individuals; and

(b) "director", in relating to a firm, means a partner in the firm.

Example: A promoter who has borrowed a loan on behalf of company, who is neither a director nor a person-in-charge, sent a cheque from the companies account to discharge its legal liability. Subsequently, the cheque was dishonoured and the complaint was lodged against him. Is he liable for an offence under section 138?

Answer: According to Section 138 of the Negotiable Instruments Act, 1881 where any cheque drawn by a person on an account maintained by him with a banker

for payment of any amount of money to another person from/out of that account for discharging any debt or liability, and if it is dishonoured by banker on sufficient grounds, such person shall be deemed to have committed an offence and shall be liable. However, in this case, the promoter is neither a director nor a person-in-charge of the company and is not connected with the day-to-day affairs of the company and had neither opened nor is operating the bank account of the company. Further, the cheque, which was dishonoured, was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Therefore, he has not committed an offence under section 138.

COGNIZANCE OF OFFENCES [SECTION 142]

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973—

(a) **Cognizance on written complaint:** Notwithstanding anything contained in Code of Criminal Procedure, 1973, a written complaint should have been made to a metropolitan or a first class judicial magistrate by the payee, or HDC of the cheque.

(b) **Limitation for filing of complaint:** such complaint is made **within one month** of the date on which the cause of action arises under clause (c) of the proviso to section 138;

Provided that the cognizance of a complaint may be taken by the court after the prescribed period, if the complainant satisfies the court that he had sufficient cause for not making a complaint within such period.

(c) **Jurisdiction of court:** no court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under section 138.

(2) **Jurisdiction of courts for the trial of offence [Section 142 (2)]:** The offence under section 138, which deals with the dishonor of cheque, shall be inquired into and tried only by a court within whose local jurisdiction,—

(a) **if the cheque is delivered for collection through an account**, the branch of the bank where the payee or holder in due course, as the case may be, **maintains the account**, is situated; or

(b) **if the cheque is presented for payment by the payee or holder in due course**, **otherwise through an account**, the branch of the drawee bank where the drawer maintains the account, is situated.

Explanation— For the purposes of clause (a), where a cheque is delivered for collection at any branch of the bank of the payee or holder in due course, then, the cheque shall be deemed to have been delivered to the branch of the bank in which the payee or holder in due course, as the case may be, maintains the account."

Example: Mr. A holds an account in Navrangpura Branch, Ahmedabad of "XYZ" Bank, issues a cheque payable in favor of B. B, who holds an account with the M.S University Road Branch, Vadodara of the "PQR" bank, deposits the said cheque at Surat Branch of 'PQR bank' and the cheque is dishonored. The complaint will have to be filed before the court having jurisdiction where the M.S University road branch is situated.

VALIDATION FOR TRANSFER OF PENDING CASES [SECTION 142A]

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 or any judgment, decree, order or direction of any court, all cases transferred to the court having jurisdiction under sub-section (2) of section 142, as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, shall be deemed to have been transferred under this Act, as if that sub-section had been in force at all material times.

(2) Notwithstanding anything contained in sub-section (2) of section 142 or sub-section (1), where the payee or the holder in due course, as the case may be, has filed a complaint against the drawer of a cheque in the court having jurisdiction under sub-section (2) of section 142 or the case has been transferred to that court under sub-section (1) and such complaint is pending in that court, all subsequent complaints arising out of section 138 against the same drawer shall be filed before the same court irrespective of whether those cheques were delivered for collection or presented for payment within the territorial jurisdiction of that court.

The above sub-section deals with respect to filing of subsequent complaints. The payee has filed a complaint against the drawer in a court with the appropriate jurisdiction, all subsequent complaints against that person regarding cheque bouncing will be filed in the same court. This will be irrespective of the mode of presentation of cheque.

(3) If, on the date of the commencement of the Negotiable Instruments (Amendment) Act, 2015, more than one prosecution filed by the same payee or holder in due course, as the case may be, against the same drawer of cheques is pending before different courts, upon the said fact having been brought to the

notice of the court, such court shall transfer the case to the court having jurisdiction under sub-section (2) of section 142, as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, before which the first case was filed and is pending, as if that sub-section had been in force at all material times.

This sub-section deals with where more than one case filed by the same payee against the same drawer before different courts. If more than one case is filed by the same payee against the same drawer before different courts, the case will be transferred to the court with the appropriate jurisdiction before which the first case was filed.

POWER OF COURT TO TRY CASES SUMMARILY [SECTION 143]

(1) **Trial of Offence:** Notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences under this Chapter shall be **tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate** and the provisions of sections 262 to 265 (both inclusive) of the said Code shall, as far as may be, apply to such trials.

In case of summary trial: Provided that in the case of any conviction in a summary trial under this section, it shall be lawful for the Magistrate to pass a sentence of **imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees.**

In case where no summary trial can be made: Provided further that when at the commencement of, or in the course of, a summary trial under this section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the said Code.

(2) **Speedy Trial:** The trial of a case under this section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the Court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

(3) **Speedy and efficient Disposal:** Every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint.

POWER TO DIRECT INTERIM COMPENSATION [SECTION 143A]

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Court trying an offence under section 138 may order the drawer of the cheque to pay interim compensation to the complainant—

(a) in a summary trial or a summons case, where he pleads not guilty to the accusation made in the complaint; and

(b) in any other case, upon framing of charge.

(2) The **interim compensation under sub-section (1) shall not exceed twenty per cent**. of the amount of the cheque.

(3) The **interim compensation shall be paid within sixty days from the date of the order** under sub-section (1), or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the drawer of the cheque.

(4) If the drawer of the cheque is acquitted, the Court shall direct the complainant to repay to the drawer the amount of interim compensation, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.

(5) The interim compensation payable under this section may be recovered as if it were a fine under section 421 of the Code of Criminal Procedure, 1973.

(6) The amount of fine imposed under section 138 or the amount of compensation awarded under section 357 of the Code of Criminal Procedure, 1973, shall be reduced by the amount paid or recovered as interim compensation under this section.

OFFENCES TO BE COMPOUNDABLE [SECTION 147]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973 every offence punishable under this Act shall be compoundable.

POWER OF APPELLATE COURT TO ORDER PAYMENT PENDING APPEAL AGAINST CONVICTION [SECTION 148]

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, in an appeal by the drawer against conviction under section 138, the Appellate Court may order the appellant to deposit such sum which shall be

a minimum of twenty per cent. of the fine or compensation awarded by the trial Court:

Provided that the amount payable under this sub-section shall be in addition to any interim compensation paid by the appellant under section 143A.

(2) The amount referred to in sub-section (1) shall be deposited within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the appellant.

(3) The Appellate Court may direct the release of the amount deposited by the appellant to the complainant at any time during the pendency of the appeal:

Provided that if the appellant is acquitted, the Court shall direct the complainant to repay to the appellant the amount so released, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.

Explanation: Thus, Section 148 provides that in the event of the conviction of the drawer of the cheque, if the drawer proceeds to file an appeal, the appellant court has the power to order the drawer of a cheque to deposit an amount. This deposited amount has to be a minimum of 20% of the fine or compensation awarded by the Magistrate Court in the appeal preferred against his/her conviction. This amount can be ordered anytime during the pendency of the appeal. The procedure relating to payment of the above stated fine and refund of the same if the appeal succeeds, is similar to what has been laid down in Section 143A of the Act.

SUMMARY

- A promissory note is an unconditional undertaking, written and signed by the maker to pay a certain sum of money only to or to the order of a certain person. It does not include a bank note or currency note.
- A bill of exchange is an unconditional written order signed by the drawer, directing a certain person to pay a certain sum of money to the specified person or to his order or to the bearer of the bill.

- A cheque is a bill of exchange drawn on a specified banker and payable only on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.
- A bearer instrument is one which is expressed to be payable to its bearer or which has last endorsement in blank.
- An instrument payable to order is the one which is expressed to be payable to a particular person.
- A negotiable instrument drawn or made in India and made payable in, or drawn upon any person resident in India shall be deemed to be inland instrument.
- Any instrument which is not an inland instrument is a foreign instrument.
- When the nature of an instrument is not clear, it is termed as ambiguous instrument. There such an instrument may be treated as either promissory or as a bill of exchange.
- Inchoate instrument is an instrument that is signed and duly stamped but otherwise wholly or partially blank.
- "At sight", "on presentment", expressions in reference to promissory note or bill of exchange means on demand. Whereas expression "After sight" in a case of promissory note means after presentment for sight and in reference to bill of exchange means after acceptance/noting/protest for non-acceptance.
- Maturity is the date of any instrument at which its payment becomes due. Any instrument is at maturity on the third day after the day on which it is expressed to be payable.
- Negotiation means transfer of a negotiable instrument by one person to another in order to make the transferee the holder of the instrument.
- Negotiation may be made by delivery or by endorsement and delivery.
- Parties to an instrument- Every person capable of contracting may bind himself and be bound by the making/ drawing/ acceptance/ indorsement / delivery and negotiation of an instruments. Minor is an exception, binding all the parties except himself.
- An agent can make, accept or indorse a negotiable instrument only if express authority has been granted to him by his principal.

- A bank under certain conditions may refuse payment of cheque or is bound to dishonor cheque and when the cheque is dishonored for insufficiency of funds in the account of a customer, it is treated as offence. The guilty may be punished with imprisonment for a term which may extend to two years or with fine of twice the amount of the cheque or with both.
- Mode of discharge–The instrument is discharged when rights and obligations or claims of all the parties are extinguished.
- Material Alteration means the alteration in the material part of the instrument resulting in the alteration in the basic parts of the nature and legal effects of the instruments and the liabilities of the parties.
- An instrument is dishonored by non-acceptance and non-payment of the instrument when duly presented.
- Notice of dishonor is served by the holder formally against the parties to the effect that instrument has been dishonored by non-acceptance or non-payment.
- Noting is the process of recording the fact and reasons of dishonor of a negotiable instrument by the notary public.
- Protest is a certificate issued by a notary public attesting the fact of dishonor of a negotiable instrument recorded upon the instrument.
- Important difference between the two is that noting consists of recording the fact and reasons of dishonor of N.I upon the instrument whereas protest is the certificate as to the fact that instrument has been dishonored.
- Payment of the amount due on instruments must be made to the holder with an interest at the specified rate expressly made payable on a promissory note or a bill of exchange. When no rate of interest is specified in the instrument, interest on the amount due shall be calculated at the rate of 18% per annum from the date at which the instrument ought to have been paid until realization of such amount.
- In respect, to decide the rights of parties on the basis of negotiable instrument, the Court is entitled to make certain presumptions of consideration, as to date, as to time of acceptance, as to time of transfer, as to order of indorsements, as to stamps and that holder is a holder in due course.
- The compensation payable by any party liable to the holder or any endorser in case of dishonor of an instrument shall be determined by the rules given under Section 117 of the Act.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Person named in the instrument to whom money is directed to be paid—
   (a) Drawer
   (b) Acceptor
   (c) Maker
   (d) Payee
2. Maker of a bill of exchange is called as—
   (a) Drawer
   (b) Drawee
   (c) Acceptor
   (d) Payee
3. Days of grace provided to the Instruments at maturity is—
   (a) 1 day
   (b) 2 days
   (c) 3 days
   (d) 5 days
4. Parties to a negotiable instrument can be discharged from liability by—
   (a) Cancellation
   (b) Payment
   (c) Release
   (d) All of the above
5. Validity period for the presentment of cheque in bank is—
   (a) 3 months
   (b) 6 months
   (c) 1 year
   (d) 2 years

6. Offences committed under the Negotiable Instruments Act can be—
   (a) Compoundable
   (b) Non- compoundable
   (c) Non- compoundable and non-bailable
   (d) bailable
7. A negotiable instrument that is payable to order can be transferred by:
   (a) Simple delivery
   (b) endorsement and delivery
   (c) endorsement
   (d) registered post
8. A negotiable instrument drawn in favor of a minor is
   (a) Void
   (b) void but enforceable
   (c) Valid
   (d) none of the above

Answers to MCQs

1. (d) **2.** (a) **3.** (c) **4.** (d) **5.** (a) **6.** (a)
7. (b) **8.** (c)

QUESTION AND ANSWER

Question 1

Explain the meaning of 'Holder' and 'Holder in due course' of a negotiable instrument. The drawer, 'D' is induced by 'A' favor a cheque in favor of P, who is an existing person. 'A' instead of sending the cheque to 'P', forgoes his name and pays the cheque into his own bank. Whether 'D' can recover the amount of the cheque from 'A's banker. Decide.

Answer

Meaning of 'Holder' and the 'Holder in due course' of a negotiable instrument: 'Holder': Holder of negotiable instrument means as regards all

parties prior to himself, a holder of an instrument for which value has at any time been given.

'Holder in due course': (i) In the case of an instrument payable to bearer means any person who, for consideration became its possessor before the amount of an instrument payable. (ii) In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable. (iii) He had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor from whom he derived his title.

The problem is based upon the privileges of a 'holder in due course'. Section 42 of the Negotiable Instrument Act, 1881, states that an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due cause claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer. In this problem, P is not a fictitious payee and D, the drawer can recover the amount of the cheque from A's bankers

Question 2

Discuss with reasons, whether the following persons can be called as a 'holder' under the Negotiable Instruments Act, 1881:

(i) X who obtains a cheque drawn by Y by way of gift.

(ii) A, the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.

(iii) M, who finds a cheque payable to bearer, on the road and retains it.

(iv) B, the agent of C, is entrusted with an instrument without endorsement by C, who is the payee.

(v) B, who steals a blank cheque of A and forges A's signature.

Answer

Person to be called as a holder: As per section 8 of the Negotiable Instruments Act, 1881 'holder' of a Negotiable Instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

On applying the above provision in the given cases—

(i) Yes, X can be termed as a holder because he has a right to possession and to receive the amount due in his own name.

(ii) No, he is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.

(iii) No, M is not a holder of the Instrument though he is in possession of the cheque, so is not entitled to the possession of it in his own name.

(iv) No, B is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.

(v) No, B is not a holder because he is in wrongful possession of the instrument.

Question 3

M drew a cheque amounting to ₹ 2 lakh payable to N and subsequently delivered to him. After receipt of cheque N endorsed the same to C but kept it in his safe locker. After sometime, N died, and P found the cheque in N's safe locker. Does this amount to Indorsement under the Negotiable Instruments Act, 1881?

Answer

No, P does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him. (Section 48, the Negotiable Instruments Act, 1881)

Question 4

M owes money to N. Therefore, he makes a promissory note for the amount in favor of N, for safety of transmission he cuts the note in half and posts one half to N. He then changes his mind and calls upon N to return the half of the note which he had sent. N requires M to send the other half of the promissory note. Decide how rights of the parties are to be adjusted.

Answer

The question arising in this problem is whether the making of promissory note is complete when one half of the note was delivered to N. Under Section 46 of the N.I. Act, 1881, the making of a P/N is completed by delivery, actual or constructive. Delivery refers to the whole of the instrument and not merely a part of it. Delivery of half instrument cannot be treated as constructive delivery of the whole. So, the claim of N to have the other half of the P/N sent to him is not

maintainable. M is justified in demanding the return of the first half sent by him. He can change his mind and refuse to send the other half of the P/N.

Question 5

P draws a bill on Q for ₹ 10,000. Q accepts the bill. On maturity, the bill was dishonored by non-payment. P files a suit against Q for payment of ₹ 10,000. Q proved that the bill was accepted for value of ₹ 7,000 and as an accommodation to the plaintiff for the balance amount i.e. ₹ 3,000. Referring to the provisions of the Negotiable Instruments Act, 1881 decide whether P would succeed in recovering the whole amount of the bill?

Answer

As per Section 44 of the Negotiable Instruments Act, 1881, when the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

Explanation—The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note, bill of exchange or cheque stands in immediate relation with the payee, and the endorser with his endorsee. Other signers may by agreement stand in immediate relation with a holder.

On the basis of above provision, P would succeed to recover ₹ 7,000 only from Q and not the whole amount of the bill because it was accepted for value as to ₹ 7,000 only and an accommodation to P for ₹ 3,000.

Question 6

State briefly the rules laid down under the Negotiable Instruments Act for determining the date of maturity of a bill of exchange. Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2018.

Answer

Calculation of maturity of a Bill of Exchange: The maturity of a bill, not payable on demand, at sight, or on presentment, is at maturity on the third day after the day on which it is expressed to be payable (Section 22, of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of bill payable on demand, at sight, or presentment.

When a bill is made payable at stated number of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance. When it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates with the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date a bill made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or the day of presentment for acceptance or sight or the day of protest for non-accordance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable (Section 22).

When the last day of grace falls on a day which is public holiday, the instrument is due and payable on the next preceding business day (Section 25).

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 4th May, 2018. The period of 100 days ends on 12th August, 2018 (May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15th August, 2018 which happens to be a public holiday. As such it will fall due on 14th August, 2018 i.e. the next preceding business day.

Question 7

A draws a bill on B. B accepts the bill without any consideration. The bill is transferred to C without consideration. C transferred it to D for value. Decide-.

(i) Whether D can sue the prior parties of the bill, and

(ii) Whether the prior parties other than D have any right of action inter se?

Give your answer in reference to the Provisions of Negotiable Instruments Act, 1881.

Answer

Problem on Negotiable Instrument made without consideration: Section 43 of the Negotiable Instruments Act, 1881 provides that a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

(i) In the problem, as asked in the question, A has drawn a bill on B and B accepted the bill without consideration and transferred it to C without consideration. Later on in the next transfer by C to D is for value. According to provisions of the aforesaid section 43, the bill ultimately has been transferred to D with consideration. Therefore, D can sue any of the parties i.e. A, B or C, as D arrived a good title on it being taken with consideration.

(ii) As regards to the second part of the problem, the prior parties before D i.e., A, B, and C have no right of action inter se because first part of Section 43 has clearly lays down that a negotiable instrument, made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction prior to the parties who receive it on consideration.

Question 8

Mr. V draws a cheque of ₹ 11,000 and gives to Mr. B by way of gift. State with reason whether -

(1) Mr.B is a holder in due course as per the Negotiable Instrument Act, 1881?

(2) Mr.B is entitled to receive the amount of ₹ 11,000 from the bank?

Answer

According to section 9 of the Negotiable Instrument Act, 1881, "Holder in due course" means-

- any person
- who for consideration
- becomes the possessor of a promissory note, bill of exchange or cheque (if payable to bearer), or the payee or endorsee thereof, (if payable to order),
- before the amount mentioned in it became payable, and

- without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In the instant case, Mr. V draws a cheque of ₹ 11,000 and gives to Mr. B by way of gift.

(i) Mr. B is holder but not a holder in due course since he did not get the cheque for value and consideration.

(ii) Mr. B's title is good and bonafide. As a holder he is entitled to receive ₹ 11,000 from the bank on whom the cheque is drawn.

Question 9

Bholenath drew a cheque in favour of Surendar. After having issued the cheque; Bholenath requested Surendar not to present the cheque for payment and gave a stop payment request to the bank in respect of the cheque issued to Surendar. Decide, under the provisions of the Negotiable Instruments Act, 1881 whether the said acts of Bholenath constitute an offence?

Answer

As per the facts stated in the question, Bholenath (drawer) after having issued the cheque, informs Surender (drawee) not to present the cheque for payment and as well gave a stop payment request to the bank in respect of the cheque issued to Surender.

Section 138 of the Negotiable Instruments Act, 1881, is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person out of that account for the discharge in whole or in part of any debt or liability, is informed by the bank unpaid either because of insufficiency of funds to honour the cheques or the amount exceeding the arrangement made with the bank, such a person shall be deemed to have committed an offence.

Once a cheque is issued by the drawer, a presumption under Section 139 of the Negotiable Instruments Act, 1881 follows and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of payment, it will not preclude an action under Section 138.

Also, Section 140 of the Negotiable Instruments Act, 1881, specifies absolute liability of the drawer of the cheque for commission of an offence under the section 138 of the Act. Section 140 states that it shall not be a defence in a prosecution for an offence under section 138 that the drawer had no reason to

believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.

Accordingly, the act of Bholenath, i.e., his request of stop payment constitutes an offence under the provisions of the Negotiable Instruments Act, 1881.

Question 10

Mr. Muralidharan drew a cheque payable to Mr. Vyas or order. Mr. Vyas lost the cheque and was not aware of the loss of the cheque. The person who found the cheque forged the signature of Mr. Vyas and endorsed it to Mr. Parshwanath as the consideration for goods bought by him from Mr. Parshwanath. Mr. Parshwanath encashed the cheque, on the very same day from the drawee bank. Mr. Vyas intimated the drawee bank about the theft of the cheque after three days. Examine the liability of the drawee bank.

Answer

Cheque payable to order [Section 85 of the Negotiable Instruments Act, 1881]

(1) Where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee is discharged by payment in due course.

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

As per the given facts, cheque is drawn payable to "Mr. Vyas or order". It was lost and Mr. Vyas was not aware of the same. The person found the cheque and forged and endorsed it to Mr. Parshwanath, who encashed the cheque from the drawee bank. After few days, Mr. Vyas intimated about the theft of the cheque, to the drawee bank, by which time, the drawee bank had already made the payment.

According to above stated section 85, the drawee banker is discharged when it has made a payment against the cheque payable to order when it is purported to be endorsed by or on behalf of the payee. Even though the signature of Mr. Vyas is forged, the banker is protected and is discharged. The true owner, Mr. Vyas, cannot recover the money from the drawee bank in this situation.

Question 11

Mr. S Venkatesh drew a cheque in favor of M who was sixteen years old. M settled his rental due by endorsing the cheque in favor of Mrs. A the owner of the house in which he stayed. The cheque was dishonored when Mrs. A presented it for payment

on grounds of inadequacy of funds. Advise Mrs. A how she can proceed to collect her dues.

Answer

Capacity to make, etc., promissory notes, etc. (Section 26 of the Negotiable Instruments Act, 1881): Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

However, a minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself.

As per the facts given in the question, Mr. S Venkatesh draws a cheque in favour of M, a minor. M endorses the same in favour of Mrs. A to settle his rental dues. The cheque was dishonoured when it was presented by Mrs. A to the bank on the ground of inadequacy of funds. Here in this case, M being a minor may draw, endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, M is not liable. Mrs. A can, thus, proceed against Mr. S Venkatesh to collect her dues.

Question 12

What are the circumstances under which a bill of exchange can be dishonored by non-acceptance? Also, explain the consequences if a cheque gets dishonored for insufficiency of funds in the account.

Answer

As per section 91 of the Negotiable Instruments Act, 1881, a bill may be dishonoured either by non-acceptance or by non-payment.

Dishonour by non-acceptance may take place in any one of the following circumstances:

(i) When the drawee either does not accept the bill within forty-eight hours (exclusive of public holidays) of presentment or refuse to accept it;

(ii) When one of several drawees, not being partners, makes default in acceptance;

(iii) When the drawee makes a qualified acceptance;

(iv) When presentment for acceptance is excused and the bill remains unaccepted; and

(v) When the drawee is incompetent to contract.

Dishonour of Cheque for insufficiency, etc. of funds in the account: As per section 138 of the Negotiable Instruments Act 1881, where any cheque drawn by a person on an account maintained by him with a banker for payment is dishonoured due to insufficiency of funds, he shall be punished with imprisonment for a term which may extend to two years or with fine which may extend to twice the amount of the cheque or with both.

Question 13

Rama executes a promissory note in the following form, 'I promise to pay a sum of ₹10,000 after three months'. Decide whether the promissory note is a valid promissory note.

Answer

The promissory note is an unconditional promise in writing. In the above question the amount is certain but the date and name of payee is missing make it a bearer instrument. As per RBI Act, a promissory note cannot be made payable to bearer - whether on demand or after certain days. Hence, the instrument is illegal as per RBI Act and cannot be legally enforced.

Question 14

C issues a cheque for ₹ 55,00,00/- in favour of D. C has sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank, in the meantime, C became bankrupt. Decide under the provisions of Negotiable Instruments Act, 1881, whether D can recover the money from C?

Answer

Section 84(1) of the Act, provides that cheque should be presented to Bank within reasonable time. If cheque is not presented within reasonable time, meanwhile the drawer suffers actual damage, the drawer is discharged to the extent of such actual damage. This would be so if the cheque would have been passed if it was presented within reasonable time. As per section 84(2), in determining what is a reasonable time, regard shall be had to (a) the nature of the instrument (b) the usage of trade and of bankers, and (c) facts of the particular case. The drawer will get discharge, but the holder of the cheque will be treated as creditor of the bank, in place of drawer. He "Will be entitled to recover the amount from Bank [section 84(3)]. In the above case drawer i.e. C has suffered damage as cheque was not presented by D within reasonable time. Hence, C will get discharged but D will be the creditor of bank for amount of cheque and can recover the amount from bank.

CHAPTER 3

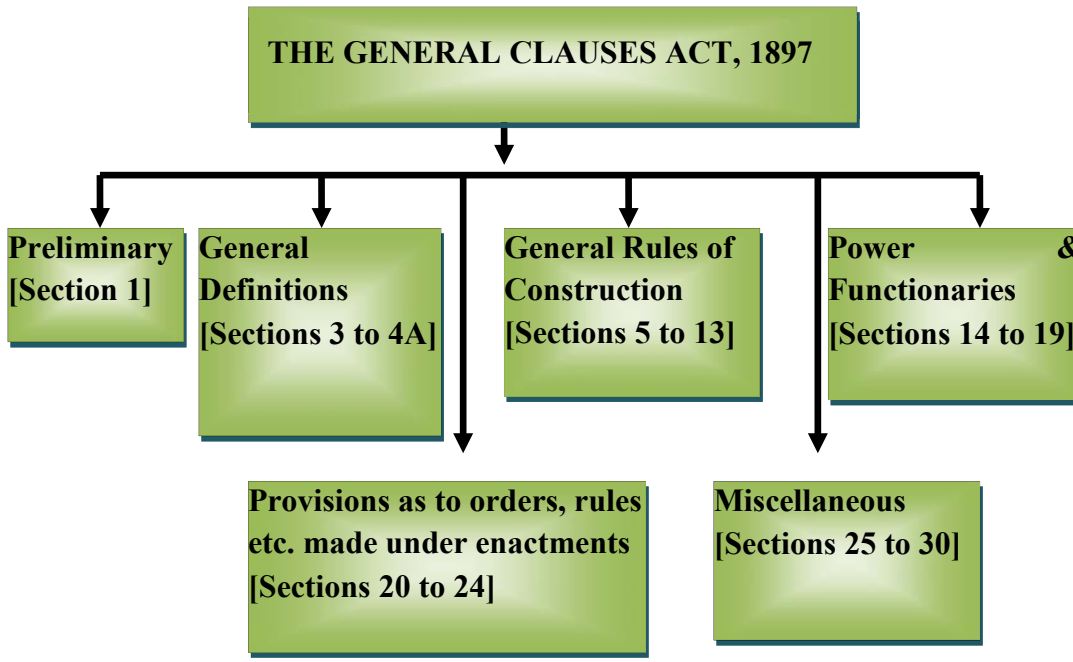
THE GENERAL CLAUSES ACT,1897

LEARNING OUTCOMES

At the end of this Chapter, you will be able to:

- Explain the purpose of General Clauses Act.
- Acquire some basic understanding of Legislation.
- Know the general definitions under the Act.
- Identify general rules of construction.
- Know powers and functionaries.
- Explain powers as to orders, rules etc. made under enactments.
- Know other miscellaneous provisions.

CHAPTER OVERVIEW



1. INTRODUCTION

Why we study General Clauses Act?

The General Clauses Act, 1897 contains 'definitions' of some words and also some general principles of interpretation. This Act intends to provide general definitions which shall be applicable to all Central Acts and Regulations where there is no definition in those Acts or regulations that emerge with the provisions of the Central Acts or regulations, unless there is anything repugnant in the subject or context.

The General Clauses Act is very effective in the absence of clear definition in the specific enactments and where there is a conflict between the pre-constitutional laws and post-constitutional laws. The Act gives a clear suggestion for the conflicting provisions and differentiates the legislation according to the commencement and enforcement to avoid uncertainty.

The General Clauses Act has been *enacted to shorten language* used in parliamentary legislation and *to avoid the repetition of the same words* in the same

course of the same piece of legislation. Act is meant to avoid the superfluity of language in a statute wherever it is possible to do so.

Example: Wherever the law provides that court will have the power to appoint, suspend or remove a receiver, the legislature simply enacted that wherever convenient the court may appoint receiver and it was implied within that language that it may also remove or suspend him. *(Rayarappan V. Madhavi Amma, A.I.R. 1950 F.C. 140)*

The General Clauses Act, 1897 was enacted on 11th March, 1897 to consolidate and extend the General Clauses Act, 1868 and 1887.

2. OBJECT, PURPOSE AND IMPORTANCE OF THE GENERAL CLAUSES ACT

The objects of the Act are several, namely:

(1) to shorten the language of Central Acts;

(2) to provide, as far as possible, for uniformity of expression in Central Acts, by giving definitions of a series of terms in common use;

(3) To state explicitly certain convenient rules for the construction and interpretation of central acts.

(4) To guard against slips and oversights by importing into every act certain common form clauses, which otherwise ought to be inserted in every central act

The purpose of the General Clauses Act is to place in one single statute different provisions as regards interpretation of words and legal principles which would otherwise have to be specified separately in many different Acts and Regulations. So, whatever General Clauses Act says whether as regards to the meaning of words or as regards legal principles, has to be read in every statute to which it applies.

The purpose of the Act has been stated by the Supreme Court in the case of The Chief Inspector of Mines v. Karam Chand Thapar. It stated that the purpose of this Act is to place in one single Statute different provisions as regards interpretation of words and legal principles which would otherwise have to be specified separately in many different Acts and regulations.5 The purpose of the Act is to avoid superfluity of language in statutes wherever it is possible to do so

The General Clauses Act, thus, makes provisions as to the construction of General Acts and other laws of all-India application. Its importance, therefore, in point of the number of enactments to which it applies, is obvious.

Much more, however, can be said about the importance of an interpretation Act, which has been called the **"Law of all Laws**". In so far as certainty in the application of the law is a desideratum (necessary) itself, an interpretation Act seeks to introduce that certainty, in the limited sphere in which it operates.

Thus, we can see that the purpose of this Act itself enshrines the importance of the Act.

- Example: A claim of the right to catch fish came under the consideration of the court in *Ananda Behera v. State of Orissa*. The court tended to decide whether the right to catch or carry fish is a movable or immovable property. It was observed
- Section 3(26) of the General Clauses Act, 1897 reads as under: - "Immovable property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth;" The S.3 Transfer of Property Act does not define the term except to say that immovable property does not include standing timber, growing crops or grass. As fish do not come under that category the definition in the General Clauses Act applies and as a profit a prendre is regarded as a benefit arising out of land it follows that it is immovable property within the meaning of the Transfer of Property Act."

Thus, the court construed "right to catch or carry fish" as an immovable property

3. APPLICATION OF THE GENERAL CLAUSES ACT

The Act not defines any "territorial extent" clause. Its application is primarily with reference to all Central legislation and also to rules and regulations made under a Central Act. It is in a sense a part of every Central Acts or Regulations. If a Central Act is extended to any territory, the General Clauses Act would also deem to be applicable in that territory and would apply in the construction of that Central Act. The Central Acts to which this Act apply are: —

(a) Acts of the Indian Parliament (central act) along with the rules and regulations made under the central act;

(b) Acts of the Dominion Legislature passed between the 15th August, 1947 and the 26th January, 1950;

(c) Acts passed before the commencement of the Constitution by the Governor-General in Council or the Governor-General acting in a legislative capacity. The Act does not define any "territorial extent" clause.

Article 367 of the Constitution of India authorises use of General Clauses Act for the interpretation of constitution. Article 367 states that

"Unless the context otherwise requires, the General Clauses Act, 1897, shall, subject to any adaptations and modifications that may be made therein under Article 372, apply for the interpretation of this Constitution as it applies for the interpretation of an Act of the Legislature of the Dominion of India".

The provisions of the General Clauses Act are mere rules of interpretation and it applies automatically in each and every case. It all depends on the facts and circumstances of each case.

In many countries, Legislatures similar to the General Clauses Act are called Interpretation Acts. But, as the provisions of the General Clauses Act (whether relating to definitions and meanings of words and terms or dealing with construction and interpretation) are, so far as may be necessary, common to every Central Act, the title "General Clauses Act" is not less appropriate than the title "Interpretation Act". **The Supreme Court had observed in the case of Chief Inspector of Mines vs. K. C. Thapar** "Whatever the General Clauses Act says, whether as regards the meanings of words or as regards legal principles, has to be read into every Act to which it applies."

The Scope and effect of each section depends upon the text of the particular section.

Example: Section 3 of the General Clauses Act, which deals with the definitional clause, applies to the General Clauses Act itself and to all Central Acts and Regulations made after the commencement of the General Clauses Act in 1897.

Similarly, **section 4** of the General Clauses Act which deals with the application of foregoing definitions to previous enactment, applies to Central Acts and after January 3, 1868 and to regulations made after January 14, 1887.

So, **there is a difference in the applicability of each section as regards** the statutes to which it applies.

The language of each section of the General Clauses Act has to be referred to ascertain to which class of instruments or enactment it applies. In certain cases,

even if no section of the General Clauses Act applies to particular case, the court applies the general principles of the General Clauses Act.

It may also be noted that the **Act also serves as a model for State General Clauses Act**. It is evident that the State General Clauses Acts should conform to the General Clauses Act of 1897, for, otherwise, divergent rules of construction and interpretation would apply and as a result, great confusion might ensue.

Before delving into the saddle of the provisions under General Clauses Act, let's have some basic understanding of law.

4. SOME BASIC UNDERSTANDING OF LEGISLATION

"Preamble": Every Act has a preamble which expresses the scope, object and purpose of the Act. It is the main source for understanding the intention of lawmaker behind the Act**. Whenever there is ambiguity in understanding any provision of Act, Preamble is accepted as an aid to construction of the Act**.

The Preamble of a Statute is a part of the enactment and can legitimately be used for construing it. However, the Preamble does not over-ride the plain provision of the Act but if the wording of the statute gives rise to doubts as to its proper construction, for example, where the words or phrase has more than one meaning and a doubt arises as to which of the two meanings is intended in the Act, the Preamble can and ought to be referred to in order to arrive at the proper construction.

In short, the Preamble to an Act discloses the primary intention of the legislature but can only be brought in as an aid to construction if the language of the statute is not clear. However, it cannot override the provisions of the enactment.

Example: (1) Preamble of the Negotiable Instruments Act, 1881 states - "An Act to define and amend the law relating to Promissory Notes, Bills of Exchange and Cheques."

(2) Preamble of the Companies Act, 2013 states – "An Act to consolidate and amend the law relating to companies."

In order to understand Preamble of the Act, it is important to know the '**Act**'. Act is a **bill passed by both the houses of Parliament and assented to by the President**. Whereas '**Bill' is a draft of a legislative proposal** put in the proper form which, when passed by both houses of Parliament and assented to by the

President becomes an Act. On getting assent from President, an Act is notified on the Official Gazettes of India.

Example: Concept paper on the Companies Act, 2013 was placed on the website of MCA on 4-8-2004. Expert committee was constituted on 2-12-2004. Committee submitted its report on 31-5-2005. Companies Bill, 2008 has introduced on 23-10-2008. New Companies Bill, 2009 was introduced in Lok Sabha on 3-8-2009. It was referred to Standing Committee on Finance. Standing committee submitted its report on 31st August, 2010. With recommended changes in the Companies Bill 2009, Companies Bill 2011 was introduced. Companies Bill, 2012 was introduced and Passed by Lok Sabha on 18-12- 2012. Passed by Rajya Sabha on 8-8-2013. Act received assent of President on 29- 8- 2013 as Companies Act, 2013. Notified in gazette on 30- 8- 2013.

"Definitions": Every Act contains definition part for the purpose of that particular Act and that definition part are usually mentioned in the Section 2 of that Act but in some other Acts, it is also mentioned in Section 3 or in other initial sections. Hence, definitions are defined in the Act itself. The object of the definition clause is to avoid the necessity of frequent repetitions in describing all the subject matter to which the word or expression so defined is intended to apply

However, if there may be words which are not defined in the definitions of the Act, the meaning of such words may be taken from General Clauses Act, 1897.

Words are defined in the respective Act. Sometimes, definitions are referred in other statutes. If words are not defined in the respective Acts, such words are to be taken from General Clauses Act.

Example (1): The word 'Company' used in the Companies Act, is defined in section 2(20) of the respective Act.

Example (2): Word 'Security' used in the Companies Act, is not defined in the respective Act. It has been defined under section 2(h) of the Securities Contracts (Regulations) Act, 1956.This word is equivalently applicable on the Companies Act, 2013. Similarly, the word 'Digital signature' used in the Companies Act, shall be construed as per the section 2(1) (p) of the Information Technology Act, 2000.

Clause 95 of Section 2 of the Companies Act, 2013 clearly says that -

Words and expressions used and not defined in this Act but defined in the Securities Contracts (Regulation) Act, 1956 (42 of 1956) or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or the Depositories Act, 1996 (22 of 1996) shall have the meanings respectively assigned to them in those Acts.

(3) The word 'Affidavit' used in section 7 during the incorporation of company, in the Companies Act, 2013, shall derive its meaning from the word 'Affidavit' as defined in the General Clauses Act, 1897.

"Means" and/or "include": Some definitions use the word "means". Such definitions are **exhaustive definitions and exactly define the term.**

Example (1): Definition of 'Company' as given in section 2(20) of the Companies Act, 2013. It states, "**Company" means** a company incorporated under this Act or under any previous company law.

Example (2): Section 2(34) of the Companies Act, 2013 defines the term director as "director" **means a** director appointed to the Board of a company.

Some definitions use the word "**include". Such definitions do not define the word but are inclusive in nature**. Where the word is defined to 'include' such and such, the definition is 'prima facie' extensive. **The word defined is not restricted to the meaning assigned to it but has extensive meaning which also includes the meaning assigned to it in the definition section**.

Example (1): Word 'debenture' defined in section 2(30) of the Companies Act, 2013 states that "**debenture" includes** debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not". This is a definition of inclusive nature.

Example (2): "Body Corporate" or "Corporation" **includes** a company incorporated outside India. [Section 2(11) of the Companies Act, 2013]

The above definition of Body Corporate does not define the term Body Corporate, but just states that companies incorporated outside India will also cover under the definition of Body Corporate, apart from other entities which are called as Body Corporate.

We may also find a word being defined as 'means and includes' such and such: here again the definition would be exhaustive.

Example: Share defined under section 2(84) of the Companies Act, 2013, states that "Share" **means** a share in the share capital of a company **and includes** stock;

On the other hand, if the word is defined 'to apply to and include', the definition is understood as extensive.

"Shall" and "May": The word **'shall'** is used to raise a presumption of something which is **mandatory or imperative** while the word **'may'** is used to connote something which is not mandatory but is **only directory or enabling**. Hence,

while interpreting any provision of law, the words "shall" and "may" have to be given utmost importance to understand what is mandatory and what is optional or directory under law.

Example (1): Section 3 of the Companies Act, 2013 states that "A company may be formed for any lawful purpose by....."

Here the word used "may" shall be read as "shall". Usage of word 'may' here makes it mandatory' for a company for the compliance of section 3 for its formation.

Example (2): Section 21 of the Companies Act, 2013, provides that documents/proceeding requiring authentication or the contracts made by or on behalf of the company, may be signed by any Key Managerial Personnel or an officer of the company duly authorised by the Board in this behalf.

Usage of the 'may' shall be read as 'may'.

The use of word 'shall' with respect to one matter and use of word 'may' with respect to another matter in the same section of a statute, will normally lead to the conclusion that the word 'shall' imposes an obligation, whereas word 'may 'confers a discretionary power *(Labour Commr., M.P.V. Burhanpur Tapti Mill, AIR, 1964 SC1687).*

In Sainik Motors v State of Rajastan J. Hidyatullah observed " the word Shall is ordinarily mandatory but it is sometimes not so interpreted if the context or the intention otherwise demands.

Our approach in this text is to provide basic understanding of law while studying any legislation. These are few concepts which every student should keep in mind while studying law. You will read the following concepts in detail in the chapter of 'Interpretation of Statutes'.

5. PRELIMINARY [SECTION 1]

"Short title" [Section 1(1)]: This Act may be called the General Clauses Act, 1897.

Preliminary is the introductory part of any law which generally contains Short Title, extent, commencement, application etc. The title although the part of the Act is in itself not an enacting provision. Every Act is given a title to carve out its own identity just like men are given their names to identify them.

The General Clauses Act contains only short title in the Preliminary part of the Act.

6. DEFINITIONS [SECTION 3]

Three sections of the General Clauses Act, i.e., sections 3 (Definitions), 4 (application of foregoing definitions to previous enactment) and 4A (Application of certain definitions to Indian laws), --contain general definitions.

Here in this chapter, we shall be discussing some of the relevant definitions or terms which are by and large seen in the Acts.

Section 3, which is the principal section containing definitions, **applies to** the **General Clauses Act itself and to post-1897 Central Acts and Regulations** unless those laws contain separate definitions of their own or there is something repugnant in the subject or context and hence definition given in section 3 cannot be applied.

Section 3 seeks to define 67 phrases and terms commonly used in enactments and are intended to serve as a dictionary for the phrases.

Bartley in his commentary on the General Clauses Act, has pointed out that a definition may be explanatory, restrictive or extensive

In this Act, and in all Central Acts and Regulations made after the commencement of this Act, unless there is anything repugnant in the subject or context-

1. **"Act" [Section 3(2)]:** 'Act', used with reference to an offence or a civil wrong, shall include a series of acts, and words which refer to acts done extend also to illegal omissions;

   An act required to be done cannot necessarily mean a positive act only and may also **include acts which one is precluded from doing from decree**. This definition is based on sections 32 and 33 of the Indian Penal Code and applies to civil wrongs as well as crimes. **'Act' includes illegal omissions as well** but it does not include an omission which is not illegal.

   In the illustration to section 36 of the Indian Penal Code, the act 'by which A causes Z's death consists of a series of acts, namely, the blows given in beating him, plus a series of illegal omissions, namely, wrongfully neglecting or refusing to supply him with food at proper times

2. **"Affidavit" [Section 3(3)]:** 'Affidavit' shall include affirmation and declaration in the case of persons by law allowed to affirm or declare instead of swearing.

   There are two important points derived from the above definition:

   1. Affirmation and declaration,

2. In case of persons allowed affirming or declaring instead of swearing.

The above definition is inclusive in nature. It states that Affidavit shall include affirmation and declarations. This definition does not define affidavit. However, we can understand this term in general parlance. Affidavit is a written statement confirmed by oath or affirmation for use as evidence in Court or before any authority.

3. **"Central Act" [Section 3(7)]: '**Central Act' shall mean an Act of Parliament, and shall include-

(a) An Act of the Dominion Legislature or of the Indian Legislature passed before the commencement of the Constitution*, and

(b) An Act made before such commencement by the Governor General in Council or the Governor General, acting in a legislative capacity;

*The date of the commencement of the Constitution is 26th January, 1950.

4. **"Central Government" [Section 3(8)]:** 'Central Government' shall-

(a) In relation to anything done before the commencement of the Constitution, mean the Governor General in Council, as the case may be; and shall include,-

(i) In relation to functions entrusted under sub-section (1) of the section 124 of the Government of India Act, 1935, to the Government of a Province, the Principal Government acting within the scope of the authority given to it under that sub-section; and

(ii) In relation to the administration of a Chief Commissioner's Province, the Chief Commissioner acting within the scope of the authority given to him under sub-section (3) of section 94 of the said Act; and

(b) In relation to anything done or to be done after the commencement of the constitution of the Constitution, mean the President; and shall include;-

(i) In relation to function entrusted under clause (1) of the article of the Constitution, to the Government of a state, the State Government acting within the scope of the authority given to it under that clause;

(ii) In relation to the administration of a Part C State before the commencement of the Constitution (Seventh Amendment) Act,

1956*, the Chief Commissioner or the Lieutenant Governor or the Government of a neighboring State or other authority acting within the scope of the authority given to him or it under article 239 or article 243 of the Constitution, as the case may be; and

(iii) In relation to the administration of a Union territory, the administrator thereof acting within the scope of the authority given to him under article 239 of the Constitution;

*The date of commencement of the Constitution (Seventh Amendment) Act, 1956 is 01st January, 1956.

The new Constitution of India, which came into force on 26 January 1950, made India a sovereign democratic republic. The new republic was also declared to be a "Union of States". Between 1947 and 1950 the territories of the princely states were politically integrated into the Indian Union. The constitution of 1950 distinguished between three main types of states and a class of territories:

Part A states, which were the former governors' provinces of British India, were ruled by a Governor appointed by the President and an elected state legislature. The nine Part A states were Assam, Bihar, Bombay, Madhya Pradesh (formerly Central Provinces and Berar), Madras, Orissa, Punjab (formerly East Punjab), Uttar Pradesh (formerly the United Provinces), and West Bengal.

Part B states, which were former princely states or groups of princely states, governed by a Rajpramukh, who was usually the ruler of a constituent state, and an elected legislature. The Rajpramukh was appointed by the President of India. The eight Part B states were Hyderabad, Jammu and Kashmir, Madhya Bharat, Mysore, Patiala and East Punjab States Union (PEPSU), Rajasthan, Saurashtra, and Travancore-Cochin.

Part C states included both the former chief commissioners' provinces and some princely states, and each was governed by a chief commissioner appointed by the President of India. The ten Part C states were Ajmer, Bhopal, Bilaspur, Coorg, Delhi, Himachal Pradesh, Cutch, Manipur, Tripura, and Vindhya Pradesh.

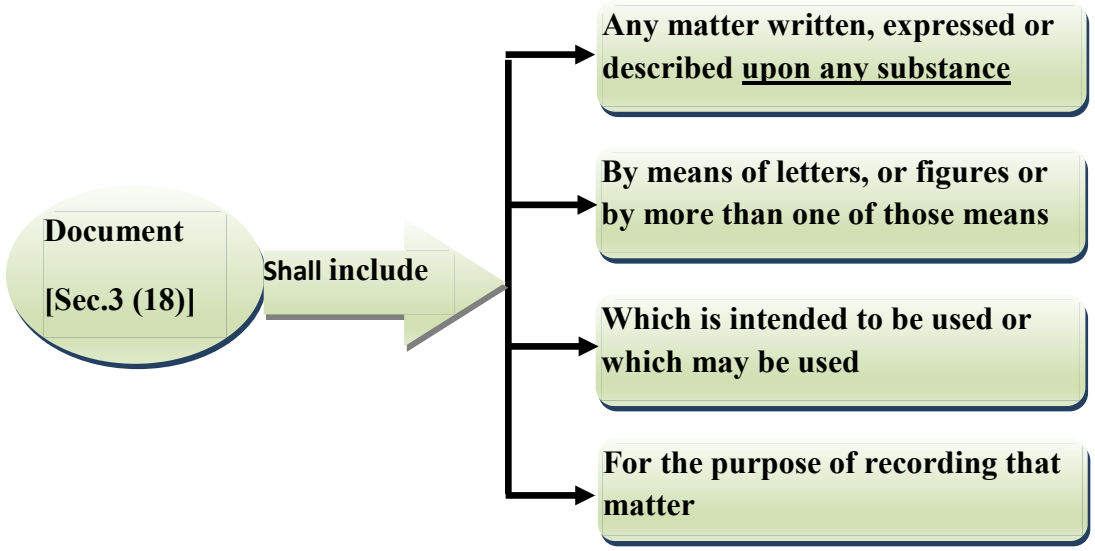
The sole **Part D** territory was the Andaman and Nicobar Islands, which were administered by a Lieutenant Governor appointed by the Central Government.

5. **"Commencement" [Section 3(13)]:** 'Commencement' used with reference to an Act or Regulation, shall mean the day on which the Act or Regulation comes into force;

Coming into force or entry into force (also called commencement) refers to the process by which legislation; regulations, treaties and other legal instruments come to have legal force and effect.

A Law cannot be said to be in force unless it is brought into operation by legislative enactment, or by the exercise of authority by a delegate empowered to bring it into operation. The theory of a statute being "in operation in a constitutional sense" though it is not in fact in operation has no validity. *[State of Orissa Vs. Chandrasekhar Singh Bhoi, Air 1970 SC 398]*

6. **"Document" [Section 3(18)]:** 'Document' shall include any matter **written, expressed** or **described** upon **any substance** by **means of letters, figures or marks** or by **more than one of those means** which is intended to be used or which may be used, for the purpose or recording that matter.



Thus, the term "Document" include any substance upon which any matter is written or expressed by means of letters or figures for recording that matter.

For example, book, file, painting, inscription and even computer files are all documents. However, it does not include Indian currency notes.

7. **"Enactment" [Section 2(19)]:** 'Enactment' shall include a Regulation (as hereinafter defined) and any Regulation of Bengal, Madras or Bombay Code,

and shall also include any provision contained in any Act or in any such Regulation as aforesaid;

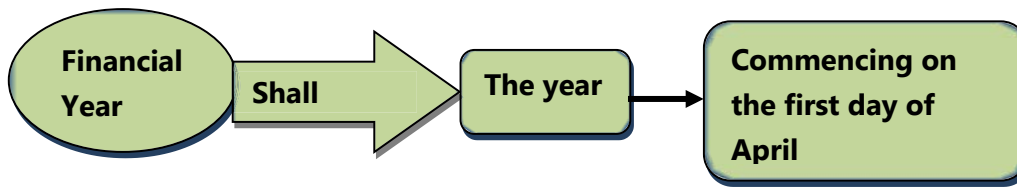
It has been held that an "enactment" would include any Act (or a provision contained therein) made by the Union Parliament or the State Legislature. Again, since "enactment" is defined to include also any provision of an Act, section 6 (Effect of repeal) would apply to a case where not only the entire Act is repealed, but also where any provision of an Act is repealed. *[State of Punjab Sukh Deo Sarup Gupta A.LR. 1970 SC 1661, 1942, para 3, affirming A.I.R. 1965 Punj. 399 and Godhra Electricity Co. v. Somalal, A.I.R. 1967 Guj. 772, 776, para 6.]*

Rules and regulation are nothing but a species of legislation. The legislature instead of enacting the same itself delegates the power to other person. Whatever is enacted by the delegate of legislature is also enactment

8. **"Financial Year" [Section 3(21)]:** Financial year shall mean the year **commencing on the first day of April.**

The term Year has been defined under Section 3(66) as a year reckoned according to the British calendar. Thus, as per General Clauses Act, Year means calendar year which starts from January to December.

Difference between Financial Year and Calendar Year: Financial year starts from first day of April but Calendar Year starts from first day of January.



9. **"Good Faith" [Section 3(22)]:** A thing shall be deemed to be done in "good faith" where it is in fact done honestly, whether it is done negligently or not;

The question of good faith under the General Clauses Act is one of fact. It is to determine with reference to the circumstances of each case. Thus, anything done with due care and attention, which is not malafide is presumed to have been done in good faith. For eg: An authority is not acting honestly where it had a suspicion that there was something wrong and did not make further enquiries

The term "Good faith" has been defined differently in different enactments. This definition of the good faith does not apply to that enactment which contains a special definition of the term "good faith" and there the definition given in that particular enactment has to be followed. This definition may be applied only if there is nothing repugnant in subject or context, and if that is so, the definition is not applicable.

In *Maung Aung Pu Vs. Maung Si Maung,* it was pointed out that the expression "good faith" is not defined in the Indian Contract Act, 1872 and the definition given here in the General Clauses Act, 1897 does not expressly apply the term on the Indian Contract Act. The definition of good faith as is generally understood in the civil law and which may be taken as a practical guide in understanding the expression in the contract Act is that nothing is said to be done in good faith which is done without due care and attention as is expected with a man of ordinary prudence. An honest purchase made carelessly without making proper enquiries cannot be said to have been made in good faith so as to convey good title.

10. **"Government" [Section 3(23)]:** 'Government' or 'the Government' shall include both the Central Government and State Government.

Hence, wherever, the word 'Government' is used, it will include Central Government and State Government both.

The object of this definition is to make it clear that the word "Government", frequently used as a convenient abbreviation, may be construed according to the context in either of the two senses indicated. Government generally connotes three wings, the Legislature, the Executive and the Judiciary; but in a narrow sense it is used to connote the Executive only. Meaning to be assigned to that expression, therefore, depends on the context in which it is used

11. **"Government Securities" [Section 3(24)]:** 'Government securities' shall mean securities of the Central Government or of any State Government, but in any Act or Regulation made before the commencement of the Constitution shall not include securities of the Government of any Part B state.

By virtue of section 4A, this definition applies to all Indian laws.

12. **"Immovable Property" [Section 3(26)]:** 'Immovable Property' shall include:

i) Land,

ii) Benefits to arise out of land, and

iii) Things attached to the earth, or

iv) Permanently fastened to anything attached to the earth.

It is an inclusive definition. It contains four elements:

a. land,

b. benefits to arise out of land,

c. things attached to the earth and

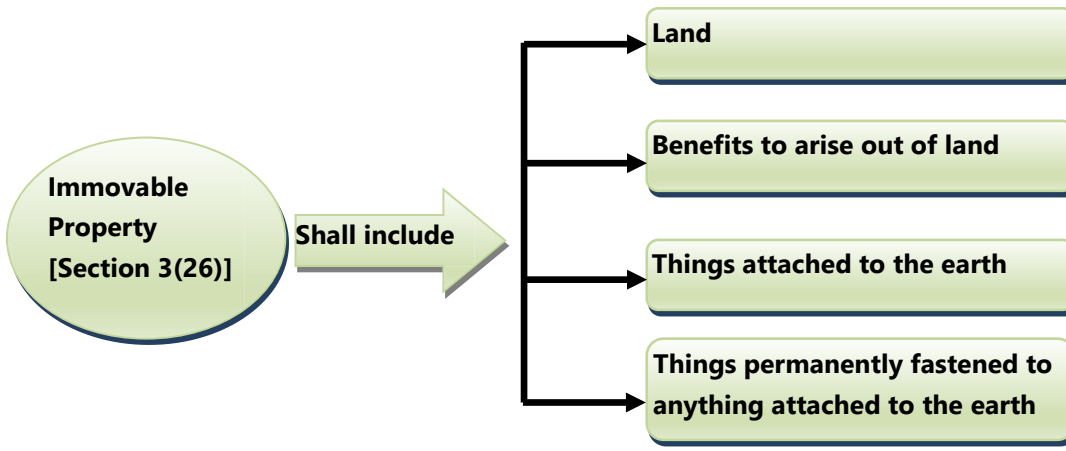
d. things permanently fastened to anything attached to the earth.

Where, in any enactment, the definition of immovable property is in the negative and not exhaustive, the definition as given in the General Clauses Act will apply to the expression given in that enactment.

Example 1:. In *Shantabai v. State of Bombay,46 the Supreme Court* pointed out that **trees must be regarded as immovable property** because they are attached to or rooted in the earth.

An agreement to convey forest produce like tendu leaves, timber bamboos etc., the soil for making bricks, the right to build on and occupy the land for business purposes and the right to grow new trees and to get leaves from trees that grow in further are all included in the term immovable property

Example 2: Right of way to access from one place to another, may come within the definition of Immovable property whereas to right to drain of water is not immovable property. Any machinery fixed to the soil, standing crops can be held as immovable property according to the General Clauses Act, 1897.



13. **"Imprisonment" [Section 3(27)]:** 'Imprisonment' shall mean imprisonment of either description as defined in the Indian Penal Code (45 of 1860);

    By section 53 of the Indian Penal Code, the punishment to which offenders are liable under that Code are imprisonment which is of **two descriptions**, namely, **rigorous**, that is with hard labour and **simple**. So, when an Act provides that an offence is punishable with imprisonment, the Court may, in its discretion, make the imprisonment rigorous or simple

14. **"Indian law" [Section 3(29)] :** 'Indian law' **shall mean** any **Act, Ordinance, Regulation, rule, order, bye law or other instrument** which before the commencement of the Constitution, had the force of law in any Province of India or part thereof or thereafter has the force of law in any Part A or Part C State or part thereof, **but does not include** any Act of Parliament of the United Kingdom or any Order in Council, rule or other instrument made under such Act;

15. **"Month" [Section 3(35)]:** 'Month' shall mean a month reckoned according to the British calendar;

    The word "month occurring in s.271 (l)(a)(i) of the Income-tax Act, 1961, was construed to mean a period of thirty days and not a month as defined in the General Clauses Act;

16. **"Movable Property" [Section 3(36)]:** 'Movable Property' shall mean property of every description, except immovable property.

    Thus, any property which is not immovable property is movable property. Debts, share, electricity are moveable property

17. **"Oath" [Section 3(37)]:** 'Oath' **shall include affirmation and declaration** in the case of persons by law allowed to affirm or declare instead of swearing.

18. **"Offence" [Section 3(38)]:** 'Offence' shall mean any act or omission made punishable by any law for the time being in force.

    Any act or omission which is if done, is punishable under any law for the time being in force, is called as offence.

19. **"Official Gazette" [Section 3(39)]:** 'Official Gazette' or 'Gazette' shall mean:

    (i) The Gazette of India, or

    (ii) The Official Gazette of a state.

The Gazette of India is a public journal and an authorised legal document of the Government of India, published weekly by the Department of Publication, Ministry of Housing and Urban Affairs. As a public journal, the Gazette prints official notices from the government. It is authentic in content, accurate and strictly in accordance with the Government policies and decisions. The gazette is printed by the Government of India Press

20. **"Person" [Section 3(42)]:** "Person" shall include:

    (i) any company, or

    (ii) association, or

    (iii) body of individuals, whether incorporated or not

21. **"Registered" [Section 3(49)]:** 'Registered' used with reference to a document, shall mean registered in India under the law for the time being force for the registration of documents.

22. **"Rule" [Section 3(51)]:** 'Rule' shall mean a rule made in exercise of a power conferred by any enactment, and shall include a Regulation made as a rule under any enactment;

23. **"Schedule" [Section 3(52)]:** 'Schedule' shall mean a schedule to the Act or Regulation in which the word occurs;

24. **"Section" [Section 3(54)]:** 'Section' shall mean a section of the Act or Regulation in which the word occurs;

25. **"Sub-section" [Section 3(61)]:** 'Sub-section' shall mean a sub-section of the section in which the word occurs;

26. **"Swear" [Section 3(62)]:** "Swear", with its grammatical variations and cognate expressions, shall include affirming and declaring in the case of persons by law allowed to affirm or declare instead of swearing.

    Note: The terms "Affidavit", "Oath" and "Swear" have the same definitions in the Act.

27. **"Writing" [Section 3(65)]:** Expressions referring to 'writing' shall be construed as including references to printing, lithography, photography and other modes of representing or reproducing words in a [1]visible forms; and

28. **"Year" [Section 3(66)]:** 'year' shall mean a year reckoned according to the British calendar.

[1] Reference of relevant definitions of section 3 is given in section 4.

Application to foregoing definitions to previous enactments [Section 4]- There are **certain definitions in section 3** of the General Clauses Act, 1897 which would **also apply to the Acts and Regulations made prior to 1987** i.e., on the previous enactments of 1868 and 1887. This provision is divided into two parts-

(1) **Application of terms/expressions to all [Central Acts] made after 3rd January, 1868, and to all Regulations made on or after the 14th January, 1887-**

Here the given relevant definitions in section 3 of the following words and expressions, that is to say, 'affidavit', 'immovable property', 'imprisonment', ''month', 'movable property', 'oath', 'person', 'section', 'and 'year' apply also, unless there is anything repugnant in the subject or context, to **all [Central Acts] made after** the **3rd January, 1868**, and to **all Regulations made on or after the 14th January, 1887.**

(2) **Application of terms/expressions to all Central Acts and Regulations made on or after the fourteenth day of January, 1887**- The relevant given definitions in the section 3 of the following words and expressions, that is to say, 'commencement', 'financial year', 'offence', 'registered', schedule', 'sub-section' and 'writing' apply also, unless there is anything repugnant in the subject or context, to all Central Acts and Regulations made on or after the fourteenth day of January, 1887.

[2]Application of certain definitions to Indian Laws [Section 4A]-

(1) The definitions in section 3 of the expressions 'Central Act', 'Central Government', ''Gazette', 'Government', 'Government Securities', 'Indian Law', and ''Official Gazette', 'shall apply, unless there is anything repugnant in the subject or context, to all Indian laws.

(2) In any Indian law, references, by whatever form of words, to **revenues of the Central Government or of any State Government shall**, on and from the first day of April, 1950, be construed as references to the Consolidated Fund of India or the Consolidated Fund of the State, as the case may be.

7. GENERAL RULES OF CONSTRUCTION: [SECTION 5 TO SECTION 13]

"Coming into operation of enactment" [Section 5]: Where any Central Act has **not specifically mentioned a particular date** to come into force, it shall be

[2]Reference of relevant definitions of section 3 is given in section 4A.

implemented on the day on which it receives the assent of the Governor General in case of a Central Acts made before the commencement of the Indian Constitution and/or, of **the President in case of an Act of Parliament**.

Example: The Companies Act, 2013 received assent of President of India on 29th August, 2013 and was notified in Official Gazette on 30th August, 2013 with the enforcement of section 1 of the Act. Accordingly, the Companies Act, 2013 came into enforcement on the date of its publication in the Official Gazette.

Where, if any specific date of enforcement is prescribed in the Official Gazette, Act shall into enforcement from such date.

Example: SEBI (Issue of Capital and Disclosure Requirements) (Fifth Amendment) Regulations, 2015 was issued by SEBI vide Notification dated 14th August, 2015 with effect from 1 January, 2016. Here, this regulation shall come into force on 1st January, 2016 rather than the date of its notification in the gazette.

The Supreme Court in *A.K. Roy v UOI, AIR 1982 SC 710*, observed that where an Act empowers the government to bring any of the provisions into operation on any day which it deems fit, no Court can issue a mandamus with a view to compel the Government to bring the same into operation on particular day.

However, in *Altemeis Rein v UOI AIR 1988 SC 1768*, it was held that if a sufficient time has elapsed since an Act or any of its provisions has been passed and it has not been brought into force (operation) by the Government, the Court through a writ can direct the Government to consider the question as to when the same should begin to operate.

In the case of *State of Uttar Pradesh v. Mahesh Narain, AIR 2013 SC 1778,* Supreme Court held that Effective date of Rules would be when the Rules are published vide Gazette notification and not from date when the Rules were under preparation.

Also, law takes no cognizance of fraction of day, thus where an Act provides that it is to come into force on the first day of January, it will come into force on as soon as the clock has struck 12 on the night of 31st Dec.

PRESUMPTION AGAINST RETROSPECTIVITY

All laws which affect substantive vested rights generally operate prospectively and there is a presumption against their retrospectivity till there are express words giving retrospective effect or where the language used necessarily implies that such retrospective operation is intended. Hence, the question whether a statutory

provision has retrospective effect or not depends primarily on the language in which it is couched.

"Effect of Repeal" [Section 6]: Where any Central legislation or any regulation made after the commencement of this Act repeals any Act made or yet to be made, unless another purpose exists, the **repeal shall not**:

- **Revive anything not enforced** or prevailed during the period at which repeal is effected or;
- **Affect the previous operation** of any enactment so repealed or anything duly done or suffered thereunder; or
- **Affect any right**, privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed; or
- **Affect any penalty**, forfeiture or punishment incurred in respect of any offence committed against any enactment so repealed; or
- **Affect any inquiry, litigation or remedy** with regard to such claim, privilege, debt or responsibility or any inquiry, litigation or remedy may be initiated, continued or insisted.

In *State of Uttar Pradesh v. Hirendra Pal Singh, (2011), 5 SCC 305,* SC held that whenever an Act is repealed, it must be considered as if it had never existed. Object of repeal is to obliterate the Act from statutory books, except for certain purposes as provided under Section 6 of the Act.

In *Kolhapur Canesugar Works Ltd. V, Union of India, AIR 2000, SC 811,* Supreme Court held that Section 6 only applies to repeals and not to omissions and applies when the repeal is of a Central Act or Regulation and not of a Rule.

In *Navrangpura Gam Dharmada Milkat Trust v. Rmtuji Ramaji, AIR 1994 Guj 75:* 'Repeal' of provision is in distinction from 'deletion' of provision. 'Repeal' ordinarily brings about complete obliteration of the provision as if it never existed, thereby affecting all incoherent rights and all causes of action related to the 'repealed' provision while 'deletion' ordinarily takes effect from the date of legislature affecting the said deletion, never to effect total effecting or wiping out of the provision as if it never existed. For the purpose of this section, the above distinction between the two is essential.

"Repeal of Act making textual amendment in Act or Regulation" [Section 6A]- Where any Central Act or Regulation made after the commencement of this Act **repeals any enactment by which the text of any Central Act or Regulation was amended** by the express **omission, insertion or substitution** of any matter,

then unless a different intention appears, the **repeal shall not affect the continuance of any such amendment made by the enactment so repealed and in operation at the time of such repeal.**

"Revival of repealed enactments" [Section 7]- (1) In any Central Act or Regulation made after the commencement of this Act, it shall be necessary, for the purpose of reviving, either wholly or partially, any enactment wholly or partially repealed, expressed to state that purpose.

(2) This section applies also to all Central Acts made after the third day of January, 1968 and to all Regulations made on or after the fourteenth day of January, 1887.

In other words, to revive a repealed statute, it is necessary to state an intention to do so.

"Construction of references to repealed enactments" [Section 8]- (1) Where this Act or Central Act or Regulation made after the commencement of this Act, repeals and re-enacts, with or without modification, any provision of a former enactment, then references in any other enactment or in any instrument to the provision so repealed shall, unless a different intention appears, be construed as references to the provision so re-enacted.

(2) Where before the fifteenth day of August, 1947, any Act of Parliament of the United Kingdom repealed and re-enacted, with or without modification, any provision of a former enactment, then reference in any Central Act or in any Regulation or instrument to the provision so repealed shall, unless a different intention appears, be construed as references to the provision so re-enacted.

In *Gauri Shankar Gaur v. State of U.P., AIR 1994 SC 169,* it was held that every Act has its own distinction. If a later Act merely makes a reference to a former Act or existing law, it is only by reference and all amendments, repeals new law subsequently made will have effect unless its operation is saved by the relevant provision of the section of the Act.

Example: In section 115 JB of the Income Tax Act, 1961, for calculation of book profits, the Companies Act, 1956 are required to be referred. With the advent of Companies Act, 2013, the corresponding change has not been made in section 115 JB of the Income Tax Act, 1961. On referring of section 8 of the General Clauses Act, book profits to be calculated under section 115 JB of the Income Tax Act will be as per the Companies Act, 2013.

"Commencement and termination of time" [Section 9]: In any legislation or regulation, it shall be sufficient, for the purpose of **excluding the first in a series** of days or any other period of time to use the word "from" and for the purpose of

including the last in a series of days or any other period of time, to use the word "to".

Example: A company declares dividend for its shareholder in its Annual General Meeting held on 30/09/2016. Under the provisions of the Companies Act, 2013, company is required to pay declared dividend within 30 days from the date of declaration i.e. from 01/10/2016 to 30/10/2016. In this series of 30 days, 30/09/2016 will be excluded and last 30th day i.e. 30/10/2016 will be included.

"Computation of time" [Section 10]: Where by any legislation or regulation, any act or proceeding is directed or allowed to be done or taken in any court or office on a certain day or within a prescribed period then, if the Court or office is closed on that day or last day of the prescribed period, the act or proceeding shall be considered as done or taken in due time if it is done or taken on the next day afterwards on which the Court or office is open.

In *K. Soosalrathnam v. Div. Engineer, N.H.C. Tirunelveli,* it was held by Madras High Court that since the last date of the prescribed period was subsequent to the date of notification, declared to be a holiday on the basis of the principles laid down in this section the last date of prescribed period for obtaining the tender schedules was extended to the next working day.

"Measurement of Distances" [Section 11]: In the measurement of any distance, for the purposes of any Central Act or Regulation made after the commencement of this Act, that distance shall, unless a different intention appears, be measured in a straight line on a horizontal plane.

"Duty to be taken pro rata in enactments" [Section 12]: Where, by any enactment now in force or hereafter to be in force, any duty of customs or excise or in the nature thereof, is leviable on any given quantity, by weight, measure or value of any goods or merchandise, then a like duty is leviable according to the same rate on any greater or less quantity.

"Gender and number" [Section 13]: In all legislations and regulations, unless there is anything repugnant in the subject or context-

(1) Words importing the masculine gender shall be taken to include females, and

(2) Words in singular shall include the plural and vice versa.

In accordance with the rule that the words importing the masculine gender are to be taken to include females, the word men may be properly held to include women, and the pronoun 'he' and its derivatives may be construes

to refer to any person whether male or female. So the words 'his father and mother' as they occur in S.125(1) (d) of the CrPC, 1973 have been construed to include 'her father and mother ' and a daughter has been held to be liable to maintain her father unable to maintain himself

But the general rule in S. 13(1) has to be applied with circumspection of interpreting laws dealing with matters of succession. Thus, the words "male descendants" occurring in S.7 and S.8 of the Chota Nagpur Tenancy Act, 1908 were not interpreted to include female descendants.

Where a word connoting a common gender is available but the word used conveys a specific gender, there is a presumption that the provisions of GC Act do not apply. Thus, the word 'bullocks' could not be interpreted to include 'cows'

Similarly, to construe previous year in S. 2(11) of the Income Tax Act to include previous years would nullify the very definition of 'previous years' enacted therein.

8. POWER AND FUNCTIONARIES [SECTION 14 TO SECTION 19]

"Power conferred to be exercisable from time to time" [Section 14]: (1) Where, by any Central Act or Regulation made after the commencement of this Act, any power is conferred, then unless a different intention appears that power may be exercised from time to time as occasion requires.

(2) This section applies to all Central Acts and Regulations made on or after the fourteenth day of January, 1887.

Relying on S.14, the SC has held that the power under S.51(3) of the States Reorganisation Act, 1956 can be exercised by the Chief Justice as and when the occasion arose for its exercise.

"Power to appoint to include power to appoint ex-officio" [Section 15]: Where by any legislation or regulation, a power to appoint any person to fill any office or execute any function is conferred, then unless it is otherwise expressly provided, any such appointment, may be made either by name or by virtue of office.

Ex-officio is a Latin word which means by virtue of one's position or office. Provision under this section states that where there is a power to appoint, the appointment may be made by appointing ex-officio as well.

"Power to appoint to include power to suspend or dismiss" [Section 16]: The authority having for the time being power to make the appointment shall also have power to suspend or dismiss any person appointed whether by itself or any other authority in exercise of that power.

Order.40, Rule 1(a) of CPC, 1908, which authorises a court to appoint a receiver, has been construed to embrace power of removing a receiver.

A.229(1) of the Constitution which empowers the Chief Justice to make appointment of officers and servants of a High Court has been interpreted to include a power to suspend or dismiss.

"Substitution of functionaries" [Section 17]: (1) In any Central Act or Regulation made after the commencement of this Act, it shall be sufficient, for the purpose of indicating the application of a law to every person or number of persons for the time being executing the functions of an office, to mention the official title of the officer at present executing the functions, or that of the officer by whom the functions are commonly executed.

(2) This section **applies also to all Central Acts made after the third day of January, 1868 and to all Regulations made on or after the fourteenth day of January, 1887.**

"Successors" [Section 18]: (1) In any Central Act or Regulation made after the commencement of this Act, it shall be sufficient, for the purpose of indicating the relation of a law to the successors of any functionaries or of corporations having perpetual succession, to express its relation to the functionaries or corporations.

(2) This section shall also apply to all Central Acts made after the third day of January, 1868 and to all Regulations made on or after the fourteenth day of January, 1887.

"Official Chiefs and subordinates" [Section 19]: A law relative to the chief or superior of an office shall apply to the deputies or subordinates lawfully performing the duties of that office in the place of their superior, to prescribe the duty of the superior. This section applies to all the 12 Central Acts made after the third day of January, 1868, and to all Regulations made on or after the fourteenth day of January, 1881.

In *K.G. Krishnayya v. State, AIR 1959* it was held that it is not essential that same statutory authority that initiated a scheme under the Road Transport Corporation Act 1950, should also implement it. It is open to the successor authority to implement or continue the same.

Similarly, in case under the **Preventive Detention Act**, where there is a change in the Advisory Board after service of the detention order, the new Advisory Board can consider the case pending before the earlier board.

9. PROVISION AS TO ORDERS, RULES ETC. MADE UNDER ENACTMENTS [SECTION 20 TO SECTION 24]

"Construction of orders, etc., issued under enactments" [Section 20]: Where by any legislation or regulation, a power to issue any notification, order, scheme, rule, form, or by-law is conferred, then expression used in the notification, order, scheme, rule, form or bye-law, shall, unless there is anything repugnant in the subject or context, have the same respective meaning as in the Act or regulation conferring power.

Example: The term 'collector' used in Rule 4 of the Land Acquisition (Companies) Rule, 1963, will have the same meaning as in Section 3(c) of the Land Acquisition Act, 1894.

In *Subhash Ram Kumar v. State of Maharashtra, AIR 2003 SC 269,* it was held that 'Notification' in common English acceptation mean and imply a formal announcement of a legally relevant fact and "notification publish in Official Gazette" means notification published by the authority of law. It is a formal declaration and should be in accordance with the declared policies or statute. Notification cannot be substituted by administrative instructions.

"Power to issue, to include power to add to, amend, vary or rescind notifications, orders, rules or bye-laws" [Section 21]: Where by any legislations or regulations a power to issue notifications, orders, rules or bye-laws is conferred, then that power, exercisable in the like manner and subject to the like sanction and conditions (if any), to add, to amend, vary or rescind any notifications, orders, rules or bye laws so issued.

In *Rasid Javed v. State of Uttar Pradesh, AIR 2010 SC 2275,* Supreme Court held that under Section 21 of the Act, an authority which has the power to issue a notification has the undoubted power to rescind or modify the notification in the like manner.

In *Shreesidhbali Steels Ltd. V. State of Uttar Pradesh, AIR 2011 SC 1175,* Supreme Court held that power under section 21 of the Act is not so limited as to be

exercised only once power can be exercised from time to time having regard to exigency of time.

"Making of rules or bye-laws and issuing of orders between passing and commencement of enactment" [Section 22]: Where, by any Central Act or Regulation which is not to come into force immediately, on the passing thereof, a power is conferred to make rules or bye-laws, or to issue orders with respect to the application of the Act or Regulation or with respect to the establishment of any Court or the appointment of any Judge or officer thereunder, or with respect to the person by whom, or the time when, or the place where, or the manner in which, or the fees for which, anything is to be done under the Act or Regulation, **then that power may be exercised at any time after passing of the Act or Regulation; but rules, bye-laws or orders so made or issued shall not take effect till the commencement of the Act or Regulation**

It is an enabling provision, its content and purpose being to facilitate the making of rules, bye laws and orders before the commencement of the enactment in anticipation of its coming into force. In other words, it validates rules, bye laws and orders made before the coming into force of the enactment, provided they are made after its passing and as preparatory to the enactment coming into force.

"Provisions applicable to making of rules or bye-laws after previous publications" [Section 23]: Where, by any Central Act or Regulation, a power to make rules or bye-laws is expressed to be given subject to the condition of the rules or bye-laws being made after previous publication, then the following provisions shall apply, namely:-

(1) The authority having power to make the rules or bye-laws shall, before making them, publish a draft of the proposed rules or bye-laws for the information of persons likely to be affected thereby;

(2) The publication shall be made in such manner as that authority deems to be sufficient, or, if the condition with respect to previous publication so requires, in such manner as the Government concerned prescribes;

(3) There shall be published with the draft a notice specifying a date on or after which the draft will be taken into consideration;

(4) The authority having power to make the rules or bye-laws, and, where the rules or bye-laws are to be made with the sanction, approval or concurrence of another authority, that authority also shall consider any objection or suggestion which may be received by the authority having power to make

the rules or bye-laws from any person with respect to the draft before the date so specified;

(5) The publication in the Official Gazette of a rule or bye-law purporting to have been made in exercise of a power to make rules or bye-laws after previous publication shall be conclusive proof that the rule or bye-laws has been duly made.

Section 23(5) raises a conclusive presumption that after the publication of the rules in the Official Gazette, it is to be inferred that the procedure for making the rules had been followed. Any irregularities in the publication of the draft cannot therefore be questioned.

It is also open to the authority publishing the draft and entitled to make the rules to **make suitable changes in the draft before finally publishing them**. It is not necessary for that authority to re-publish the rules in the amended form before their final issue so long as the changes made are ancillary to the earlier draft and cannot be regarded as foreign to the subject matter thereof.

"Continuation of orders etc., issued under enactments repealed and re-enacted" [Section 24]: Where any **Central Act or Regulation**, is, after, the commencement of this Act, **repealed and re-enacted with or without modification**, then unless it is otherwise expressly provided any appointment notification, order, scheme, rule, form or bye-law, made or issued under the repealed Act, continue in force, and be deemed to have been made or issued under the notification, order, scheme, rule, form or bye-law, made or issued under the provisions so re-enacted and when any Central Act or Regulation, which, by a notification under section 5 or 5A of the Scheduled District Act, 1874, or any like law, has been extended to any local area, has, by a subsequent notification, been withdrawn from the re-extended to such area or any part thereof, the provisions of such Act or Regulation shall be deemed to have been repealed and re-enacted in such area or part within the meaning of this section.

This section accords statutory recognition to the general principle that if a statute is repealed and re-enacted in the same or substantially the same terms, the re-enactment neutralizes the previous repeal and the provisions of the repealed Act which are re-enacted, continue in force without interruption. If however, the statute is repealed and re-enacted in somewhat different terms, the amendments and modifications operate as a repeal of the provisions of the repealed Act which are changed by and are repugnant to the repealing Act.

In *State of Punjab v. Harnek Singh, AIR 2002 SC 1074,* It was held that investigation conducted by Inspectors of Police, under the authorization of notification issued under Prevention of Corruption Act, of 1947 will be proper and will not be quashed under new notification taking the above power, till the aforesaid notification is specifically superseded or withdrawn or modified under the new notification.

The Mines Act of 1923 was repealed and replaced by the Mines Act of 1952. Rules made under the repealed Act must be deemed to continue in force by virtue of this section until superseded.

Where an Act is repealed and re-enacted, the fact that the repealed Act stated that rules made under that Act shall have effect as if enacted in the Act does not mean that the rules automatically disappear with the repeal of the Act under which they are made and that there is no room for the application of this section.

10. MISCELLANEOUS [SECTION 25 TO SECTION 30]

"Recovery of fines" [Section 25]: Section 63 to 70 of the Indian Penal Code and the provisions of the Code of Criminal Procedure for the time being in force in relation to the issue and the execution of warrants for the levy of fines shall apply to all fines imposed under any Act, Regulation, rule or bye-laws, unless the Act, Regulation, rule or bye-law contains an express provision to the contrary.

"Provision as to offence punishable under two or more enactments" [Section 26]: Where an act or omission constitutes an offence under two or more enactments, then the offender shall be liable to be prosecuted and punished under either or any of those enactments, but shall not be punished twice for the same offence.

Article 20(2) of the Constitution states that no person shall be prosecuted and punished for the same offence more than once.

According to the Supreme Court, a plain reading of section 26 shows that there is no bar to the trial or conviction of an offender under two enactments, but there is only a bar to the punishment of the offender twice for the same offence. In other words, the section provides that where an act or omission constitutes an offence under two enactments, the offender may be prosecuted and punished under either or both the enactments but shall not be liable to be punished twice for the same offence.

In State of *M.P. v. V.R. Agnihotri, AIR 1957 SC 592* it was held that when there are two alternative charges in the same trial, e.g., section 409 of the Indian Penal

Code and section 5(2) of the Prevention of Corruption Act, the fact that the accused is acquitted of one of the charges will not bar his conviction on the other

Provisions of Section 26 and Article 20(2) of the Constitution apply only when the two offences which form the subject of prosecution is the same, i.e., the ingredients which constitute the two offences are the same. If the offences under the two enactments are distinct and not identical, none of these provisions will apply

"Meaning of Service by post" [Section 27]: Where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

(i) Properly addressing

(ii) Pre-paying, and

(iii) Posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

In *United Commercial Bank v. Bhim Sain Makhija, AIR 1994 Del 181***:** A notice when required under the statutory rules to be sent by 'registered post acknowledgement due' is instead sent by 'registered post' only, the protection of presumption regarding serving of notice under 'registered post' under this section of the Act neither tenable not based upon sound exposition of law.

In *Jagdish Singh.v Natthu Singh, AIR 1992 SC 1604,* it was held that where a notice is sent to the landlord by registered post and the same is returned by the tenant with an endorsement of refusal, it will be presumed that the notice has been served.

In *Smt. Vandana Gulati v. Gurmeet Singh alias Mangal Singh, AIR 2013 All 69,* it was held that where notice sent by registered post to person concerned at proper address is deemed to be served upon him in due course unless contrary is proved. Endorsement 'not claimed/not met' is sufficient to prove deemed service of notice.

"Citation of enactments" [Section 3(28)]: (1) In any Central Act or Regulation, and in any rule, bye law, instrument or document, made under, or with reference to any such Act or Regulation, any enactment may be cited by reference to the title or short title (if any) conferred thereon or by reference to the number and years thereof, and any provision in an enactment may be cited by reference to the section or sub-section of the enactment in which the provision is contained.

(2) In this Act and in any Central Act or Regulation made after the commencement of this Act, a description or citation of a portion of another enactment shall, unless a different intention appears, be construed as including the word, section or other part mentioned or referred to as forming the beginning and as forming the end of the portion comprised in the description or citation.

"Saving for previous enactments, rules and bye laws" [Section 29]: The provisions of this Act respecting the construction of Acts, Regulations, rules or bye-laws made after commencement of this Act shall not affect the construction of any Act, Regulation, rule or bye-law is continued or amended by an Act, Regulation, rule or bye-law made after the commencement of this Act.

"Application of Act to Ordinances" [Section 30]: In this Act the expression Central Act, wherever it occurs, except in Section 5 and the word 'Act' in clauses (9), (13), (25), (40), (43), (53) and (54) of section 3 and in section 25 shall be deemed to include Ordinance made and promulgated by the Governor General under section 23 of the Indian Councils Act, 1861 or section 72 of the Government of India Act, 1915, or section 42 of the Government of India Act, 1935 and an Ordinance promulgated by the President under Article 123 of the Constitution.

SUMMARY

- General Clauses Act, 1897 intends to provide general definitions which shall be applicable to all Central Acts and Regulations where there is no definition in those Acts.
- Every Act has a preamble which expresses the scope, object and purpose of the Act. It is the main source for understanding the intention of lawmaker behind the Act.
- Financial year shall mean the year commencing on the first day of April.
- Where legislation has not specifically mentioned to come into force on a prescribed date, it shall be implemented on the day that it receives the assent of the President.
- Whenever an Act is repealed, it must be considered as if it had never existed.
- Where by any legislation, any act or proceeding is directed or allowed to be done or taken in any court or office on a certain day or within a prescribed period then, if the Court or office is closed on that day, the act or

proceeding shall be considered as done or taken in due time if it is done or taken on the next day afterwards on which the Court or office is open.

- In any legislation, words importing the masculine gender shall be taken to include females, and words in singular shall include the plural and vice versa.
- Power to appoint includes power to appoint ex-officio.
- Power to appoint includes power to suspend or dismiss.
- A law relative to the chief or superior of an office shall apply to the deputies or subordinates lawfully performing the duties of that office in the place of their superior.
- Where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by properly addressing, pre-paying, and posting by registered post.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. The General Clauses Act, 1897 intends to:
   (a) Provide general definitions.
   (b) Applicable to all Central Acts and Regulations.
   (c) Applicable where there is no definition, unless there is anything repugnant in the subject or context.
   (d) All of the above.
2. The General Clauses Act is one of the oldest Acts, came into force on:
   (a) 01st April, 1897
   (b) 11th March, 1897
   (c) 11th March, 1887
   (d) 01st April, 1868
3. The preamble is most important in any legislation, it:
   (a) Provides definitions in the Act.
   (b) Expresses scope, object and purpose of the Act.

(c) Provides summary of the entire Act.

(d) None of the above.

4. As per a Rule of an Educational Institution, every student may come on weekends for extra classes but every student shall appear on a weekly test conducted in the institute, which means:

(a) Attending extra classes on weekend is optional but appearing in weekly test is compulsory

(b) Attending weekend classes is compulsory but appearing in weekly test is optional

(c) Attending weekend classes and appearing in weekly test, both are compulsory for students

(d) Attending weekend classes and appearing in weekly test both are optional for students.

5. Which of the following is not an Immovable Property?

(a) Land

(b) Building

(c) Timber

(d) Machinery permanently attached to the land

6. Where an act of parliament does not expressly specify any particular day as to the day of coming into operation of such Act, then it shall come into operation on the day on which

(a) It receives the assent of the President

(b) It receives the assent of the Governor General

(c) It is notified in the official gazette

(d) None of these

7. Where an act or omission constitutes an offence under two or more enactments, then the offender shall be liable to be prosecuted and punished under

(a) Under either or any of those enactments

(b) Twice for the same offence

(c) Either a. or b. as per the discretion of the court

(d) none of these

Answer to MCQs

1. (d) **2.** (b) **3.** (b) **4.** (a) **5.** (c) **6.** (a)

7. (a)

QUESTION AND ANSWER

Question 1

What is "Financial Year" under the General Clauses Act, 1897?

Answer

According to Section 3(21) of the General Clauses Act, 1897, 'Financial Year' shall mean the year commencing on the first day of April.

The term year has been defined under Section 3(66) as a year reckoned according to the British calendar. Thus as per General Clauses Act, Year means calendar year which starts from January to December.

Hence, in view of the both above definitions, it can be concluded that Financial Year is a year which starts from first day of April to the end of March

Question 2

What is "Immovable Property" under the General Clauses Act, 1897?

Answer

According to Section 3(26) of the General Clauses Act, 1897, 'Immovable Property' shall include:

(i) Land,

(ii) Benefits to arise out of land, and

(iii) Things attached to the earth, or permanently fastened to anything attached to the earth.

For example, trees are immovable property because trees are benefits arise out of the land and attached to the earth. However, timber is not immovable property as the same are not permanently attached to the earth. In the same manner, buildings are immovable property.

Question 3

As per the provisions of the Companies Act, 2013, a whole time Key Managerial Personnel (KMP) shall not hold office in more than one company except its subsidiary company at the same time. Referring to the Section 13 of the General Clauses Act, 1897, examine whether a whole time KMP can be appointed in more than one subsidiary company?

Answer

Section 203(3) of the Companies Act, 2013 provides that whole time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. With respect to the issue that whether a whole time KMP of holding company be appointed in more than one subsidiary companies or can be appointed in only one subsidiary company.

It can be noted that Section 13 of General Clauses Act, 1897 provides that the word 'singular' shall include the 'plural', unless there is anything repugnant to the subject or the context. Thus, a whole time key managerial personnel may hold office in more than one subsidiary company as per the present law.

Question 4

A notice when required under the Statutory rules to be sent by "registered post acknowledgment due" is instead sent by "registered post" only. Whether the protection of presumption regarding serving of notice by "registered post" under the General Clauses Act is tenable? Referring to the provisions of the General Clauses Act, 1897, examine the validity of such notice in this case.

Answer

As per the provisions of Section 27 of the General Clauses Act, 1897, where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

(i) Properly addressing,

(ii) Pre-paying, and

(iii) Posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

Therefore, in view of the above provision, since, the statutory rules itself provides about the service of notice that a notice when required under said statutory rules to be sent by 'registered post acknowledgement due', then, if notice was sent by

'registered post' only it will not be the compliance of said rules. However, if such provision was not provided by such statutory rules, then service of notice if by registered post only shall be deemed to be effected.

Furthermore, in similar case of *In United Commercial Bank v. Bhim Sain Makhija, AIR 1994 Del 181:* A notice when required under the statutory rules to be sent by 'registered post acknowledgement due' is instead sent by 'registered post' only, the protection of presumption regarding serving of notice under 'registered post' under this section of the Act neither tenable not based upon sound exposition of law.

Question 5

X owned a land with fifty tamarind trees. He sold his land and the timber (obtained after cutting the fifty trees) to Y. X wants to know whether the sale of timber tantamount to sale of immovable property. Advise him with reference to provisions of "General Clauses Act, 1897".

Answer...

"Immovable Property" [Section 3(26) of the General Clauses Act, 1897]: 'Immovable Property' shall include:

(i) Land,

(ii) Benefits to arise out of land, and

(iii) Things attached to the earth, or

(iv) Permanently fastened to anything attached to the earth.

It is an inclusive definition. It contains four elements: land, benefits to arise out of land, things attached to the earth and things permanently fastened to anything attached to the earth. Where, in any enactment, the definition of immovable property is in the negative and not exhaustive, the definition as given in the General Clauses Act will apply to the expression given in that enactment.

In the instant case, X sold Land along with timber (obtained after cutting trees) of fifty tamarind trees of his land. According to the above definition, Land is immovable property; however, timber cannot be immovable property since the same are not attached to the earth.

Question 6

What is the meaning of service by post as per provisions of The General Clauses Act, 1897?

Answer

"Meaning of Service by post" [Section 27 of the General Clauses Act, 1897]: Where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:

(i) properly addressing

(ii) pre-paying, and

(iii) posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

Question 7

Komal Ltd. declares a dividend for its shareholders in its AGM held on 27th September, 2018. Referring to provisions of the General Clauses Act, 1897 and Companies Act, 2013, advice:

(i) The dates during which Komal Ltd. is required to pay the dividend?

(ii) The dates during which Komal Ltd. is required to transfer the unpaid or unclaimed dividend to unpaid dividend account?

Answer

As per section 9 of the General Clauses Act, 1897, for computation of time, the section states that in any legislation or regulation, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time to use the word "from" and for the purpose of including the last in a series of days or any other period of time, to use the word "to".

(i) **Payment of dividend:** In the given instance, Komal Ltd. declares dividend for its shareholder in its Annual General Meeting held on 27/09/2018. Under the provisions of Section 127 of the Companies Act, 2013, a company is required to pay declared dividend within 30 days from the date of declaration, i.e. from 28/09/2018 to 27/10/2018. In this series of 30 days, 27/09/2018 will be excluded and last 30th day, i.e. 27/10/2018 will be included. Accordingly, Komal Ltd. will be required to pay dividend within 28/09/2018 and 27/10/2018 (both days inclusive).

(ii) **Transfer of unpaid or unclaimed divided:** As per the provisions of Section 124 of the Companies Act, 2013, where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the

declaration, to any shareholder entitled to the payment of the dividend, the company shall, within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the "Unpaid Dividend Account" (UDA). Therefore, Komal Ltd. shall transfer the unpaid/unclaimed dividend to UDA within the period of 28th October, 2018 to 3rd November, 2018 (both days inclusive).

Question 8

'Repeal' of provision is different from 'deletion' of provision. Explain as per the General Clauses Act, 1897.

Answer

In *Navrangpura Gam Dharmada Milkat Trust Vs. Rmtuji Ramaji, AIR 1994 Guj 75* case, it was decided that 'Repeal' of provision is in distinction from 'deletion' of provision. 'Repeal' ordinarily brings about complete obliteration (abolition) of the provision as if it never existed, thereby affecting all incoherent rights and all causes of action related to the 'repealed' provision while 'deletion' ordinarily takes effect from the date of legislature affecting the said deletion, never to effect total effecting or wiping out of the provision as if it never existed.

CHAPTER 4

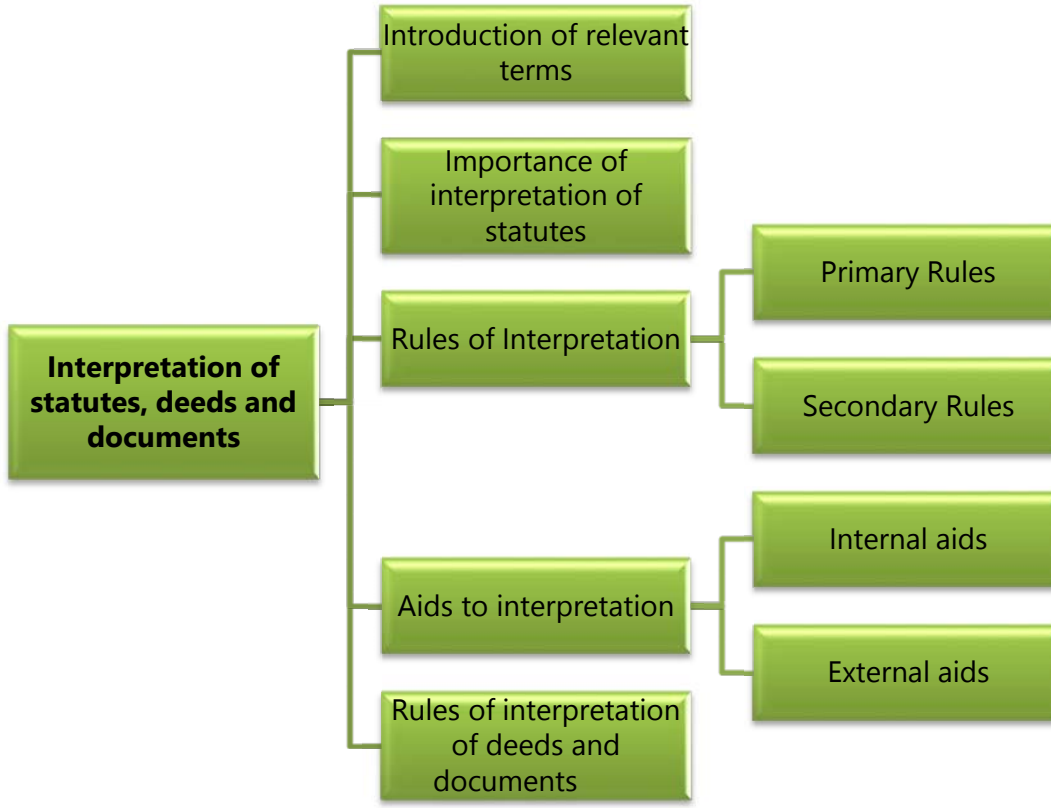
INTERPRETATION OF STATUTES

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Know the need for interpretation of statutes.
- Explain the various Rules of Interpretation of Statutes.
- Know of various internal and external aids to interpretation.
- Understand Rules of Interpretation of Deeds and Documents.

CHAPTER OVERVIEW



1. INTRODUCTION

This study relates to **'Interpretation of Statutes, Deeds and Documents'**. So, first of all we must understand what these terms and some other terms denote. It would, therefore, be important for us at this stage itself to understand the terms **'Statute', 'Document', 'Instrument', 'Deed'** and **'Interpretation'**.

'Statute': To the common man the terms **'Statute'** generally means the laws and regulations of every sort without considering from which source they emanate.

However, the term **'Statute'** has been defined as the written will of the legislature solemnly expressed according to the forms necessary to constitute it the law of the State. Normally, the term denotes an Act enacted by the legislative authority (e.g. Parliament of India).

The Constitution does not use the terms 'statute' though one finds the terms 'law' used at many places. The terms 'law' is defined as including any ordinance, order, bye-law, rule, regulation, notification, and the like.

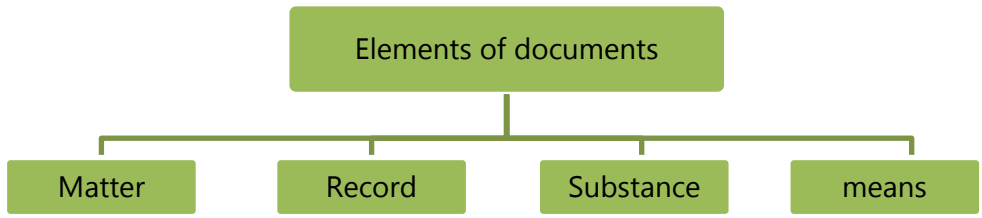
In short 'statute' signifies written law in contradiction to unwritten law.

'Document': Generally understood, a document is a paper or other material thing giving information, proof or evidence of anything. The Law defines 'document' in a more technical form. Section 3 of the Indian Evidence Act, 1872 states that 'document' means any matter expressed or described upon any substance by means of letters, figures or marks or by more than one of those means, intended to be used, or which may be used, for the purpose of recording that matter.

Example: A writing is a document, any words printed, photographed are documents.

Section 3(18) of the General Clauses Act, 1897 states that the term 'document' shall include any matter written, expressed or described upon any substance by means of letters, figures or marks, or by more than one of those means which is intended to be used, or which may be used, for the purpose of recording this matter.

Generally, documents comprise of following four elements:



(i) **Matter**—This is the first element. Its usage with the word "any" shows that the definition of document is comprehensive.

(ii) **Record**—This second element must be certain mutual or mechanical device employed on the substance. It must be by writing, expression or description.

(iii) **Substance**—This is the third element on which a mental or intellectual elements comes to find a permanent form.

(iv) **Means**—This represents forth element by which such permanent form is acquired and those can be letters, any figures, marks, symbols which can be used to communicate between two persons.

'Instrument': In common parlance, 'instrument' means a formal legal document which creates or confirms a right or records a fact. It is a formal writing of any kind,

such as an agreement, deed, charter or record, drawn up and executed in a technical form. It also means a formal legal document having legal effect, either as creating liability or as affording evidence of it. Section 2(14) of the Indian Stamp Act, 1899 states that 'instrument' includes every document by which any right or liability is or purports to be created, transferred, extended, extinguished or recorded.

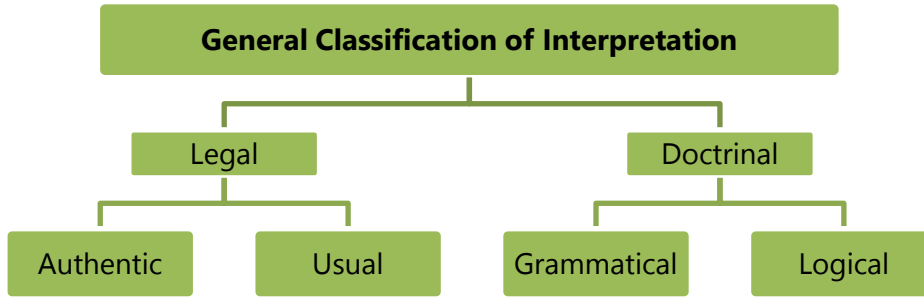
'Deed': The Legal Glossary defines 'deed' as an instrument in writing (or other legible representation or words on parchment or paper) purporting to effect some legal disposition. Simply stated deeds are instruments though all instruments may not be deeds. However, in India no distinction seems to be made between instruments and deeds.

'Interpretation': By interpretation is meant the process by which the Courts seek to ascertain the meaning of the legislature through the medium of the authoritative forms in which it is expressed. Simply stated, 'interpretation' is the process by which the real meaning of an Act (or a document) and the intention of the legislature in enacting it (or of the parties executing the document) is ascertained. 'Interpretation' signifies expounding the meaning of abstruse words, writings, etc., making out of their meaning, explaining, understanding them in a specified manner. A person is there by aided in arguing, contesting and interpreting the proper significance of a section, a proviso, explanation or schedule to an Act or any document, deed or instrument.

Importance of Interpretation: Interpretation, thus, is a familiar process of considerable significance. In relation to statute law, interpretation is of importance because of the inherent nature of legislation as a source of law. The process of statute making and the process of interpretation of statutes take place separately from each other, and two different agencies are concerned. An interpretation of Act serves as the bridge of understanding between the two.

Judicial determination of questions of law requires the use of materials of various types, depending on the nature of the question. In the interpretation of statutory provisions the material used will naturally have a sharply legal haracter, as distinct from the application of a general common law doctrine where it may have a more diffused character. In statutes, greater accuracy is, therefore, required. The process of interpretation is more legalistic and makes more intensive use of the legal technique in statutory interpretation, as contrasted with the application of common law rules.

Classification of Interpretation:



Jolowicz, in his **Lectures on Jurisprudence** (1963 ed., p. 280) speaks of interpretation thus: Interpretation is usually said to be either 'legal' or 'doctrinal'. It is **'legal'** when there is an actual rule of law which binds the Judge to place a certain interpretation of the statute. It is **'doctrinal'** when its purpose is to discover 'real' and 'true' meaning of the statute. 'Legal' interpretation is sub-divided into 'authentic' and 'usual'. It is 'authentic' when rule of interpretation is derived from the legislator himself; it is 'usual' when it comes from some other source such as custom or case law. Thus when Justinian ordered that all the difficulties arising out of his legislation should be referred to him for decision, he was providing for 'authentic' interpretation, and so also was the Prussian Code, 1794, when it was laid down that Judges should report any doubt as to its meaning to a Statute Commission and abide by their ruling.

'Doctrinal' interpretation may again be divided into two categories: 'grammatical' & 'logical'. It is 'grammatical' when the court applies only the ordinary rules of speech for finding out the meaning of the words used in the statute. On the other hand, when the court goes beyond the words and tries to discover the intention of the statute in some other way, then it is said resort to what is called a 'logical' interpretation.

According to **Fitzerald**, interpretation is of two kinds – 'literal' and 'functional'. The literal interpretation is that which regards conclusively the verbal expression of the law. It does not look beyond the 'literaligis'. The duty of the Court is to ascertain the intention of the legislature and seek for that intent in every legitimate way, but first of all in the words and the language employed. 'Functional' interpretation, on the other hand, is that which departs from the letter of the law and seeks elsewhere for some other and more satisfactory evidence of the true intention of the legislature. In other words, it is necessary to determine the relative claims of the letters and the spirit of the enacted law. In all

ordinary cases, the Courts must be content to accept the letter of the law as the exclusive and conclusive evidence of the spirit of the law **(Salmon: Jurisprudence**, 12th ed., pp. 131-132). It is essential to determine with accuracy the relations which subsist between the two methods.

Interpretation and Construction: It would also be worthwhile to note, at this stage itself, the difference between the terms **'Interpretation' and Construction**. While more often than not the two terms are used interchangeably to denote a process adopted by the courts to ascertain the meaning of the legislative form in which it is expressed, these two terms have different connotations.

The cardinal rule of construction of a statute is to read it literally, which means by giving to the words used by the legislature their ordinary, natural and grammatical meaning. If such reading leads to absurdity and the words are susceptible of another meaning, the court may adopt the same. If no such alternative construction is possible, the court must adopt the ordinary rules of literal interpretation.

Whereas cardinal law of interpretation is that if the language is simple and unambiguous, it is to be read with the clear intention of the legislation. *[CWT v. Smt. Muthu Zulaika(2000)]*

For the purpose of construction of a statute the same has to be read as a whole. *[State of Bihar v. CIT, (1993) 202 ITR 535, 550 (Pat)]*

Difference between Interpretation and Construction: Interpretation differs from construction. Interpretation is of finding out the true sense of any form and the construction is the drawing of conclusion respecting subjects that lie beyond the direct expression of the text. *[Bhagwati Prasad Kedia v. C.I.T,(2001)]*

It is the duty of the courts to give effect to the meaning of an Act when the meaning can be equitably gathered from the words used. Words of legal import occurring in a statute which have acquired a definite and precise sense, must be understood in that sense. *(State of Madras v. Gannon Dunkerly Co. AIR 1958)*

When the legislature uses certain words which have acquired a definite meaning over a period of time, it must be assumed that those words have been used in the same sense.

Thus, where the Court adheres to the plain meaning of the language used by the legislature, it would be 'interpretation' of the words, but where the meaning is not plain, the court has to decide whether the wording was meant to cover the situation before the court. Here the court would be resorting to what is called 'construction', however, the two terms – 'interpretation' and 'construction' –

overlap each other and it is rather difficult to state where 'interpretation' leaves off and 'construction' begins.

2. WHY DO WE NEED INTERPRETATION/ CONSTRUCTION?

No doubt in modern times, the enacted laws are drafted by legal experts, yet they are expressed in language and no language is so perfect as to leave no ambiguities. Further, by its very nature, a statute is an edict of the legislature and many-a-time the intent of the legislature has to be gathered not only from the language but the surrounding circumstances that prevailed at the time when that particular law was enacted. If any provision of the statute is open to two interpretations, the Court has to choose that interpretation which represents the true intention of the legislature. Also, it is not within human powers to foresee the manifold set of facts which may arise in the future and even if it were so it is not possible to provide for them in terms free from all ambiguity. All these aspects add to give great prominence to the subject of interpretation and construction in the practical administration of the law.

It would be worthwhile to note what **Denning L.J.** has said on the need for statutory interpretation: It is not within human powers to foresee the manifold sets of facts which may arise; and that, even if it were, it is not possible to provide for them in terms free from all ambiguity. The English language is not an instrument of mathematical precision. Our literature would be much the poorer if it were. This is where the draftsmen of Acts of Parliament have often been unfairly criticized. A judge, believing himself to be fettered by the supposed rule that he must look to the language and nothing else, laments that the draftsmen have not provided for this or that, or have been guilty of some or other ambiguity. It would certainly save the judges' trouble if Acts of Parliament were drafted with divine prescience and perfect clarity. In the absence of it, when a defect appears, a judge can not simply fold his hands and blame the draftsman. He must set to work on the constructive task of finding the intention of Parliament, and he must do this, not only from the language of the statute, but also from a consideration of the social conditions which gave rise to it, and of the mischief which it was passed to remedy, and then he must supplement the written word so as to give 'force and life' to the intention of the legislature.

It has been rightly said that a statute is the will of the legislature. The fundamental rule of interpretation of a statute is that it should be expounded according to the intent of those that made it. In the event of the words of the

statute being precise and unambiguous in themselves it is only just necessary to expound those words in their natural and ordinary sense: thus far and no further. This is because these words distinctly indicate the intention of the legislature. The purpose of interpretation is to discern the intention which is conveyed either expressly or impliedly by the language used. If the intention is express, then the task becomes one of 'verbal construction' alone. But in the absence of any intention being expressed by the statute on the question to which it gives rise and yet some intention has to be, of necessity, imputed to the legislature regarding it, then the interpreter has to determine it by inference based on certain legal principles. In such a case, the interpretation has to be one which is commensurate with the public benefit. Consequently, if a statute levies a penalty without expressly mentioning the recipient of the penalty, then, by implication, it goes to the officers of the State.

The subject of the interpretation of a statute, therefore, seems to fall under two general heads:

(a) What are the principles which govern the construction of the language of an Act of Parliament?

(b) What are those principles which guide the interpreter in gathering the intention on those incidental points on which the legislature is necessarily presumed to have entertained an opinion but on which it has not expressed any?

Through the process of interpretation, the Court seeks to discern the meaning of the legislation through the medium of authoritative forms in which it is expressed.

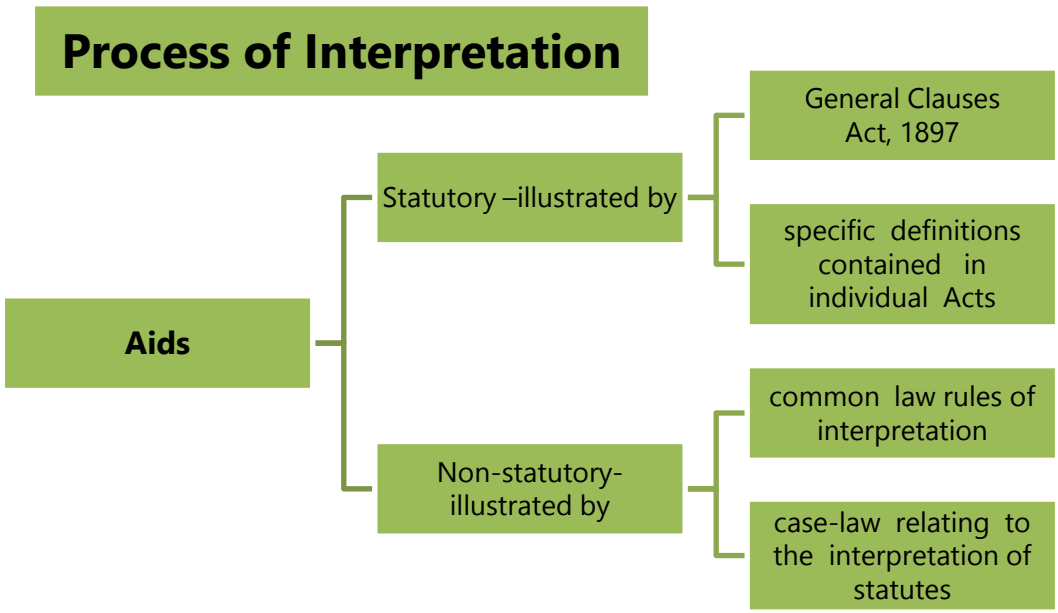
As we have noted earlier, 'interpretation' may be either 'grammatical' or 'logical'. 'Grammatical interpretation' concerns itself exclusively with the verbal expression of the law: it does not go beyond the letter of the law. 'Logical interpretation', on the other hand, seeks more satisfactory evidence of the true intention of the legislature.

In all ordinary cases, 'grammatical interpretation' is the sole form allowable. The Court cannot take from or add to modify the letter of the law. This rule is, however, subject to some expectations: firstly, where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness. As regard the defect to ambiguity, the Court is under a duty to travel beyond the letter of the law so as to determine from the other sources the true intention of the legislature. In the case of the statutory expression being defective on account of inconsistency, the court must ascertain the spirit of the law. Secondly, if the

text leads to a result which is so unreasonable that it is self-evident that the legislature could not mean what it says, the court may resolve such impasse by inferring logically the intention of the legislature.

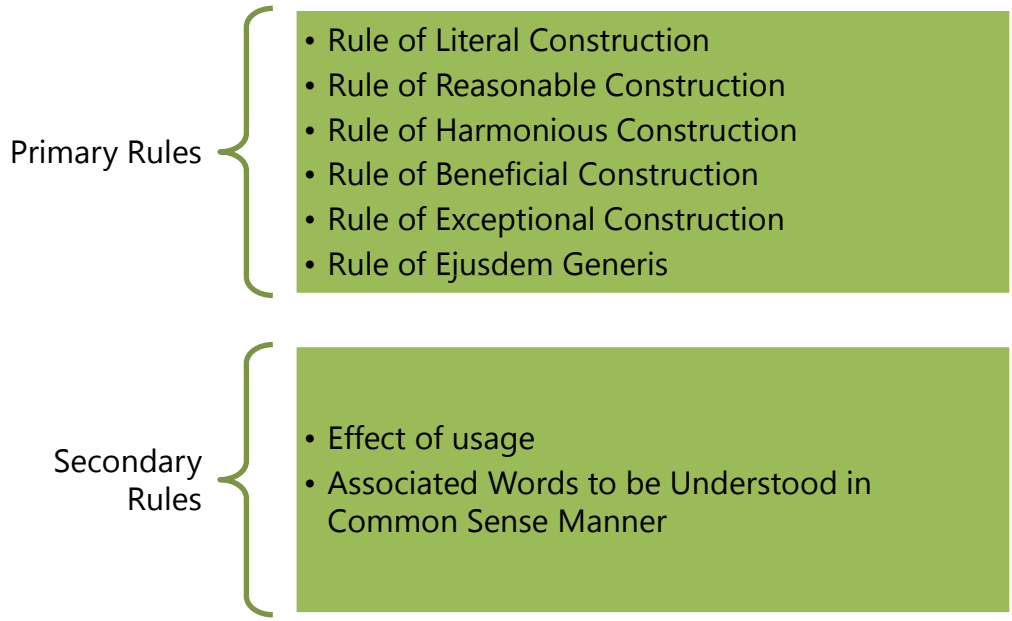
About one thing there seems to be no controversy at all, a statute is enforceable at law, howsoever unreasonable it may be. The duty of the court is to administer the law as it stands. It is not within its jurisdiction to see whether the law is just or unreasonable. The ascertainment of the justification or reasonableness of law is the exclusive domain of the legislature and it alone can consider alteration or modification of the law passed by it. Until it is altered or modified or amended, the court has no choice but to enforce the law as it is.

In this process of interpretation, several aids are used. They may be statutory or non-statutory. The former category (statutory aids) is illustrated by the General Clauses Act, and by specific definitions contained in individual Acts, as also by certain provisions of a general nature which are, for example, contained in the Indian Penal Code", and are relevant to the construction of penal enactments. The latter is illustrated by common law rules of interpretation (including certain presumptions relating to interpretation), and also by case-law relating to the interpretation of statutes.



3. RULES OF INTERPRETATION/ CONSTRUCTION

Over a period, certain rules of interpretation/construction have come to be well recognized. However, these rules are considered as guides only and are not inflexible. These rules can be broadly classified as follows:



(A) PRIMARY RULES

(1) Rule of Literal Construction: It is the cardinal rule of construction that words, sentences and phrases of a statute should be read in their ordinary, natural and grammatical meaning so that they may have effect in their widest amplitude. At the same time, the elementary rule of construction has to be borne in mind that words and phrases of technical nature are *'prima facie'* used in their technical meaning, if they have any, and otherwise in their ordinary popular meaning.

When the language of the statute is plain and unambiguous and admits of only one meaning, no question of construction of a statute arises, for the Act speaks for itself. The meaning must be collected from the expressed intention of the legislature *(State of U.P. v. Vijay Anand, AIR 1963 SC 946)*. A word which has a definite and clear meaning should be interpreted with that meaning only, irrespective of its consequences.

Sometimes, occasions may arise when a choice has to be made between two interpretations – one narrower and the other wider or bolder. In such a situation, if the narrower interpretation would fail to achieve the manifest purpose of the legislation, one should rather adopt the wider one.

For **example**, when we talk of disclosure of **the nature of concern or interest, financial or otherwise'** of a director or the manager of a company in the subject-matter of a proposed motion (as referred to in section 102 of the Companies Act, 2013), we have to interpret in its broader sense that any concern or interest containing any information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon. Whatever, What is required is a full and frank disclosure without reservation or suppression, as, for instance where a son or daughter or father or mother or brother or sister is concerned in any contract or matter, the shareholders ought fairly to be informed of it and the material facts disclosed to them. Here a restricted narrow interpretation would defeat the very purpose of the disclosure.

Further, the phrase and sentences are to be construed according to the rules of grammar. This was emphasized in no uncertain terms by the Supreme Court in the case of *S.S. Railway Company vs. Workers Union (AIR 1969 S.C. at 518)* when it is stated that the courts should give a literal meaning to the language used by the legislature unless the language is ambiguous or its literal sense gives rise to any anomaly or results in something which may defeat the purpose of the Act. It is the duty of the court to give effect to the intent of the legislature and in doing so, its first reference is to the literal meaning of the words employed. Where the language is plain and admits of only one meaning, there is no room for interpretation and only that meaning is to be enforced even though it is absurd or mischievous, the maxim being ***'absoluta sententia expositore non indiget'*** (which means a simple preposition needs no expositor i.e., when you have plain words capable of only one interpretation, no explanation to them is required).

Similarly, when a matter which should have been, but has not been, provided for in a statute cannot be supplied by courts as to do so would amount to legislation and would not be construction.

For **example:** Section 71 of the U.P. District Boards Act, 1922 provided that a Board may dismiss its secretary by special resolution which in certain cases required sanction of the Local Government. Section 90 of the same Act conferred a power to suspend the secretary pending, *inter alia*, the orders of any authority whose sanction was necessary for his dismissal. Section 71 of the Act was

amended in 1931 and it then provided that a resolution of dismissal was not to take effect till the expiry of the period of appeal or till the decision of the appeal, if it was so presented. However Section 90 of the Act was not correspondingly amended. The Supreme Court observed that it was unfortunate that when the legislature came to amend the old Section 71 of the Act it forgot to amend Section 90 in conformity with the amendment of Section 71. The Court, however emphasized that while no doubt it is the duty of the Court to try and harmonise the various provisions of an Act passed by the legislature, it is certainly not the duty of the court to stretch the word used by the legislature to fill in gaps or omissions in the provisions of an Act.

However, sometimes the courts may look at the setting or the context in which the words are used and the circumstances in which the law has come to be passed to decide whether there is something implicit behind the words actually used which would control the literal meaning of the words used. If there are two possible constructions of a clause, one a mere mechanical and literal construction based on the rules of grammar and the other which emerges from the setting in which the clause appears and the circumstances in which it came to be enacted and also from the words used therein, the courts may prefer the second construction which, though may not be literal, may be a better one. *(Arora vs. State of U.P., AIR 1964 S.C. 1230 at 1236-37).*

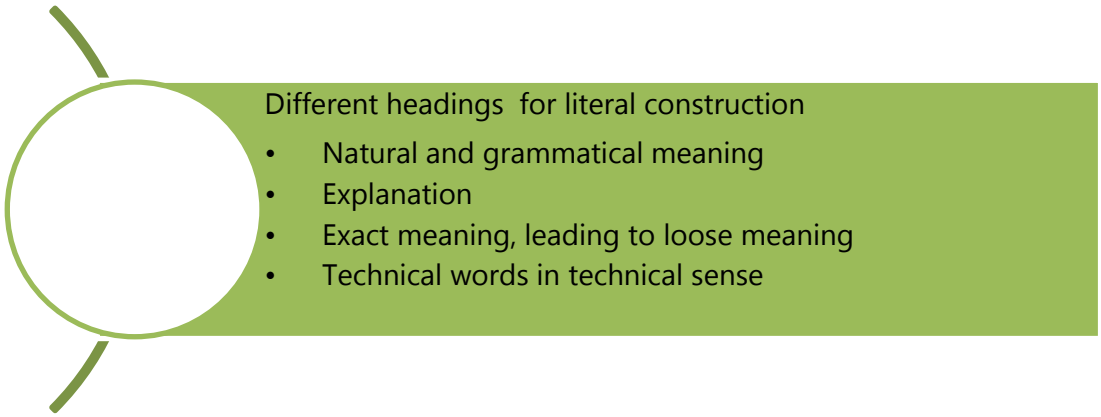
Words used in the popular sense: It dealing with mattes regarding the general public, statute are presumed to use words in their popular sense. But to deal with particular business or transaction, words are presumed to be used with the particular meaning in which they are used and understood in the particular business. However, words in statutes are generally construed in their popular meaning and not in their technical meaning.

It is the general rule that omissions are not likely to be inferred. From this it brings another rule that nothing is to be added to or taken away from a statute unless there are some adequate grounds to justify the inference that the legislature intended something which it omitted to express. "It is a wrong thing to add into an Act of Parliament words which are not there and, in the absence of clear necessity, it is a wrong thing to do." If a case has not been provided for in a statute. It is not to be dealt with merely because there seems to be no good reason why it should have been omitted, and the omission appears to be consequentially unintentional.

Reasonable corrections are not to over-ride plain terms of a statute. A construction that will render ineffective any part of the language of a statute will normally be rejected.

For example, if an Act plainly gave a right of appeal from one Court of Quarter Sessions to another, it was held that such a provision though extraordinary and perhaps an oversight could not be eliminated.

This Rule of literal interpretation can be read and understood under the following headings:



(I) Natural and grammatical meaning: Statute are to be first understood in their natural, ordinary, or popular sense and must be construed according to their plain, literal and grammatical meaning. If there is an inconsistency with any express intention or declared purpose of the statute, or it involves any absurdity, repugnancy, inconsistency, the grammatical sense must then be modified, extended or abridged only to avoid such an inconvenience, but no further. *[(State of HP v. Pawan Kumar(2005)]*

Example: In a question before the court whether the sale of betel leaves was subject to sales tax. In this matter SC held that betel leaves could not be given the dictionary, technical or botanical meaning when the ordinary and natural meaning is clear and unambiguous. Being the word of everyday use it must be understood in its popular sense by which people are conversant with it as also the meaning which the statute dealing with the matter would attribute to it. Therefore, the sale of betel leaves was liable to sale tax. *(Ramavtar V. Assistant Sales Tax Officer, AIR 1961 SC 1325)*

(II) Explanation of the Rule: When it is said that words are to be understood first in their natural, ordinary or popular sense, it is meant that the words must be qualified that natural, ordinary or popular meaning which they have

in relation to the subject matter with reference to which and the context in which they have been used in the statute. The meaning of a word depend upon its text and context. In the construction of statutes, the context means the statute as a whole and other statutes *in pari materia* (where two enactments have common purpose in an analogous case).

Example: In construing of the Andhra Pradesh General Sales Tax Rules, 1957, the words "Livestock" means all domestic animals will not include 'chicks' construing in the popular sense although in literal sense animal refers to any and every animate object as distinct from inanimate object. (*Royal Hatcheries Pvt. Ltd v. State of AP, AIR 1994 SC 666)*

(III) Exact meaning preferred to loose meaning: This is the another point regarding the rule of literal construction that exact meaning is preferred to loose meaning in an Act of Parliament. As every word has a secondary meaning too. Therefore, in applying this rule one should be careful not to mix up the secondary meaning with the loose meaning. Wherever the secondary meaning points to that meaning which statute meant, preference should be given to that secondary meaning.

Example: Word 'obtain 'in it general sense means some request or effort to acquire or get something but its secondary meaning is to acquire or get without any qualification and if in a statute the secondary meaning is preferred, it cannot be said that preference has been given to loose meaning.

(IV) Technical words in technical sense: This point of literal construction is that technical words are understood in the technical sense only.

Example, in construing of word 'practice' in Supreme Court Advocates Act, 1951, it was observed that practice of law generally involves the exercise of both the functions of acting and pleading on behalf of a litigant party. When legislature confers upon an advocate the right to practice in a court, it is legitimate to understand that expression as authorizing him to appear and plead as well as to act on behalf of suitors in that court.*(Ashwini Kumar Ghose V. Arabinda Bose AIR 1952 SC 369)*

(2) Rule of Reasonable Construction: According to this Rule, the words of a statute must be construed ***'ut res magis valeat quam pereat'*** meaning thereby that words of statute must be construed so as to lead to a sensible meaning. Generally the words or phrases of a statute are to be given their ordinary meaning. A statute must be construed in such a manner so as to make it effective

and operative on the principle of *ut res magis valeat quam pereat*. So while interpreting a law, two meanings are possible, one making the statute absolutely vague and meaningless and other leading to certainty and a meaningful interpretation, in such case the later interpretation should be followed.*(Pratap Singh v State of Jharkhand(2005)3 SCC 551)*

Example, in the case of *Dr. A.L. Mudaliar vs. LIC of India (1963) 33 Comp Cas. 420 (SC)*, it was held that the Memorandum of Association of a company must be read fairly and its import derived from a reasonable interpretation of the language which it employs. Further, in order to determine whether a transaction is intra vires the objects of a company, the objects clause should be reasonably construed: neither with rigidity nor with laxity. *[Waman Lal Chotanlal Parekh vs. Scindia Steam Navitation Co. Ltd. (1944) 14 Comp. Cas. 69 (Bom.)]*.

Thus, if the Court finds that giving a plain meaning to the words will not be a fair or reasonable construction, it becomes the duty of the court to depart from the dictionary meaning and adopt the construction which will advance the remedy and suppress the mischief provided the Court does not have to resort to conjecture or surmise. A reasonable construction will be adopted in accordance with the policy and object of the statute.

(3) Rule of Harmonious Construction: When there is doubt about the meaning of the words of a statute, these should be understood in the sense in which they harmonise with the subject of the enactment and the object which the legislature had in view. Their meaning is found not so much in a strictly grammatical or etymological propriety of language, nor even in its popular use, as in the subject or in the occasion on which they are used and the object to be attained.

Where there are in an enactment two or more provisions which cannot be reconciled with each other, they should be so interpreted, wherever possible, as to give effect to all of them. This is what is known as the Rule of Harmonious Construction. An effort should be made to interpret a statute in such a way as harmonises with the object of the statute.

Example: As per the facts given in the *Raj Krishna V. Binod AIR1954 SC 202*, there was a conflict between section 33(2) and 123(8) of the Representation of People Act, 1951. Section 33(2) stated that a government servant may nominate or second a candidate seeking election, whereas section 123(8) provided that a government servant is not entitled to assist a candidate in an election in any manner except by casting his vote. SC observed that both these provision should be harmoniously interpreted and held that a government servant was entitled to

nominate or second a candidate seeking election to the state legislature assembly. This harmony could be achieved only if section 123(8) of the Act is interpreted as conferring power on a government servant of voting as well as of proposing and seconding a candidature and forbidding him from assisting a candidate in any other manner.

Example: Conflict between section 17(1) and section 18(1) of the Industrial Disputes Act, 1947 applies the principal of Harmonious construction by harmonizing apparent conflict between two or more of its provisions. Section 17 of the Act provides that (1) Every report of a Board or court together with any minute of dissent recorded therewith, every arbitration award and every award of a Labour Court, Tribunal or National Tribunal shall, within a period of thirty days from the date of its receipt by the appropriate government, be published in such manner as the appropriate government thinks fit. Whereas sub-section (2) provides that the award published under sub-section (1) shall be final and shall not be called in question by any court in any manner whatsoever.

Section 18(1) of the Act provides that a settlement arrived at by agreement between the employer and workman otherwise than in the course of conciliation proceeding shall be binding on the parties to the agreement.

In case where a settlement is arrived after receipt of the award of the Labour Tribunal by the Government before its publication, the issue was whether the Government was still required by section 17(1) to publish the award. On construction of these two provisions, Supreme Court held that settlement which becomes effective from the date of signing, the industrial dispute comes to an end and the award becomes ineffective and the government cannot publish it. *[Sirsilk Ltd. V. Govt. of Andhra Pradesh, AIR 1964 SC160]*

It must always be borne in mind that a statute is passed as a whole and not in sections and it may well be assumed to be animated by one general purpose and intent. The Court's duty is to give effect to all the parts of a statute, if possible. But this general principle is meant to guide the courts in furthering the intent of the legislature, not overriding it. When rigid adherence to the general rule would require disregard of clear indications to the contrary, this rule must be applied. The sections and sub-sections must be read as parts of an integral whole and being inter-dependent. Therefore, importance should not be attached to a single clause in one section overlooking the provisions of another section. If it is impossible to avoid inconsistency, the provision which was enacted or amended later in point of time must prevail.

The Rule of Harmonious Construction is applicable only when there is a real and not merely apparent conflict between the provisions of an Act, and one of them has not been made subject to the other. When after having construed their context the words are capable of only a single meaning, the rule of harmonious construction disappears and is replaced by the rule of literal construction.

(4) Rule of Beneficial Construction or the Heydon's Rule: Where the language used in a statute is capable of more than one interpretation, the most firmly established rule for construction is the principle laid down in the *Heydon's case (1584) 3 Co. Rep 7a 76 ER 637*. The rule which is also known as 'purposive construction' or mischieve rule, enables consideration of four matters in construing an Act:

(1) what was the law before the making of the Act;

(2) what was the mischief or defect for which the law did not provide;

(3) what is the remedy that the Act has provided; and

(4) what is the reason for the remedy.

The rule then directs that the courts must adopt that construction which 'shall suppress the mischief and advance the remedy.'

Therefore, even in a case where the usual meaning of the language used falls short of the whole object of the legislature, a more extended meaning may be attributed to the words, provided they are fairly susceptible of it. If, however, the circumstances show that the phraseology in the Act is used in a larger sense than its ordinary meaning then that sense may be given to it. If the object of a statute is public safety then its working must be interpreted widely to give effect to that object. Thus, the legislature having intended, while passing the Workmen's Compensation Act, 1923 that every workman in the prescribed trade should be entitled to compensation, it was held that the Act ought to be so construed, as far as possible, as to give effect to its primary provisions.

Statutes which require something to be done.

Example, a statute which requires notice of action for anything done, are to be construed as including an omission of an act which ought to be done as well as the commission of a wrongful act. Where a statute requires something to be done by a person, it would generally be sufficient compliance with it if the thing is done by another person on his behalf and by his authority, for it would be presumed that the statute does not intend to prevent the application of the general principle of law: ***'qui facit per alium facit per se'*** (he who acts though another is

deemed to act in person).This would be so unless there is something in either the language or the object of the statute which shows that personal act alone was intended.

However, it has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are ambiguous and are reasonably capable of more than one meaning *(CIT vs. Sodra Devi, 1957 SC 832)*.

Example of application of this mischief rule is also well-found in the construction of section 2(d) of the Prize Competition Act, 1955. This section defines 'prize competition' as "any competition in which prizes are offered for the solution of any puzzle based upon the building up arrangement, combination or permutation of letters, words or figures". The issue is whether Act applies to competitions which involve substantial skill and are not in the nature of gambling. Supreme Court, after referring to the previous state of law, to the mischief that continued under that law and to the resolutions of various states under Article 252(1) authorizing Parliament to pass the Act. It was stated that having regard to the history of the legislation, the declared object thereof and the wording of the statute, we are of opinion that the competitions which are sought to be controlled and regulated by the Act are only those competitions in which success does not depend on any substantial degree of skill. *(RMD Chamarbaugwalla V. Union of India, AIR 1957 SC 628)*.

The correct principle is that after the words have been construed in their context and it is found that the language is capable of bearing only one construction, the rule in Heydon's case ceases to be controlling and gives way to the plain meaning rule. Lord Simon explains this aspect that Heydon's case is available at two stages:

(i) before ascertaining the plain and primary meaning of the statute, and

(ii) secondly, at the stage when the court reaches the conclusion that there is no such plain meaning.

(5) Rule of Exceptional Construction: The rule of exceptional construction stands for the elimination of statutes and words in a statute which defeat the real objective of the statute or make no sense. It also stands for construction of words 'and', 'or', 'may', 'shall' & 'must'.

This rule has several aspects, viz.:

(a) ***The Common Sense Rule:*** Despite the general rule that full effect must be given to every word, if no sensible meaning can be fixed to a word or phrase, or if it would defeat the real object of the enactment, it should be eliminated. The words of a statute must be so construed as to give a

sensible meaning to them, if at all possible. They ought to be construed ***'utres magis valeat quam pereat'*** meaning thereby that it is better for a thing to have effect than to be made void.

(b) ***Conjunctive and Disjunctive Words 'or' 'and':*** The word **'or'** is normally disjunctive and **'and'** is normally conjunctive. However, at times they are read as *vice versa* to give effect to the manifest intention of the legislature as disclosed from the context. This would be so where the literal reading of the words produces an unintelligible or absurd result. In such a case 'and' may by read for 'or' and 'or' for 'and' even though the result of so modifying the words is less favourable to the subject, provided that the intention of the legislature is otherwise quite clear.

Example: In the Official Secrets Act, 1920, as per section 7 any person who attempts to commit any offence under the principal Act or this Act, or solicits or incites or endeavours to persuade another person to commit an offence, or aids or abets **and** does any act preparatory to the commission of an offence'. Here, the word 'and' in bold is to be read as 'or'. Reading 'and' as 'and' will result in unintelligible and absurd sense and against the clear intention of the Legislature. *[R v. Oakes, (1959)]*

(c) ***'May', 'must' and 'shall':*** Before discussing this aspect, it would be worth-while to note the terms **'mandatory'** and **'directory'**. Practically speaking, the distinction between a provision which is **'mandatory'** and one which is **'directory'** is that when it is mandatory, it must be strictly observed; when it is 'directory' it would be sufficient that it is substantially complied with. However, we have to look to the substance and not merely the form: an enactment in mandatory form might substantially be directory and, conversely, a statute in directory form may in substance be mandatory. Hence, it is the substance that counts and must take precedence over mere form. If a provision gives a power coupled with a duty, it is mandatory: whether it is or is not so would depend on such consideration as:

— the nature of the thing empowered to be done,

— the object for which it is done, and

— the person for whose benefit the power is to be exercised

(i) 'May': It is well settled that enabling words are construed as compulsory, wherever the object of the power is to give effect to a legal right: the use of the word 'may' in a statutory provision would not by itself show that the provision is directory in nature. In some cases, the legislature may use the word 'may' as a

matter of pure conventional courtesy and yet intend a mandatory force. Therefore, in order to interpret the legal import of the word 'may', we have to consider various factors,

Example the object and the scheme of the Act, the context or background against which the words have been used, the purpose and advantages of the Act sought to be achieved by use if this word and the like.

Where the word 'may' involves a discretion coupled with an obligation or where it confers a positive benefit to the general class of subjects, or where a remedy would be advanced and a mischief suppressed, or where giving the word a directory significance would defeat the very object of the Act then word 'may' should be interpreted to convey a mandatory force. Thus, where a discretion is conferred upon a public authority coupled with an obligation, the word 'may' should be construed to mean a command. Similarly when an order of the Government or a statute confers a power on an authority in the discharge of a public duty, and though such power appears to be merely permissive, it is imperative that the authority should exercise that power in the discharge of its duties: there the word 'may' assumes mandatory force.

The, word **'may' is often read as 'shall' or 'must'** when there is something in the nature of the thing to be done, which makes it the duty of the person on whom the power is conferred to exercise the power. No general rule can be laid down for deciding whether any particular provision in a statute is mandatory, meaning thereby that non-observance thereof involves the consequences of invalidity, or only directory, i.e. a discretion, non-observance of which does not entail the consequence of invalidity, whatever other consequences may occur. But in each case the Court has to decide the legislature's intent. Did the legislature intend in making the statutory provision that non observance of this would entail invalidity or did it not? To decide this, we have to consider not only the actual words used, but the scheme of the statute, the intended benefit to the public or what is enjoined by the provisions and the material danger to the public by the contravention of the scheme. The use of the expression 'shall' or 'may' is not decisive. Having regard to the context, the expression 'may' has varying significance. In one context, it may be purely permissive, while in another context it may confer a power and make it obligatory upon the person invested with the power to exercise it as laid down. Therefore, while undoubtedly the word 'may' generally does not mean 'must' or 'shall' yet the same word 'may' is capable of meaning 'must' or 'shall' in the light of the context in which it occurs.

(ii) Shall: the use of the word shall would not of itself make a provision of the act mandatory. It has to be construed with reference to the context in which it is used. Thus, as against the Government the word 'shall' when used in statutes is to be construed as 'may' unless a contrary intention is manifest. Hence, a provision in a criminal statute that the offender shall be punished as prescribed in the statute is not necessarily to be taken as against the Government to direct prosecution under that provision rather than under some other applicable statute.

Therefore, generally speaking when a statute uses the word 'shall' *prima facie* it is mandatory but it is sometimes not so interpreted if the context or intention of the legislature otherwise demands. Thus, under certain circumstances the expression 'shall' is construed as 'may'. Yet, it has to be emphasized that the term 'shall' in its ordinary significance, is mandatory and the Court shall ordinarily give that interpretation to the term, unless such an interpretation leads to some absurd or inconvenient consequence or be at variance with the intent of the legislature to be collected from other parts of the Act.

For ascertaining the real intention of the legislature, the Court may consider amongst other things:

— the nature and design of the statute,

— the consequence which would flow from construing it one way or the other,

— the impact of other provisions by resorting to which the necessity of complying with the provision in question can be avoided,

— whether or not the statute provides any penalty if the provision in question is not complied with,

— if the provision in question is not complied with, whether the consequences would be trivial or serious, and

— most important of all, whether the object of the legislation will be defeated or furthered.

Where a specific penalty is provided in statute itself for non-compliance with the particular provision of the Act, no discretion is left to the Court to determine whether such provision is directory or mandatory – it has to be taken as mandatory.

The use of word 'shall' with respect to one matter and use of word 'may' with respect to another matter in the same section of at statute, will normally lead to the conclusion that the word 'shall' imposes an obligation, whereas word 'may

'confers a discretionary power *(Labour Commr., M.P.V. Burhanpur Tapti Mill, AIR, 1964 SC1687).*

(6) Rule of Ejusdem Generis: The term **'ejusdem generis'** means **'of the same kind or species'.** Simply stated, the rule means:

(i) Where any Act enumerates different subjects, general words following specific words are to be construed (and understood) with reference to the words that precede them. Those general words are to be taken as applying to things of the same kind as the specific words previously mentioned, unless there is something to show that a wider sense was intended. Thus, the rule of **ejusdem generis** means that where specific words are used and after those specific words, some general words are used, the general words would take their colour from the specific words used earlier.

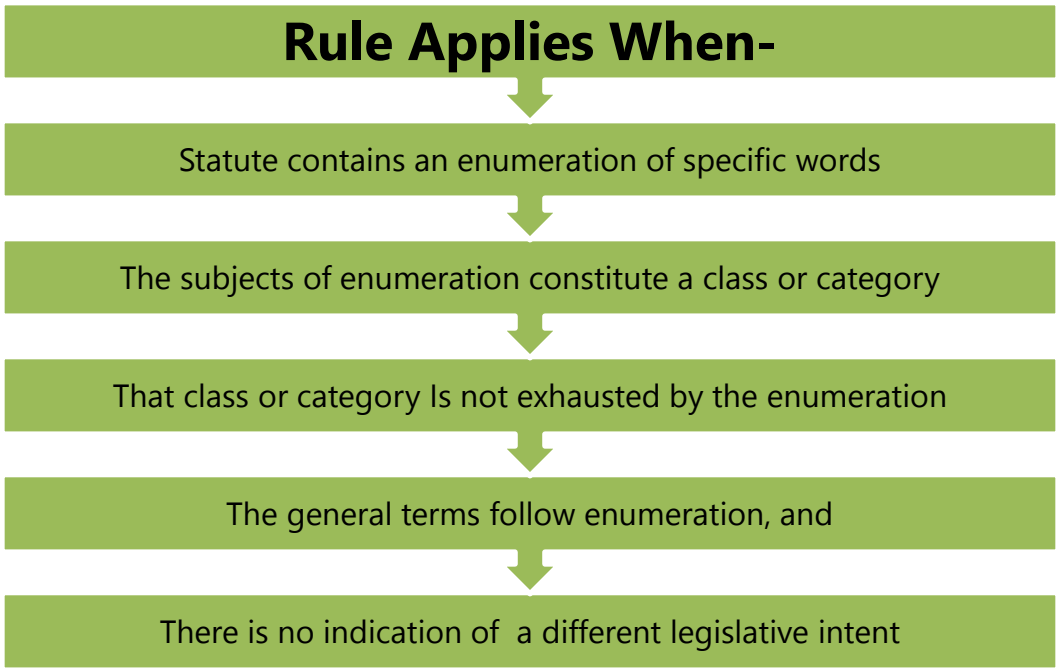
For instance 'in the expression in consequence of war, disturbance or any other cause', the words 'any other cause' would take colour from the earlier words 'war, disturbance' and therefore, would be limited to causes of the same kind as the two named instances. Similarly, where an Act permits keeping of dogs, cats, cows, buffaloes and other animals, the expression 'other animals' would not include wild animals like lions and tigers, but would mean only domesticated animals like horses, etc.

Where there was prohibition on importation of 'arms, ammunition, or gunpower or any other goods' the words 'any other goods' were construed as referring to goods similar to 'arms, ammunition or gun powder' *(AG vs. Brown (1920), 1 KB 773)*.

(ii) If the particular words used exhaust the whole genus (category), then the general words are to be construed as covering a larger genus.

(iii) We must note, however, that the general principle of 'ejusdem generis' applies only where the specific words are all the same nature. When they are of different categories, then the meaning of the general words following those specific words remains unaffected-those general words then would not take colour from the earlier specific words.

In the expression charges, rates, duties and taxes', the term charges was read ejusdem generis taking colour from the succeeding terms rates, duties, and taxes. Here, the general category preceded the enumeration of specific categories and so rule of ejusdem generis was technically not applicable and the court in fact applied the more general rule- *Noscitur a sociis* and rightly limited the meaning of the term charges.



It is also to be noted that the courts have a discretion whether to apply the 'ejusdem generis' doctrine in particular case or not. **For example**, the 'just and equitable' clause in the winding-up powers of the Courts is held to be not restricted by the first five situations in which the Court may wind up a company.

(B) OTHER (SECONDARY) RULES OF INTERPRETATION.

(1) Effect of usage: Usage or practice developed under the statute is indicative of the meaning recognized to its words by contemporary opinion. A uniform notorious practice continued under an old statute and inaction of the Legislature to amend the same are important factors to show that the practice so followed was based on correct understanding of the law. When the usage or practice receives judicial or legislative approval it gains additional weight.

In this connection, we have to bear in mind two Latin maxims:

(i) *'Optima Legum interpres est consuetude'* (the custom is the best interpreter of the law); and

(ii) *'Contempranea exposito est optima et fortissinia in lege'* (the best way to interpret a document is to read it as it would have been read when made). Therefore, the best interpretation/construction of a statute or any other document is that which has been made by the contemporary authority.

Simply stated, old statutes and documents should be interpreted as they would have been at the time when they were enacted/written.

Contemporary official statements throwing light on the construction of a statute and statutory instruments made under it have been used as contemporanea exposition to interpret not only ancient but even recent statutes in India.

Example: Documents issued by the Government simultaneously with the notification under section 16(1) of the Securities Contracts (Regulation) Act, 1956 were used as contemporanea expositio of the notification. *[DeshBandhu Gupta & Co. v. Delhi Stock Exchange Association Ltd., AIR 1979 SC]*

(2) Associated Words to be Understood in Common Sense Manner: When two words or expressions are coupled together one of which generally excludes the other, obviously the more general term is used in a meaning excluding the specific one. On the other hand, there is the concept of ***'Noscitur A Sociis'*** ('it is known by its associates'), that is to say 'the meaning of a word is to be judged by the company it keeps'. When two or more words which are capable of analogous (similar or parallel) meaning are coupled together, they are to be understood in their cognate sense (i.e. akin in origin, nature or quality). They take, as it were, their colour from each other, i.e., the more general is restricted to a sense analogous to the less general. It is a rule wider than the rule of ejusdem generis, rather ejusdem generis is only an application of the noscitur a sociis. It must be borne in mind that nocitur a sociis, si merely a rule of construction and it cannot prevail in cases where it is clear that the wider words have been deliberately used in order to make the scope of the defined word correspondingly wider.

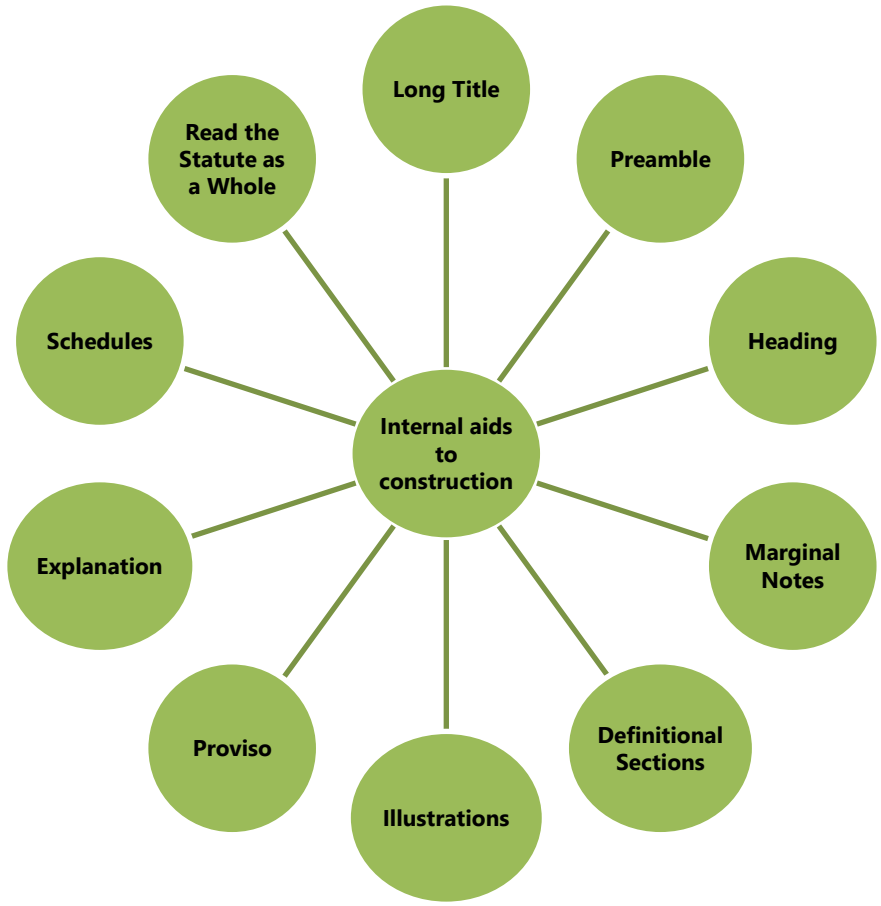
For **example**, in the expression 'commercial establishment means an establishment which carries on any business, trade or profession', the term 'profession' was construed with the associated words 'business' and 'trade' and it was held that a private dispensary was not within the definition. *(Devendra M. Surti (Dr.) vs. State of Gujrat, AIR 1969 SC 63 at 67)*.

The term 'entertainment' would have a different meaning when used in the expression 'houses for public refreshment, resort and entertainment' than its generally understood meaning of theatrical, musical or similar performance. Similarly, the expression 'place of public resort' would have one meaning when coupled with the expression 'roads and streets' and the same express 'place of public resort' would have quite a different meaning when coupled with the word 'houses'.

In construing of the terms powers, privileges and immunities of a house of the Legislature of a state conferred in the Article 194 of the Constitution, the Supreme court said that the word 'powers' must take its colour from words in immediate connection with it and that it should be construed to refer not to legislative powers but to powers of a house which are necessary for the conduct of its business. *[State of Karnataka v. Union of India, AIR 1978 SC]*

4. INTERNAL AIDS TO INTERPRETATION/ CONSTRUCTION

Every enactment has its Title, Preamble, Heading, Marginal Notes, Definitional Sections/Clauses, Illustrations etc. They are known as 'internal aids to construction' and can be of immense help in interpreting/construing the enactment or any of its parts.



(a) **Long Title:** An enactment would have what is known as a 'Short Title' and also a 'Long Title'. The 'Short Title' merely **identifies** the enactment and is chosen merely for convenience, the 'Long Title' on the other hand, **describes** the enactment and does not merely identify it.

It is now settled that the Long Title of an Act is a part of the Act. We can, therefore, refer to it to ascertain the object, scope and purpose of the Act and so is admissible as an aid to its construction.

Example: Full title of the Supreme Court Advocates (Practice in High Courts) Act, 1951 specify that this is an Act to authorize Advocates of the Supreme Court to practice as of right in any High Court.

So, the title of a statute is an important part of the Act and may be referred to for the purpose of ascertaining its general scope and of throwing light on its construction, although it cannot override the clear meaning of the enactment. *[Aswini kumar Ghose v. Arabinda Bose, AIR 1952 SC]*

(b) **Preamble:** The Preamble expresses the scope, object and purpose of the Act more comprehensively than the Long Title. The Preamble may recite the ground and the cause of making a statute and the evil which is sought to be remedied by it.

Like the Long Tile, the Preamble of a Statute is a part of the enactment and can legitimately be used for construing it. However, the Preamble does not over-ride the plain provision of the Act but if the wording of the statute gives rise to doubts as to its proper construction, **for example**, where the words or phrase has more than one meaning and a doubt arises as to which of the two meanings is intended in the Act, the Preamble can and ought to be referred to in order to arrive at the proper construction.

In short, the Preamble to an Act discloses the primary intention of the legislature but can only be brought in as an aid to construction if the language of the statute is not clear. However, it cannot override the provisions of the enactment.

Example: Use of the word 'may' in section 5 of the Hindu Marriage Act, 1955 provides that "a marriage may be solemnized between two Hindus....." has been construed to be mandatory in the sense that both parties to the marriage must be Hindus as defined in section 2 of the Act. It was held that a marriage between a Christian male and a Hindu female solemnized under the Hindu Marriage Act was void. This result was reached also having regard to the preamble of the Act which reads: 'An Act to amend and codify the

law relating to marriage among Hindus" [*Gullipoli Sowria Raj V. Bandaru Pavani, (2009)1 SCC714]*

(c) **Heading and Title of a Chapter:** If we glance through any Act, we would generally find that a number of its sections applicable to any particular object are grouped together, sometimes in the form of Chapters, prefixed by Heading and/or Titles. These Heading and Titles prefixed to sections or groups of sections can legitimately be referred to for the purpose of construing the enactment or its parts. However, there is a conflict of opinion about the weightage to be given to them. While one section of opinion considers that a heading is to be regarded as giving the key to the interpretation of the clauses ranged under it and might be treated as 'preambles to the provisions following it', the other section of opinion is emphatic that resort to the heading can only be taken when the enacting words are ambiguous. According to this view headings or titles prefixed to sections or group of sections may be referred to as to construction of doubtful expressions, but cannot be used to restrict the plain terms of an enactment.

We must, however, note that the heading to one group of sections cannot be used to interpret another group of sections.

Example: Chapter contained in the Code of Criminal Procedure, 1973 read as 'Limitation for taking cognizance of certain offences', was not held to be controlling and it was held that a cumulative reading of various provisions in the said chapter clearly indicated that the limitation prescribed therein was only for the filing of the complaint or initiation of the prosecution and not for taking cognizance. *[Bharat Damodar Kale v. State of A.P., air 2003 SC]*

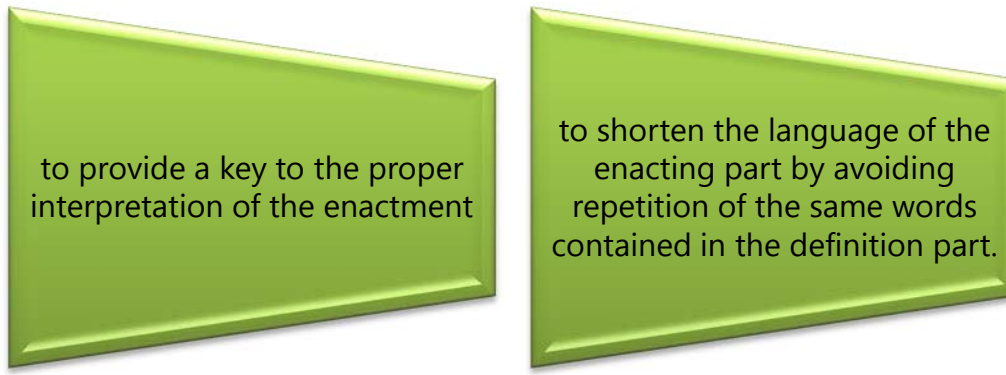
(d) **Marginal Notes:** Although there is difference of opinion regarding resort to Marginal Notes for construing an enactment, the generally held view is that the Marginal Notes appended to a Section cannot be used for construing the Section. In *C.I.T. vs. Ahmedbhai Umarbhai & Co. (AIR 1950 SC 134 at 141)*, Patanjali Shastri, J., had declared: "Marginal notes in an Indian statute, as in an Act, of Parliament cannot be referred to for the purpose of construing the statute", and the same view has been taken in many other cases. Many cases show that reference to marginal notes may be permissible in exceptional cases for construing a section in a statute. [*Deewan Singh v. Rajendra Pd. Ardevi, (2007)10 SCC , Sarabjit Rick Singh v. Union of India, (2008) 2 SCC]*

However, marginal notes appended to Articles of the Constitution have been held to be part of the Constitution as passed by the Constituent Assembly and therefore have been made use of in construing the Articles.

Example: Article 286 of the constitution furnishing "prima facie", some clue as to the meaning and purpose of the Article *[Bengal Immunity Co. Ltd. v. State of Bihar, AIR1955SC]*

(e) **Definitional Sections/Interpretation Clauses:** The legislature has the power to embody in a statute itself the definitions of its language and it is quite common to find in the statutes 'definitions' of certain words and expressions used in the body of the statute. When a word or phase is defined as having a particular meaning in the enactment, it is that meaning alone which must be given to it in interpreting a Section of the Act unless there be anything repugnant in the context. The Court cannot ignore the statutory definition and try and extract what it considers to be the true meaning of the expression independently of it.

The purpose of a definition clause is two-fold: (i) to provide a key to the proper interpretation of the enactment, and (ii) to shorten the language of the enacting part by avoiding repetition of the same words contained in the definition part every time the legislature wants to refer to the expressions contained in the definition.



Construction of definitions may understood under the following headings:

(i) Restrictive and extensive definitions

(ii) Ambiguous definitions

(iii) Definitions subject to a contrary context

(i) Restrictive and extensive definitions: The definition of a word or

expression in the definition section may either be restricting of its ordinary meaning or may be extensive of the same.

When a word is defined to **'mean'** such and such, the definition is *'prima facie'* restrictive and exhaustive we must restrict the meaning of the word to that given in the definition section.

But where the word is defined to **'include'** such and such, the definition is *'prima facie'* extensive: here the word defined is not restricted to the meaning assigned to it but has extensive meaning which also includes the meaning assigned to it in the definition section.

We may also find a word being defined as **'means and includes'** such and such: here again the definition would be exhaustive.

On the other hand, if the word is defined '**to apply to and include',** the definition is understood as extensive.

Example: The usage of word 'any' in the definition connotes extension for 'any' is a word of every wide meaning and prima facie the use of it excludes limitation.

It has been a universally accepted principle that where an expression is defined in an Act, it must be taken to have, throughout the Act, the meaning assigned to it by the definition, unless by doing so any repugnancy is created in the subject or context.

Example: Inclusive definition of lease given under section 2(16)(c) of the Stamp Act, 1899 has been widely construed to cover transaction for the purpose of Stamp Act which may not amount to a lease under section 105 of the Transfer of property Act, 1882. *[State of Uttarakhand v. Harpal Singh Rawat,(2011) 4 SCC 575]*

Section 2(m) of the Consumer Protection Act, 1986 contains an inclusive definition of 'person'. It has been held to include a 'company' although it is not specifically named therein *[Karnataka Power Transmission Corporation v. Ashok Iron Works Pvt. Ltd., (2009)3 SCC 240]*

A definition section may also be worded as '**is deemed to include'** which again is an inclusive or extensive definition as such a words are used to bring in by a legal fiction something within the word defined which according to its ordinary meaning is not included within it.

For example: If A is deemed to be B, compliance with A is in law compliance with B and contravention of A is in law contravention of B

(ii) Ambiguous definitions: Sometime we may find that the definition section may itself be ambiguous, and so it may have to be interpreted in the light of the other provisions of the Act and having regard to the ordinary meaning of the word defined. Such type of definition is not to be read in isolation. It must be read in the context of the phrase which it defines, realising that the function of a definition is to give accuracy and certainty to a word or phrase which would otherwise be vague and uncertain but not to contradict it or depose it altogether.

Example: Termination of service of a seasonal worker after the work was over does not amount to retrenchment as per the Industrial Disputes Act, 1947. *[Anil Bapurao Karase v. Krishna Sahkari Sakhar Karkhana, AIR 1997 SC 2698]*. But the termination of employment of a daily wager who is engaged in a project, on completion of the project will amount to retrenchment if the worker had not been told when employed that his employment will end on completion of the project. *[S.M. Nilajkarv.Telecom District Manager Karnataka, (2003)4 SCC]*.

(iii) Definitions subject to a contrary context: When a word is defined to bear a number of inclusive meanings, the sense in which the word is used in a particular provision must be ascertained from the context of the scheme of the Act, the language of the provision and the object intended to be served thereby.

(f) **Illustrations:** We would find that many, though not all, sections have illustrations appended to them. These illustrations follow the text of the Sections and, therefore, do not form a part of the Sections. However, illustrations do form a part of the statute and are considered to be of relevance and value in construing the text of the sections. However, illustrations cannot have the effect of modifying the language of the section and can neither curtail nor expand the ambit of the section.

Example: In holding that section 73 of the Indian Contract Act , 1872 does not permit the award of interest as damages for mere detention of debt, the privy Council rejected the argument that illustration given in the Act can be used for arriving at a contrary result. It was observed that nor can an illustration have the effect of modifying the language of the section which alone forms the enactment.

In a case the Supreme court took the aid of illustration appended to section 43 of the Transfer of Property Act, 1882 for conclusion that the said provision applies to transfer of spes succession is and enables the transferee to claim the property, provided other conditions of the sections are satisfied. Venkatarama Aiyer, J., observed that it is not to be readily assumed that an illustration to a section is repugnant to it and rejected. *[Jumma Masjid v. Kodimaniandra Deviah, AIR 1962 SC 847]*

(g) **Proviso:** The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision. It carves out an exception to the main provision to which it has been enacted as a proviso and to no other. *(Ram Narain Sons Ltd. vs. Assistant Commissioner of Sales Tax, AIR 1955 SC 765)*.

Distinction between Proviso, exception and saving Clause

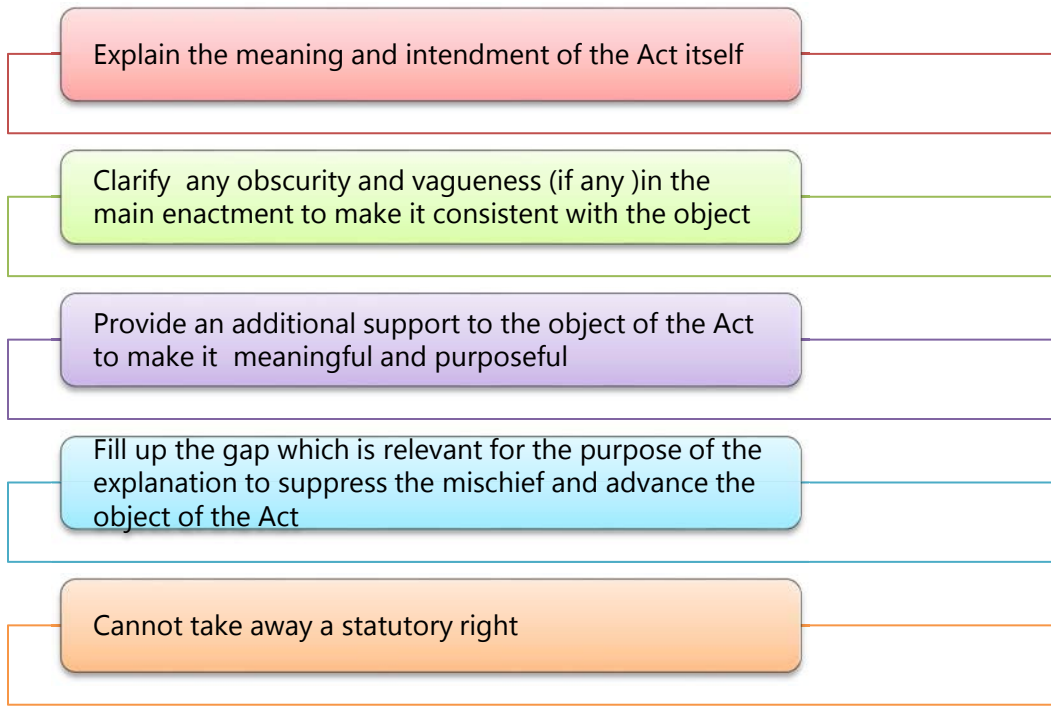
There is said to exist difference between provisions worded as 'proviso',' Exception', or 'Saving Clause'.

Differences		
'Exception' is intended to restrain the enacting clause to particular cases	'Proviso' is used to remove special cases from general enactment and provide for them specially	'Saving clause' is used to preserve from destruction certain rights, remedies or privileges already existing

(h) **Explanation:** An Explanation is at times appended to a section to explain the meaning of the text of the section. An Explanation may be added to include something within the section or to exclude something from it. An Explanation should normally be so read as to harmonise with and clear up

any ambiguity in the main section. It should not be so construed as to widen the ambit of the section.

In *Sundaram Pillai v. Pattabiraman, Fazal Ali*, J. gathered the following objects of an explanation to a statutory provision:



However, it would be wrong to always construe an explanation limited to the aforesaid objects. The meaning to be given to an explanation will really depend upon its terms and not on any theory of its purpose.

(i) **Schedules:** The Schedules form part of an Act. Therefore, they must be read together with the Act **for all purposes of construction**. However, the expressions in the Schedule cannot control or prevail over the expression in the enactment. If there appears to be any inconsistency between the schedule and the enactment, the enactment shall always prevail. They often contain details and forms for working out the policy underlying the sections of the statute **for example** schedules appended to the Companies Act, 2013, to the Constitution of India.

(j) **'Read the Statute as a Whole':** It is the elementary principle that construction of a statute is to be made of all its parts taken together and not of one part only. Lord Waston, speaking with regard to **deeds** had

stated thus: The deed must be read as a whole in order to ascertain the true meaning of its several clauses, and the words of each clause should be so interpreted as to bring them into harmony with other provisions – if that interpretation does no violence to the meaning of which they are naturally susceptible. And the same approach would apply with equal force with regard to Acts and Rules passed by the legislature.

One of the safest guides to the construction of sweeping general words is to examine other words of like import in the same enactment or instrument to see what limitations must be imposed on them. If we find that a number of such expressions have to be subjected to limitations and qualifications and that such limitations and qualifications are of the same nature, that circumstance forms a strong argument for subjecting the expression in dispute to a similar limitation and qualification.

For example, if one section of an Act requires 'notice' should be given, then a verbal notice would generally be sufficient. But, if another section provides that 'notice' should be 'served' on the person or 'left' with him, or in a particular manner or place, then it would obviously indicate that a written notice was intended.

5. EXTERNAL AIDS TO INTERPRETATION/ CONSTRUCTION

Society does not function in a void. Everything done has its reasons, its background, the particular circumstances prevailing at the time, and so on. These factors apply to any enactment as well. These factors are of great help in interpreting/construing an Act and have been given the convenient nomenclature of **'External Aids to Interpretation'**. Apart from the statute itself there are many matters which may be taken into account when the statute is ambiguous. These matters are called external aids. Some of these factors are enumerated below:

External Aids					
Historical Setting	Consolidating Statutes & Previous Law	Usage	Earlier & Later Acts and Analogous Acts	Dictionary Definitions	Use of Foreign Decisions

(a) **Historical Setting:** The history of the external circumstances which led to the enactment in question is of much significance in construing any enactment. We have, for this purpose, to take help from all those external or historical facts which are necessary in the understanding and comprehension of the subject matter and the scope and object of the enactment. History in general and Parliamentary History in particular, ancient statutes, contemporary or other authentic works and writings all are relevant in interpreting and construing an Act. We have also to consider whether the statute in question was intended to alter the law or leave it where it stood before.

(b) **Consolidating Statutes & Previous Law:** The Preambles to many statutes contain expressions such as "An Act to consolidate" the previous law, etc. In such a case, the Courts may stick to the presumption that it is not intended to alter the law. They may solve doubtful points in the statute with the aid of such presumption in intention, rejecting the literal construction.

(c) **Usage:** Usage is also sometimes taken into consideration in construing an Act. The acts done under a statute provide quite often the key to the statute itself. It is well known that where the meaning of the language in a statute is doubtful, **usage** – how that language has been interpreted and acted upon over a long period – may determine its true meaning. It has been emphasized that when a legislative measure of doubtful meaning has, for several years, received an interpretation which has generally been acted upon by the public, the Courts should be very unwilling to change that interpretation, unless they see cogent reasons for doing so.

(d) **Earlier & Later Acts and Analogous Acts:** Exposition of One Act by Language of Another:

The general principle is that where there are different statutes in *'pari materia'* (i.e. in an analogous case), though made at different times, or even expired and not referring to each other, they shall be taken and construed together as one system and as explanatory of each other.

If two Acts are to be read together then every part of each Act has to construed as if contained in one composite Act. But if there is some clear discrepancy then such a discrepancy may render it necessary to hold the later Act (in point of time) had modified the earlier one. However, this does not mean that every word in the later Act is to be interpreted in the same way as in the earlier Act.

Where the later of the two Acts provides that the earlier Act should, so far as consistent, be construed as one with it then an enactment in the later statute that nothing therein should include debentures was held to exclude debentures from the earlier statute as well.

Where a single section of one Act (say, Act 'A') is incorporated into another statute (say Act 'B'), it must be read in the sense which it bore in the original Act from which it is taken consequently, it would be legitimate to refer to all the rest of Act 'A' to ascertain what that Section means, though one Section alone is incorporated in the new Act (Act 'B').

Suppose the earlier bye-law limited the appointment of the chairman of an organisation to a person possessed of certain qualifications and the later bye-law authorises the election of any person to be the chairman of the organisation. In such a case, the later bye-law would be so construed as to harmonise and not to conflict with the earlier bye-law: the expression 'any person' used in the later bye-law would be understood to mean only **any eligible person** who has the requisite qualifications as provided in the earlier bye-law.

- **Earlier Act Explained by the Later Act:** Not only may the later Act be construed in the light of the earlier Act but it (the later Act) sometimes furnishes a legislative interpretation of the earlier one, if it is '*pari materia*' and if, **but only if**, the provisions of the earlier Act are ambiguous.

  Where the earlier statute contained a negative provision but the later one merely omits that negative provision: this cannot by itself have the result of substantive affirmation. In such a situation, it would be necessary to see how the law would have stood without the original provision and the terms in which the repealed sections are re-enacted.

  The general rules and forms framed under an Act which enacted that they should have the same force as if they had been included in it any may also be referred to for the purposes of interpretation of the Act.

- **Reference to Repealed Act:** Where a part of an Act has been repealed, it loses its operative force. Nevertheless, such a repealed part of the Act may still be taken into account for construing the un-repealed part. This is so because it is part of the history of the new Act.

(e) **Dictionary Definitions:** First we have to refer to the Act in question to find out if any particular word or expression is defined in it. Where we find that a

word is not defined in the Act itself, we may refer to dictionaries to find out the general sense in which that word is commonly understood. However, in selecting one out of the several meanings of a word, we must always take into consideration the context in which it is used in the Act. It is the fundamental rule that the meanings of words and expressions used in an Act must take their colour from the context in which they appear. Further, judicial decisions laying down the meaning of words in construing statutes in '*pari materia*' will have greater weight than the meaning furnished by dictionaries. However, for technical terms reference may be made to technical dictionaries.

(f) **Use of Foreign Decisions:** Foreign decisions of countries following the same system of jurisprudence as ours and given on laws similar to ours can be legitimately used for construing our own Acts. However, prime importance is always to be given to the language of the Indian statute. Further, where guidance can be obtained from Indian decisions, reference to foreign decisions may become unnecessary.

6. RULES OF INTERPRETATION/ CONSTRUCTION OF DEEDS AND DOCUMENTS

The first and foremost point that has to be borne in mind is that one has to find out what a reasonable man, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

It is inexpedient to construe the terms of one deed by reference to the terms of another.

Further, it is well established that the same word cannot have two different meanings in the same document, unless the context compels the adoption of such a rule.

The Golden Rule is to ascertain the intention of the parties to the instrument after considering all the words in the document/deed concerned in their ordinary, natural sense. For this purpose, the relevant portions of the document have to be considered as a whole. The circumstances in which the particular words had been used have also to be taken into account. Very often, the status and training of the parties using the words have also to be taken into account as the same words may be used by an ordinary person in one sense and by a trained person or a specialist in quite another special sense. It has also to be considered that very

many words are used in more than one sense. It may happen that the same word understood in one sense will give effect to all the clauses in the deed while taken in another sense might render one or more of the clauses ineffective. In such a case the word should be understood in the former and not the latter sense.

It may also happen that there is a conflict between two or more clauses of the same document. An effort must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect to. If, however, it is not possible to give effect to all of them, then it is the earlier clause that will over-ride the latter one.

Similarly, if one part of the document is in conflict with another part, an attempt should always be made to read the two parts of the document harmoniously, if possible. If that is not possible, then the earlier part will prevail over the latter one which should, therefore, be disregarded.

SUMMARY

Enacted laws, Acts and Rules are drafted by legal experts and so it is expected that the language used will leave little room for interpretation of construction. Interpretation or construction of statutes helps in finding of the meaning of ambiguous words and expressions given in the statutes and resolving inconsistency lying therein. If any provision of the statute is open to two interpretations, the Court has to choose that interpretation which represents the true intention of the legislature. The best interpretation of statutes is possible by adoption of various guiding rules of construction and aids to construction of statutes. The courts are the best interpreters. They strongly lean against a construction which reduces the statute to a futility. A statute or any enacting provision therein must be so construed as to make it effective and operative on the principle expressed in the maxim: *ut res magis valeat quam pereat*.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Formal legal document which creates or confirms a right or record a fact is a—

   (a) Document

   (b) Deed

   (c) Statute

   (d) Instrument

2. Which among the following is the cardinal rule of construction of statutes—
   (a) Harmonious Rule of construction
   (b) Beneficial Rule of construction
   (c) Literal Rule of construction
   (d) Reasonable Rule of construction
3. Rule of Reasonable Construction is based on the maxim—
   (a) Absolut asentenia expositor non indigent
   (b) Ut res magis valeat quam pareat
   (c) Quo facit per alium facit per se
   (d) contemporanea expositio
4. Rule of Beneficial construction is also known as—
   (a) Purposive construction
   (b) Mischieve Rule
   (c) Heydons's Rule
   (d) All of the Above
5. Pick the odd one out of the following aids to interpretation—
   (a) Preamble
   (b) Marginal Notes
   (c) Proviso
   (d) Usage
6. Which rule of construction is applicable where there is a real and not merely apparent conflict between the provisions of an Act, and one of them has not been made subject to the other—
   (a) Rule of Beneficial construction
   (b) Rule of Literal construction
   (c) Rule of Harmonious construction
   (d) Rule of Exceptional construction

7. An internal aid that may be added to include something within the section or to exclude something from it, is—

   (a) Proviso

   (b) Explanation

   (c) Schedule

   (d) Illustrations

8. An aid that expresses the scope, object and purpose of the Act—

   (a) Title of the Act

   (b) Heading of the Chapter

   (c) Preamble

   (d) Definitional sections

Answer to MCQs

1. (d) **2.** (c) **3.** (b) **4.** (d) **5.** (d) **6.** (c)
7. (b) **8.** (c)

QUESTION AND ANSWER

Question 1

Explain the rule of 'beneficial construction' while interpreting the statutes quoting an example.

Answer

Where the language used in a statute is capable of more than one interpretation, the most firmly established rule for construction is the principle laid down in the Heydon's case. This rule enables, consideration of four matters in constituting an act :

(1) what was the law before making of the Act,

(2) what was the mischief or defect for which the law did not provide,

(3) what is the remedy that the Act has provided, and

(4) what is the reason for the remedy.

The rule then directs that the courts must adopt that construction which 'shall suppress the mischief and advance the remedy'. Therefore even in a case where

the usual meaning of the language used falls short of the whole object of the legislature, a more extended meaning may be attributed to the words, provided they are fairly susceptible of it. If the object of any enactment is public safety, then its working must be interpreted widely to give effect to that object. Thus in the case of Workmen's Compensation Act, 1923 the main object being provision of compensation to workmen, it was held that the Act ought to be so construed, as far as possible, so as to give effect to its primary provisions.

However, it has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are ambiguous and are reasonably capable of more than one meaning *[CIT v. Sodra Devi (1957) 32 ITR 615 (SC)]*.

Question 2

Explain the principles of "Grammatical Interpretation" and "Logical Interpretation" of a Statute. What are the duties of a court in this regard?

Answer

Principles of Grammatical Interpretation and Logical Interpretation: In order to ascertain the meaning of any law/ statute the principles of Grammatical and Logical Interpretation is applied to conclude the real meaning of the law and the intention of the legislature behind enacting it.

Meaning: Grammatical interpretation concerns itself exclusively with the verbal expression of law. It does not go beyond the letter of the law, whereas Logical interpretation on the other hand, seeks more satisfactory evidence of the true intention of the legislature.

Application of the principles in the court: In all ordinary cases, the grammatical interpretation is the sole form allowable. The court cannot delete or add to modify the letter of the law. However, where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness, the court is under a duty to travel beyond the letter of law so as to determine the true intentions of the legislature. So that a statute is enforceable at law, however, unreasonable it may be. The duty of the court is to administer the law as it stands rather it is just or unreasonable.

However, if there are two possible constructions of a clause, the courts may prefer the logical construction which emerges from the setting in which the clause appears and the circumstances in which it came to be enacted and also the words used therein.

Question 3

(i) What is the effect of proviso? Does it qualify the main provisions of an Enactment?

(ii) Does an explanation added to a section widen the ambit of a section?

Answer

(i) Normally a Proviso is added to a section of an Act to except something or qualify something stated in that particular section to which it is added. A proviso should not be, ordinarily, interpreted as a general rule. A proviso to a particular section carves out an exception to the main provision to which it has been enacted as a Proviso and to no other provision. *[Ram Narian Sons Ltd. Vs. Commissioner of Sales Tax AIR (1955) S.C. 765]*

(ii) Sometimes an explanation is added to a section of an Act for the purpose of explaining the main provisions contained in that section. If there is some ambiguity in the provisions of the main section, the explanation is inserted to harmonise and clear up and ambiguity in the main section. Something may added be to or something may be excluded from the main provision by insertion of an explanation. But the explanation should not be construed to widen the ambit of the section.

Question 4

Gaurav Textile Company Limited has entered into a contract with a Company. You are invited to read and interpret the document of contract. What rules of interpretation of deeds and documents would you apply while doing so?

Answer

The rules regarding interpretation of deeds and documents are as follows :

First and the foremost point that has to be borne in mind is that one has to find out what reasonable man, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

It is inexpedient to construe the terms of one deed by reference to the terms of another. Further, it is well established that the same word cannot have two different meanings in the same documents, unless the context compels the adoption of such a rule.

The Golden Rule is to ascertain the intention of the parties of the instrument after considering all the words in the documents/deed concerned in their ordinary,

natural sense. For this purpose, the relevant portions of the document have to be considered as a whole. The circumstances in which the particular words have been used have also to be taken into account. Very often, the status and training of the parties using the words have also to be taken into account as the same words maybe used by a ordinary person in one sense and by a trained person or a specialist in quite another sense and a special sense. It has also to be considered that very many words are used in more than one sense. It may happen that the same word understood in one sense will give effect to all the clauses in the deed while taken in another sense might render one or more of the clauses ineffective. In such a case the word should be understood in the former and not in the latter sense.

It may also happen that there is a conflict between two or more clauses of the same documents. An effect must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect. If, however, it is not possible to give effect of all of them, then it is the earlier clause that will override the latter one.

Question 5

How will you interpret the definitions in a statute, if the following words are used in a statute ?

(i) Means, (ii) Includes

Give one illustration for each of the above from statutes you are familiar with.

Answer

Interpretation of the words "Means" and "Includes" in the definitions- The definition of a word or expression in the definition section may either be restricting of its ordinary meaning or may be extensive of the same.

When a word is defined to 'mean' such and such, the definition is 'prima facie' restrictive and exhaustive, we must restrict the meaning of the word to that given in the definition section.

But where the word is defined to 'include' such and such, the definition is 'prima facie' extensive, here the word defined is not restricted to the meaning assigned to it but has extensive meaning which also includes the meaning assigned to it in the definition section.

Example—

Definition of Director [section 2(34) of the Companies Act, 2013]—Director means a director appointed to the board of a company. The word "means" suggests exhaustive definition.

Definition of Whole time director [Section 2(94) of the Companies Act, 2013]—Whole time director includes a director in the whole time employment of the company. The word "includes" suggests extensive definition. Other directors may be included in the category of the whole time director.

Question 6

Differentiate Mandatory Provision from a Directory Provision. What factors decide whether a provision is directory or mandatory?

Answer

Practically speaking, the distinction between a provision which is 'mandatory' and one which is 'directory' is that when it is mandatory, it must be strictly observed; when it is 'directory' it would be sufficient that it is substantially complied with. However, we have to look to the substance and not merely the form, an enactment in mandatory form might substantially be directory and, conversely, a statute in directory form may in substance be mandatory. Hence, it is the substance that counts and must take precedence over mere form. If a provision gives a power coupled with a duty, it is mandatory: whether it is or is not so would depend on such consideration as:

- the nature of the thing empowered to be done,
- the object for which it is done, and
- the person for whose benefit the power is to be exercised.

Question 7

Define Grammatical Interpretation. What are the exceptions to grammatical interpretation?

Answer

Grammatical Interpretation and its exceptions: 'Grammatical interpretation' concerns itself exclusively with the verbal expression of the law, it does not go beyond the letter of the law. In all ordinary cases, 'grammatical interpretation' is the sole form allowable. The Court cannot take from or add to modify the letter of the law.

This rule, however, is subject to some exceptions:

(i) Where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness. As regard the defect to ambiguity, the Court is under a duty to travel beyond the letter of the law so as to determine from the other sources the true intention of the legislature. In the case of the statutory expression being defective on account of inconsistency, the court must ascertain the spirit of the law.

(2) If the text leads to a result which is so unreasonable that it is self-evident that the legislature could not mean what it says, the court may resolve such impasse by inferring logically the intention of the legislature.

Question 8

Write short note on:

(i) Provision

(ii) Explanation,

with reference to interpretation of Statutes, Deeds and Documents.

Answer

(i) **Proviso:** The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision.

(ii) **Explanation:** An Explanation is at times appended to a section to explain the meaning of the text of the section. An Explanation may be added to include something within the section or to exclude something from it. An Explanation should normally be so read as to harmonise with and clear up any ambiguity in the main section. It should not be so construed as to widen the ambit of the section.

The meaning to be given to an explanation will really depend upon its terms and not on any theory of its purpose.

Question 9

Explain 'Mischieve Rule' for interpretation of statute. Also, give four matters it considers in construing an Act.

Answer

Mischieve Rule: Where the language used in a statute is capable of more than one interpretation, principle laid down in the Heydon's case is followed. This is known as 'purposive construction' or 'mischieve rule'. The rule then directs that the courts must adopt that construction which 'shall suppress the mischief and advance the remedy'.

It has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are ambiguous and are reasonably capable of more than one meaning.

It enables consideration of four matters in construing an Act:

(1) what was the law before the making of the Act;

(2) what was the mischief or defect for which the law did not provide;

(3) what is the remedy that the Act has provided; and

(4) what is the reason for the remedy.

Question 10

Explain how 'Dictionary Definitions' can be of great help in interpreting / constructing an Act when the statute is ambiguous.

Answer

Dictionary Definitions: First we refer the Act in question to find out if any particular word or expression is defined in it. Where we find that a word is not defined in the Act itself, we may refer to dictionaries to find out the general sense in which that word is commonly understood. However, in selecting one out of the several meanings of a word, we must always take into consideration the context in which it is used in the Act. It is the fundamental rule that the meanings of words and expressions used in an Act must take their colour from the context in which they appear. Further, judicial decisions laying down the meaning of words in construing statutes *in pari materia* will have greater weight than the meaning furnished by dictionaries. However, for technical terms, reference may be made to technical dictionaries.