Final Course

(Revised Scheme of Education and Training)

Study Material

(Modules 1 to 3)

Paper 4

Corporate and Economic Laws

Part – I : Corporate Laws

Module – 1

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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BEFORE WE BEGIN …

Revised Scheme of Education and Training: Bridging the competence gap

The role of a Chartered Accountant is evolving continually to assume newer responsibilities in a dynamic environment. There has been a notable shift towards strategic decision making and entrepreneurial roles that add value beyond traditional accounting and auditing. The causative factors for the change include globalisation leading to increase in cross border transactions and consequent business complexities, significant developments in information and technology and financial scams underlining the need for a stringent regulatory set up. These factors necessitate an increase in the competence level of Chartered Accountants to bridge the gap in competence acquired and competence expected from stakeholders. Towards this end, the competence requirements are being stepped up to enable aspiring Chartered Accountants to acquire the requisite professional competence to take on new roles.

Concurrent Practical Training along with academic education: Key to achieving the desired level of Professional Competence

Under the Revised Scheme of Education and Training, at the Final Level, you are expected to apply the professional knowledge acquired through academic education and the practical exposure gained during articleship training in addressing issues and solving practical problems. The integrated process of learning through academic education and practical training should also help you to inculcate the requisite technical competence, professional skills and professional values, ethics and attitudes necessary for achieving the desired level of professional competence.

Corporate and Economic Laws: Dynamic Subject Area

Corporate and Economic Laws is one of the dynamic subjects of the Chartered Accountancy course. This subject at the Final level is divided into two parts, namely, Part I: Corporate Laws for 70 marks and Part II: Economic Laws for 30 marks.

Part I: Corporate Laws comprises of the law and procedures under the Companies Act, 2013 and the Securities Laws covering significant provisions of Securities Contract (Regulation) Act, 1956 read with the Securities Contract (Regulation) Rules, 1957 and the Securities Exchange Board of India Act, 1992 read with SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015.

Part II: Economic Laws comprises of significant provisions of select economic laws namely, the Foreign Exchange Management Act, 1999, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Prevention of Money Laundering Act, 2002, the Foreign Contribution Regulation Act, 2010, the Insolvency and Bankruptcy Code, 2016 and the Arbitration and Conciliation Act, 1996.

The liberalisation and globalisation of our economic policies to be in tune with the global changes brings in several reforms in the Corporate and Economic Laws of our country on day to today basis. These laws are being amended and fine-tuned to be more dynamic, vibrant for corporate

growth, infusing more capital into the country and at the same time protecting and safeguarding the interests of various stakeholders. The statutory authority in charge with the administration of these laws, clarify various issues through the notification, clarifications and through the legislative amendments the meaning and scope of certain provisions to implement the provisions of the Act.

This Study Material is based on the provisions of Company law, Securities Laws, and the Economic Laws which are amended by the concerned authorities vide significant notifications and circulars issued upto 30th April, 2019. This Study Material is relevant for May 2020 examinations and onwards.

Further, if any legislative amendments are notified from 1st May, 2019 to 31st October, 2019, students would be informed about the developments through Revision Test Paper (RTP) for May 2020 examination. Similarly, for amendments notified for the period 1st November, 2019 to 30th April, 2020 students would be informed through Revision Test Paper (RTP) for November 2020 examination.

For May 2020 examinations onwards, certain topics of the syllabus have been excluded/included in line with the announcement dated 24th June, 2019 hosted on the BoS Announcement Portal. This study material has been revised taking into account the above exclusions/inclusions. Also, exclusions/inclusions of the topics from the syllabus are done through Study Guidelines.

Moreover, students are advised to check the Board of Studies Knowledge Portal regularly for further developments.

Framework of Chapters: Uniform Structure comprising of specific components

Efforts have been made to present the 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 three modules for ease of handling by students. The first two modules are on Corporate Laws comprising of Company Law and the Securities laws and the third module is on Economic Laws.

Each chapter of the Study Material has 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 detailed in the first page of each chapter. Demonstration of these learning outcomes would help you to achieve the desired level of technical competence
2.	Content	The concepts and provisions of Corporate and Economic Laws are explained in student-friendly manner with the aid of examples/ diagrams /flow charts wherever possible. 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 concepts/provisions. These value additions would, thus, help you develop conceptual clarity and get a good grasp of the topic.
3.	**Exercise Questions with Answers**	The exercise questions and answers would help you to analyse the provisions of Corporate and Economic Laws and apply the same in problem solving, thus, sharpening your application skills. In effect, these questions would test your ability to analyse, interpret and apply the concepts/provisions learnt in solving problems and addressing issues. Small case scenarios have also been given to test your analytical ability and interpretational skills.

We hope that these student-friendly features in the Study Material improves your learning curve and sharpens your analytical and interpretational skills.

Happy Reading and Best Wishes!

SYLLABUS

PAPER – 4: CORPORATE AND ECONOMIC LAWS

(One paper - Three hours - 100 marks)

PART–I: CORPORATE LAWS (70 Marks)

SECTION A: COMPANY LAW

Objective:

To acquire the ability to analyze, interpret and apply the provisions of the company law in practical situations

Contents:

1. **The Companies Act, 2013** and Rules framed thereunder in its entirety with specific reference to section 149 onwards:
   - (i) Appointment and Qualifications of Directors
   - (ii) Appointment and remuneration of Managerial Personnel
   - (iii) Meetings of Board and its powers
   - (iv) Inspection, inquiry and Investigation
   - (v) Compromises, Arrangements and Amalgamations
   - (vi) Prevention of Oppression and Mismanagement
   - (vii) Winding Up
   - (viii) Producer Companies
   - (ix) Companies incorporated outside India
   - (x) Miscellaneous Provisions
   - (xi) Compounding of offences, Adjudication, Special Courts
   - (xii) National Company Law Tribunal and Appellate Tribunal
2. **Corporate Secretarial Practice–**Drafting of Notices, Resolutions, Minutes and Reports

Note: The provisions of the Companies Act, 1956 which are still in force would form part of the syllabus till the time their corresponding or new provisions of the Companies Act, 2013 are enforced.

SECTION B: SECURITIES LAWS

Objective:

To acquire the ability to analyse the significant provisions of select securities laws

1. **The Securities Contract (Regulation) Act, 1956 and the Securities Contract (Regulation) Rules, 1957:** Introduction and important provisions
2. **The Securities Exchange Board of India Act, 1992,** SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015

PART II: ECONOMIC LAWS (30 MARKS)

Objective:

To acquire the ability to analyse the significant provisions of select economic laws:

Contents:

1. **The Foreign Exchange Management Act, 1999:** Introduction, broad structure of FEMA, Definition, Regulation and Management of Foreign Exchange, Contraventions and Penalties in brief, miscellaneous provisions
2. **The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002**: Important Definitions, Regulation of Securitisation and Reconstruction of Financial Assets of Banks and Financial Institutions, Enforcement of Security Interest, Offences and Penalties, Miscellaneous Matters
3. **The Prevention of Money Laundering Act, 2002**: Definitions, Punishment for the Offence of Money laundering, Obligation of Banking Companies, Financial Institutions and Intermediaries or a person carrying on a designated business or profession, Appellate Tribunal, Special Court, Procedure for Attachment and Confiscation of Property and Recovery of fines and penalties.
4. **Foreign Contribution Regulation Act, 2010:** Definitions, Regulation of Foreign contribution and miscellaneous provisions
5. **The Arbitration and Conciliation Act, 1996**: General Provisions, Arbitration agreement, Tribunal, Conciliation
6. **The Insolvency and Bankruptcy Code, 2016**: Preliminary, Corporate insolvency resolution process, Liquidation process and other provisions

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 affected every year by way of study guidelines, if any.

SIGNIFICANT ADDITIONS/MODIFICATIONS IN 2019 EDITION OVER 2017 EDITION

Division of syllabus	Chapters	Amendments
Part I- Section A	**Company Law (Chapters 1-13)**	• Incorporated relevant amendments from 1st May, 2017 to 30th April, 2019 • Changes in Presentation through insertion of flowchart, table, diagram etc. • Addition of examples for conceptual clarity • Insertion of explanation of the provisions (wherever required) for better understanding along with the reference of relevant Rules, wherever required. • Changes in the coverage of the topics in line with the modification in the coverage of the syllabus made vide announcement dated 24th June, 2019. • Addition of more questions for practice under the heading "test your knowledge".
Part I- Section B	**Securities Laws (Chapters 1-2)**	• Incorporation of amendments from 1st May, 2017 to 30th April, 2019 made through the Regulatory Authorities and the Finance Act from time to time. • Changes in Presentation through insertion of flowchart, table, diagram etc. • Changes in the coverage of the topics in line with the modification in the coverage of the syllabus made vide announcement dated 24th June, 2019. • Addition of more questions for practice under the heading "test your knowledge".
Part II	**Economic Laws (Chapters 1- 6)**	• Incorporation of amendments from 1st May, 2017 to 30th April, 2019 made through the Regulatory

		Authorities and the Finance Act from time to time. • Changes in Presentation through insertion of flowchart, table, diagram. • Addition of more examples • Insertion of explanation of the provisions (wherever required) for better understanding • Changes in the coverage of the topics in line with the modification in the coverage of the syllabus made vide announcement dated 24th June, 2019. • Addition of more questions for practice under the heading "test your knowledge".

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CHAPTER-7: WINDING UP

CHAPTER 1

APPOINTMENT AND QUALIFICATIONS OF DIRECTORS

LEARNING OUTCOMES

By the end of this chapter, students will be able to:

- Know the provisions relating to the appointment of directors, number of directors, women directors and others.
- Understand about the Director Identification Number, its allotment and other matters relating to DIN.
- Know as to who are Independent Directors, their appointment, qualifications, tenure, etc.
- Understand the provisions relating to the additional director, alternate director, nominee director and casual vacancy.
- Know about the provisions relating to small shareholders' director, retirement by rotation, principle of proportional representation for appointment, maximum directorships, etc
- Understand the disqualifications pertaining to the appointment as director, duties of directors, vacation of office of director, resignation of director, removal of director, etc.

1. INTRODUCTION

According to Section 2 (*10*) of the Companies Act, 2013 (in short 'the Act'), "**Board of Directors**" or "**Board**", in relation to a company, means the collective body of the directors of the company.

According to section 2(*34*) "director" means a director appointed to the Board of a company.

The directors are the individuals who are appointed to manage the business affairs of a company. A company is an artificial person created by law having separate legal existence but without any physical body or mind of its own. It needs to be managed through the human beings. Though the shareholders being owners are physically available to manage their company but as their number grows, all of them together may not be able to manage the affairs; and if they do so it shall be mismanagement and nothing else. That's why the concept of directors has emerged. The directors (within the permissible limit) may be elected from among the shareholders or outsiders, if required, may also be appointed as directors.

Legal position of Directors

As regards legal position of directors in relation to a company, they can be considered both agents and trustees. As agents, they bind the company as their principal as soon as they enter into various transactions on its behalf. The law of agency comes into play and it governs the relationship between the company and its directors. At times, the company itself is principal as well as agent in respect of certain acts which cannot be delegated. The Companies Act, 2013 lays down provisions requiring as to when the company needs to act both as principal as well as agent and when the directors need to act as agent of the company. It may be noted that where directors are empowered to take certain decisions, the company cannot negate them or issue directions to the directors directing them to go for a particular decision except that it may replace the directors with the ones of its choice. As trustees, the directors are required to take care of properties, moneys, trade secrets, etc. belonging to the company. In fact, as trustees the directors are in a fiduciary relationship with the company (and not with any individual shareholder) and if such relationship is broken and the company suffers a loss because of the illegal acts of the directors, the erring directors will be required to reimburse the loss suffered by the company. The office of directorship is an office of trust.

The definition of 'officer' given in Section 2 (59) of the Act, *inter-alia,* includes 'director' which means a director, at certain times, is also the officer of the company. Since an officer is an employee of the company, the director as officer is also an employee so far as certain provisions of the Companies Act, 2013 are concerned.

Collective body of the directors

The collective body of the directors is called the 'Board of Directors' or simply the 'Board'. It is the Board which takes decisions at its meetings and not any individual director. This is the reason why a quorum (*i.e.* presence of minimum directors at the Board meetings) is prescribed so that collective

decisions are taken. At times, if permitted, the decisions can be taken by the Board without calling a meeting but in that case too they are collective decisions.

2. COMPANY TO HAVE BOARD OF DIRECTORS [SECTION 149]

Section 149 of the Act contains provisions which require every company to have a duly constituted Board of Directors. These provisions are stated as under:

Number of Directors: According to section 149(1), every company shall have a Board of Directors consisting of **individuals as directors**. Thus, any person other than individuals like a body corporate, firm or association of persons cannot be appointed as director.

Every company shall have-

(a) minimum number of directors:

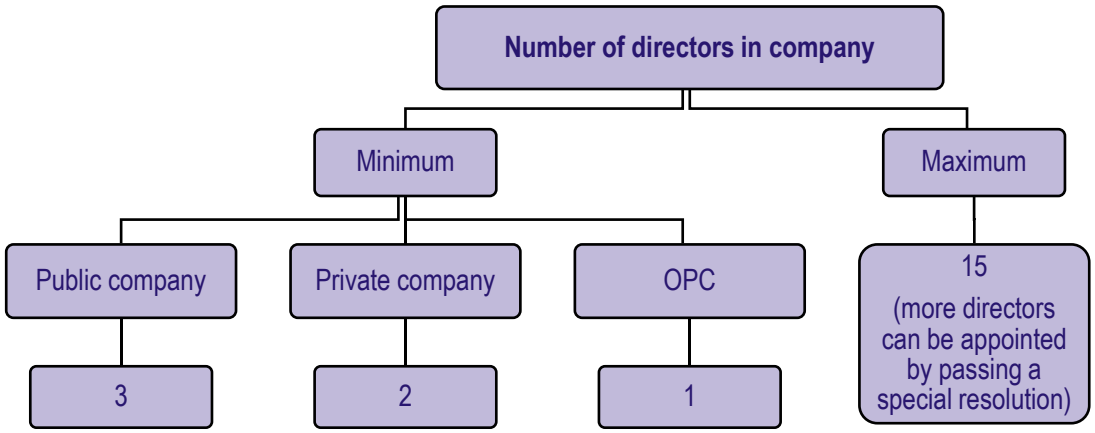
(A) in case of a Public Company - 3,

(B) in case of a Private Company - 2, and

(C) in case of a One Person Company (OPC) - 1

(b) maximum number of directors: 15

Note: If the company wants to appoint more than 15 directors, it can do so after passing a special resolution.



Exemptions

*(A) A **Government company** is exempted: (i) from the application of Section 149 (1) (b) which requires a company to have a maximum of fifteen directors only; and (ii) from the application*

of First Proviso to Section 149 (1) which enables a company to appoint more than fifteen directors after passing a special resolution.

However, above exemption is applicable only if such Government company has not committed a default in filing its financial statements under Section 137 or Annual return under Section 92 with the registrar. [Notification No. G.S.R. 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13-06-2017].

(B) Similar exemption, as above, is also applicable to ***Section 8 Companies*** *subject to the condition that such a company has not committed a default in filing its financial statements under Section 137 or Annual return under Section 92 with the registrar. [Notification No. 466 (E), dated 5th June, 2015 (as amended by Notification No. 584 (E), dated 13th June, 2017)].*

(c) **Woman director:** At least one woman director shall be on the Board of such class or classes of companies as has been prescribed in Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 *[Second proviso to section 149(1)]*

Rule 3 provides that the following classes of companies shall appoint at least one woman director-

(1)	every listed company;
(2)	every other public company having -
	(A) paid–up share capital of one hundred crore rupees or more; or
	(B) turnover of three hundred crore rupees or more.

Explanation.- For the purposes of having a woman director on the board, it is clarified that the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

Compliance by a newly incorporated company: A company, which has been incorporated under the Act and is covered by the provisions requiring appointment of a woman director, shall comply with such provisions within a period of six months from the date of its incorporation.

Filling of Intermittent Vacancy of Woman Director: Any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

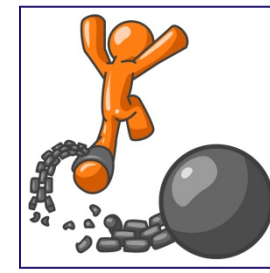
Example: Sheetal was occupying the office of woman director in a company but due to her sudden death on 17th March, 2019, the intermittent vacancy so occurred was required to be filled-up at the earliest because she was the only woman director on the board. The

immediate Board meeting was held on 25th June, 2019. The vacancy of the women director must be filled-up latest by 25th June, 2019 if not filled-up earlier *i.e.* within three months till 16th June, 2019 from the date of arsing of the intermittent vacancy.

(d) **Resident Director:** Every company shall have at least one director who stays in India for a total period of not less than one hundred and eighty-two days during the financial year.

However, in case of a newly incorporated company the above requirement shall apply proportionately at the end of the financial year in which it is incorporated. *[Section 149(3)]*

(e) **Independent Director**: Prescribed large public companies are required to appoint independent directors on their Board with a view to boost the level of corporate governance. Such large companies are the backbone of any economy and therefore, they must be managed in the best possible manner including adhereing to the specified legal provisions. An independent director needs to have an independent mindset which should not be unduly influenced by the other members of the Board; and if such members take any decision which is illegal or not in the best interest of the company or economy it must be hindered by the independent directors at the outset. The provisions relating to independent directors are discussed later in the Chapter.



(f) **Interested Director**: An interested director is one among the other directors who constitute Board of Directors. In fact, when an existing director becomes interested in a transaction of the company, he is called interested director; and he needs to disclose his interest at the appropriate forum and at appropriate time. The provisions regarding interested director are discussed in another Chapter.

(g) **Executive and Non-Executive Directors:** The Board of Directors may comprise both executive and non-executive directors. The executive directors are responsible for managing different business operations undertaken by the company. It is their responsibility that the departments which they head operate smoothly. In contrast, the non-executive directors participate through Board meetings in discussions relating to framing of policies for the efficient management of the company. Independent directors are a type of non-executive directors. They are not as active as executive directors. They are to be held liable only if they knowingly consented to the wrongful acts.

3. APPOINTMENT OF DIRECTORS [SECTION 152]

Section 152 of the Act deals with the matters relating to appointment of directors.

(i) Appointment of First Directors

Where no provision is made in the articles of a company for the appointment of the first directors, the **subscribers to the memorandum** who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed. [Section 152(1)]

In case of a One Person Company (OPC), **an individual being member** shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section. [Section 152(1)]

In simple words, the above provisions are discussed below:

Usually, articles of the company contain the names of the first directors. In case it is not so, then the individual subscribers to the memorandum are deemed to be the first directors. The corporate bodies, if they are also subscribers, shall not be capable of becoming directors. The first directors shall hold the office until the directors are duly appointed. In fact, the term of first directors is limited to the holding of first Annual General Meeting (AGM). So far as OPC is concerned, the individual member of the OPC is deemed as first director. Thereafter, such member may appoint director or directors as per his requirements.

(ii) Appointment of subsequent Directors

Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting. [refer Section 152(2)]

At a general meeting, the shareholders of the company (*i.e.* the owners) gather and take decisions. Generally, every director shall be appointed by the company in general meeting except where the Companies Act expressly provides some other procedure for appointment of directors. For example, it is expressly provided in the Act that additional directors or alternate directors can be appointed by the Board of Directors if the articles of the company empower Board in this respect[1].

[1] As per Section 161, explained later on.

(iii) Other Requirements of Appointment

(a) **Allotment of Director Identification Number (DIN):** A person shall be appointed as a director of a company only when he has been allotted DIN under section 154 or any other number as may be prescribed under section 153. [refer Section 152(3)]

(b) **Providing of DIN and furnishing of Declaration by the proposed Director:** Every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number (DIN) or such other number as may be prescribed under Section 153. Further, he shall also furnish a declaration that he is not disqualified to become a director under this Act. [refer Section 152(4)]

(c) **Written Consent to act as Director:** A person appointed as a director shall not act as a director unless he gives his written consent to hold the office as director. The consent shall be furnished to the company on or before his appointment as director in Form DIR-2.

The company shall file the consent of the director with the Registrar within 30 days of such appointment in Form DIR-12 along with the prescribed fee as prescribed [refer Section 152 (5) and Rule 8 of the Companies (Appointment and Qualification of Directors) Rules, 2014].

(d) **Explanatory Statement in case of appointment of Independent Director:** In case an independent director is appointed in the general meeting, an explanatory statement for such appointment annexed to the notice for the general meeting, shall include a statement that in the opinion of the Board, he fulfills the conditions specified in this Act for such an appointment [refer Proviso to Section 152 (5)].

Exemptions

Non-applicability of Section 152 (5):

(1) Section 152 (5) regarding 'furnishing of consent to act as a director' shall not apply in case of Government company where appointment of the director is done by the Central Government or State Government. [Notification No. G.S.R. 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13-06-2017].

(2) Similar exemption from Section 152(5) is also applicable to a section 8 company. [Notification No. 466 (E), dated 5th June, 2015 as amended by Notification No. 584 (E), dated 13th June, 2017].

***Note:** In both the above cases, the exemption is applicable only if such a company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

(iv) Retirement of Directors by Rotation [Section 152(6)]

Section 152 (6) deals with retirement of directors by rotation. The reason behind incorporation of such a provision in the Statute is that at no stage a self-perpetuating management should take control of the company. Under the model of self-perpetuating management, the board of directors is allowed to control its own composition *i.e.* such board can dictate the terms like how long a director can serve, and even it can elect and re-elect directors itself. This type of model may not be conducive to the healthy growth of the company. In effect, shareholders are the owners of the company but they cannot usurp the powers of the directors and interefere in the matters of managing the company. The concept of rotational directors enables them not to re-elect a retiring director for whom they have an unfavourable opinion. The provisions of Section 152 (6) are stated as under:

(a) Unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of public company shall—

(A) be persons whose period of office is liable to determination by retirement of directors by rotation; and

(B) save as otherwise expressly provided in this Act, be appointed by the company in general meeting.

(b) The remaining directors in the case of any such company shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

(c) At the first annual general meeting of a public company held next after the date of the general meeting at which the first directors are appointed and at every subsequent annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office.

It is to be noted that the provision regrding 'retirement by rotation' is applicable to a public company or a private company which is subsidiary of a public company. A pure private company is exempted, and therefore, if the articles permit it can appoint all its directors as non-rotational directors or permanent directors.

The articles of a public company may provide for the retirement of all the directors at every annual general meeting. If such is not the case, then not less than two-thirds of the total number of directors of that public company shall be the persons who are liable to retire by rotation. In other words, the articles must provide that minmum two-thirds of the total number of directors shall be liable to retirement by rotation. Such directors are called rotational directors.

The term "total number of directors" shall not include independent directors, whether appointed under the Companies Act, 2013 or any other law for the time being in force, on the Board of a company. Thus, independent directors are not liable to retire by rotation and therefore, they are non-rotational directors.

[2]Further, any person appointed as a nominee director being nominated by any institution in pursuance of the provisions of any law or any agreement (like when a financial institution that has been created by an Act of Parliament nominates a person as its nominee director on the Board of a company which has availed financial assistance from such institution) cannot be considered as a director liable to retire by rotation. Nominee director may also be appointed by the Central Government or the State Government by virtue of its shareholding in a Government company.

One-third of directors to retire at AGM: Once the number of directors who are liable to retire by rotation is determined, only one-third out of that number shall retire. If such number is neither three nor a multiple of three, then, the number nearest to one-third, shall be considered and such of the directors shall retire from office.

Example 1: A company is having six directors.

Directors liable to retire by rotation: 6 * 2/3 i.e. 4

No. of directors to retire at AGM: 4* 1/3, *i.e.* 1.33 or nearest to 1/3rd is 1.

Example 2: A company is having 7 directors.

Directors liable to retire by rotation 7*2/3 i.e. 4.7 or 5 (not less than two-third)

No. of directors to retire at AGM: 5* 1/3 i.e. 1.67 or nearest to 1/3rd is 2.

Example 3: A company is having 9 directors out of which 3 are independent directors. The 'total number of directors' for the purpose of calculation of number of rotational directors shall be six only because three independent directors are to be excluded. Rest of the calculations shall be as per Example 1.

(d) The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot.

The above provision (d) clarifies the basic question that after the determination of number of directors liable to retire by rotation, who should actually retire at the AGM? For this purpose it is provided that the directors who have been longest in the office since their last appointment are the directors who need to be retired first. However, it

[2] Refer Section 161 (3).

may happen that some of those were appointed as directors on the same day. In that case, if there exists any mutual understanding relating to retirement among such directors, that should be followed; otherwise the determination shall be done by draw of lots.

(e) At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto.

Re-appointment: When a director is retired a vacancy is created. To fill that vacancy, the company may re-appoint the retiring director itself at the AGM. If the retiring director is not re-appointed, the company may appoint some other person at his place but in that case provisions of Section 160[3] are to be complied with.

The clause regarding appointment of directors for filling the vacancies created by retiring directors is quite important, for at no stage the number of directors should fall short of minimum directors required in a company. However, so long as the clause regarding minimum required directors is fulfilled the company may also resolve not to appoint anyone in place of retiring director.

In case Annual General Meeting is not held on due date, then the retirement of rotational directors cannot be postponed to that particular date when the AGM shall be held in future. The directors who are liable to retire must vacate the office of director on that very date when the AGM is ought to have been held.

Non-rotational Directors: Remaining 1/3rd or less number of total directors (after determining the number of rotational directors) are not liable to retire by rotation. These are called non-rotational directors. They may also be appointed at the general meeting or as per the provisions contained in the articles of the company.

(v) Deemed re-appointment of retiring Directors under certain circumstances [Section 152(7)]

Section 152 (7) paves way for deemed appointment of a retiring director as under:

(a) ***Adjournment of general meeting:*** If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place.

In case that day is a national holiday, the meeting shall be adjourned till the next succeeding day which is not a holiday, at the same time and place.

(b) ***Deemed re-appointment:*** If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the

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[3] Section 160 is discussed later in the Chapter.

vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting.

Exceptions to deemed re-appointment: In the following circumstances, a retiring director shall not be deemed as re-appointed:

(A) if at that meeting or at the previous meeting, a resolution for the re-appointment of such director has been put to the meeting and lost *i.e.* his re-appointment has not been considered favourably because of non-passing of resolution;

(B) if the retiring director has, by a notice in writing addressed to the company or its Board of directors, expressed his unwillingness to be so re-appointed;

(C) if he is not qualified or is disqualified for appointment;

(D) if a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of this Act; or

(E) if Section 162 is applicable to the case *i.e.* where a single resolution was used to appoint two or more persons as directors without first moving a proposal which was required to be agreed to at the meeting and no vote was being cast against it. In such a case, Section 162 is contravened and two or more appointments made by a single resolution are void. Consequently, retiring director is not deemed to be re-appointed.

Note: For the purposes of Section 152, the "retiring director" means a director retiring by rotation[4].

Exemptions

Non-applicability of Sections 152 (6) and 152 (7): *Section 152 (6) and 152 (7) of the Act of 2013, shall not apply to:*

(a) a Government company, which is not a listed company, in which not less than fifty-one per cent. of 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;

(b) a subsidiary of a Government company, referred to in (a) above.

subject to the condition that such a company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

[Notification No. G.S.R. 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13-06-2017].

[4] Explanation to Section 152 (7).

4. DIRECTOR IDENTIFICATION NUMBER (DIN) [SECTION 152 (3) AND SECTIONS 153 TO 159]

"Director Identification Number" (DIN)[5]: DIN means an identification number allotted by the Central Government to any individual, intending to be appointed as director or to any existing director of a company, for the purpose of his identification as a director of a company.

It is provided that the Director Identification Number (DIN) obtained by the individuals prior to the notification of the '*Specification of Definitions Details Rules*' shall be the DIN for the purpose of the Companies Act, 2013.

Further, it is to be noted that "Director Identification Number" (DIN) shall include the Designated Partnership Identification Number (DPIN) issued under section 7 of the Limited Liability Partnership Act, 2008 and the rules made thereunder.

Requirement of DIN: According to Section 152 (3), no person shall be appointed as a director of a company unless he has been allotted the Director Identification Number (DIN) under section 154 or any other number as may be prescribed under section 153.

Filing of Application for allotment of DIN: Section 153 deals with the filing of application for allotment of DIN. Accordingly, every individual intending to be appointed as director of a company shall make an application for allotment of DIN to the Central Government in the prescribed form and manner and along with prescribed fees.

It is provided that the Central Government may prescribe any identification number which shall be treated as Director Identification Number and in case any individual holds or acquires such identification number, the requirement of Section 153 shall not apply or apply in such manner as may be prescribed.

Further, Rule 9 of the *Companies (Appointment and Qualification of Directors) Rules, 2014* states the following **procedure** for making an **application for allotment of DIN before appointment in an existing company**:

(1) Every applicant, who intends to be appointed as director of an existing company shall make an application electronically in Form DIR-3, to the Central Government[6] for allotment of a Director Identification Number (DIN) along with the prescribed fees.

It is provided that in case of proposed directors not having approved DIN, the particulars of maximum three directors shall be mentioned in Form No.INC-32 (SPICe) and DIN may be allotted to maximum three proposed directors through Form INC-32 (SPICe).

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[5] As per Rule 2 (1) (e) of the Companies (Specification of Definitions Details) Rules, 2014

[6] *Vide* Notification No. S.O. 1354(E) dated 21st May, 2014, issued by MCA, the powers and functions of the Central Government in respect of allotment of Director Identification Number under Sections 153 and 154 stand delegated to the Regional Director, Joint Director, Deputy Director or Assistant Director posted in the office of Regional Director at Noida.

(2) The Central Government shall provide an electronic system to facilitate submission of application for the allotment of DIN through the portal on the website of the Ministry of Corporate Affairs.

(3) (a) The applicant shall download Form DIR-3 from the portal, fill in the required particulars sought therein, verify and sign the form and after attaching copies of the following documents, scan and file the entire set of documents electronically-

(i) photograph;

(ii) proof of identity;

(iii) proof of residence;

(iiia) board resolution proposing his appointment as director in an existing company

(iv) specimen signature duly verified.

(b) Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital Signature Certificate and shall be verified digitally by a company secretary in full time employment of the company or by the managing director or director or CEO or CFO of the company in which the applicant is intended to be appointed as director in an existing company.

(4) In case the name of a person does not have a last name, then his or her father's or grandfather's surname shall be mentioned in the last name along with the declaration in Form No.DIR-3A.

Allotment of DIN: According to section 154, the Central Government shall allot a Director Identification Number (DIN) to the applicant in the prescribed manner **within one month** from the receipt of application.

Rule 10 of the *Companies (Appointment and Qualification of Directors) Rules, 2014* provides the following procedure for rejection or allotment of DIN:

(i) On the submission of the Form DIR-3 on the portal and on payment of the requisite fees, an application number shall be generated by the system automatically.

(ii) After generation of application number, the Central Government shall process the applications received for allotment of DIN and decide on the approval or rejection thereof and communicate the same to the applicant along with the DIN allotted in case of approval by way of a letter by post or electronically or in any other mode, within a period of **one month** from the receipt of such application.

(iii) If the Central Government, on examination, finds such application to be defective or incomplete in any respect, it shall give intimation of such defect or incompleteness, by placing it on the website and by email to the applicant who has filed such application. The applicant

shall be directed to rectify the defects or incompleteness by resubmitting the application within a period of 15 days of such placing on the website and email.

It is provided that the Central Government shall –

(a) reject the application and direct the applicant to file fresh application with complete and correct information, where the defect has been rectified partially or the information given is still found to be defective;

(b) treat and label such application as invalid in the electronic record in case the defects are not removed within the given time; and

(c) inform the applicant either by way of letter by post or electronically or in any other mode.

(iv) In case of rejection or invalidation of application, the fee so paid with the application shall neither be refunded nor adjusted with any other application.

Note 1: All DINs allotted to individual(s) by the Central Government before the commencement of these rules shall be deemed to have been allotted to them under these rules.

Note 2: The DIN so allotted under these rules is valid for the life-time of the applicant and shall not be allotted to any other person.

Prohibition on obtaining more than one DIN: According to Section 155, no individual, who has already been allotted a DIN under section 154, shall apply for, obtain or possess another DIN.

Director to intimate DIN: According to Section 156, every existing director shall, within one month of the receipt of DIN from the Central Government, intimate his DIN to the company or all the companies wherein he is a director.

Company to inform DIN to Registrar: According to section 157 (1), every company shall, within 15 days of the receipt of intimation under section 156, furnish the DIN of all its directors to the Registrar or any other officer or authority as may be specified by the Central Government with such fees or additional fees as may be prescribed. Every such intimation shall be furnished in the prescribed form and manner.

According to Rule 10A of the Companies (Appointment and Qualification of Directors) Rules, 2014[7]:

(1) Every director, functioning as a director in one or more companies on or before the 30th June, 2007 and who has not yet intimated his DIN to such company or companies shall, within one month of the receipt of Director Identification Number from the Central Government, intimate his Director Identification Number to the company or all companies wherein he is a director as per Form DIR-3B.

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[7] Inserted by the Companies (Appointment and Qualification of Directors) (Amendment) Rules, 2014, w.e.f. 18-09-2014.

(2) The intimation by the company of Director Identification Number of its directors under section 157 shall be furnished in Form DIR-3C within 15 days of receipt of intimation under section 156."

Punishment for failure to furnish the DIN to Registrar: According to Section 157 (2)[8] if any company fails to furnish the DIN to Registrar, it shall be liable to a penalty as under:

- ₹ 25,000 and in case of continuing failure, with a further penalty of ₹ 100 for each day after the first during which such failure continues, subject to a maximum of ₹ 1,00,000.
- Further, every defaulting officer of the company shall be liable to a penalty as under:

  Minimum penalty of ₹ 25,000 and in case of continuing failure, with a further penalty of ₹ 100 for each day after the first during which such failure continues, subject to a maximum of ₹ 1,00,000.

Obligation to indicate DIN: According to Section 158, every person or company, while furnishing any return, information or particulars as are required to be furnished under the Companies Act, 2013, shall mention the Director Identification Number in such return, information or particulars in case such return, information or particulars relate to the director or contain any reference of any director.

Punishment for contravention of Sections 152, 155 and 156: Section 159[9] provides that if any individual or director of a company makes any default in complying with any of the provisions of section 152, section 155 and section 156, such individual or director of the company shall be liable to a penalty as under:

- Penalty upto ₹ 50,000 and where the default is a continuing one, with a further penalty up to ₹ 500 for each day after the first during which such default continues.

Cancellation or Surrender or De-activation and Re-activation of DIN:

Rule 11 of the *Companies (Appointment and Qualification of Directors) Rules, 2014*[10] lays down the procedure for cancellation or surrender or deactivation and re-activation of DIN as under:

(1) The Central Government or Regional Director (Northern Region), Noida or any officer authorised by the Regional Director may, upon being satisfied on verification of particulars or documentary proof attached with the application received along with prescribed fee from any person, cancel or deactivate the DIN in case -

  (a) the DIN is found to be duplicated in respect of the same person provided the data related to both the DINs shall be merged with the validly retained number;

  (b) the DIN was obtained in a wrongful manner or by fraudulent means;

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[8] As substituted by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. **2-11-2018**.
[9] As substituted by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. 2-11-2018.
[10] As amended by the Companies (Appointment and Qualification of Directors) (Fourth Amendment) Rules, 2018, dated 05-07-2018, w.e.f. 10-07-2018.

However, before cancellation or deactivation of DIN pursuant to the clause (b) above, an opportunity of being heard shall be given to the concerned individual.

For this purpose

(i) the term "wrongful manner" means if the DIN is obtained on the strength of documents which are not legally valid or incomplete documents are furnished or on suppression of material information or on the basis of wrong certification or by making misleading or false information or by misrepresentation.

(ii) the term "fraudulent" means if the DIN is obtained with an intent to deceive any other person or any authority including the Central Government.

(c) of the death of the concerned individual;

(d) the concerned individual has been declared as a person of unsound mind by a competent Court;

(e) if the concerned individual has been adjudicated an insolvent.

(f) on an application made in Form DIR-5 by the DIN holder to surrender his or her DIN along with declaration that he has never been appointed as director in any company and the said DIN has never been used for filing of any document with any authority, the Central Government may deactivate such DIN.

However, before deactivation of any DIN in the above case (f), the Central Government shall verify e-records.

(2) The Central Government or Regional Director (Northern Region), or any officer authorised by the Central Government or Regional Director (Northern Region) shall, deactivate the Director Identification Number (DIN), of an individual who does not intimate his particulars in e-form DIR-3-KYC within the stipulated time in accordance with Rule 12A.

(3) The de-activated DIN shall be re-activated only after e-form DIR-3 is filed along with the fee as prescribed under the *Companies (Registration Offices and Fees) Rules, 2014.*

Intimation of Changes in Particulars specified in DIN Application:

Rule 12[11] of the Companies (Appointment and Qualification of Directors) Rules, 2014, provides for the following procedure for intimation of changes in particulars specified in the DIN application:

(1) Every individual who has been allotted a DIN under these rules shall, in the event of any change in his particulars as stated in Form DIR-3, intimate such change(s) to the Central

[11] As substituted by the Companies (Appointment and Qualification of Directors) Amendment Rules, 2014, w.e.f. 18-09-2014.

Government within a period of thirty days of such change(s) in Form DIR-6 in the following manner, namely:

(i) The applicant shall download Form DIR-6 from the portal, fill in the relevant changes, verify the Form and attach duly scanned copy of the proof of the changed particulars and submit electronically;

(ii) the form shall be digitally signed by a chartered accountant in practice or a company secretary in practice or a cost accountant in practice;

(iii) the applicant shall submit the Form DIR-6;

(2) The Central Government, upon being satisfied, after verification of such changed particulars from the enclosed proofs, shall incorporate the said changes and inform the applicant by way of a letter by post or electronically or in any other mode confirming the effect of such change in the electronic database maintained by the Ministry.

(3) The DIN cell of the Ministry shall also intimate the change(s) in the particulars of the director submitted to it in Form DIR-6 to the concerned Registrar(s) under whose jurisdiction the registered office of the company(s) in which such individual is a director is situated.

(4) The concerned individual shall also intimate the change(s) in his particulars to the company or companies in which he is a director within 15 days of such change.

5. RIGHT OF PERSONS OTHER THAN RETIRING DIRECTORS TO STAND FOR DIRECTORSHIP [SECTION 160]

A person who is not a retiring director is also eligible to stand for directorship. Section 160 of the Act and Rule 13 of *the Companies (Appointment and Qualification of Directors) Rules, 2014* contain provisions in this respect. These are discussed as under:

(i) ***Requirement of Written Notice:***

(a) A person who is not a retiring director shall be eligible for appointment as a director at any general meeting, if he has left at the registered office of the company a notice in writing under his hand signifying his candidature as a director at least 14 days before the meeting.

(b) Instead of above person, some other member of the company who intends to propose such other person as a director can also leave a written notice at the registered office of the company signifying his intention to propose the other person as a candidate for directorship at least 14 days before the meeting.

(ii) ***Requirement of Deposit:*** The written notice needs to be accompanied with the deposit of ₹ 1,00,000 or such higher amount as may be prescribed.

Exception: The requirement of deposit of ₹ 1,00,000 shall not apply:

(a) in case of appointment of an independent director; or

(b) in case of appointment of a director recommended by the Nomination and Remuneration Committee, if any, constituted under Section 178 (1); or

(c) in case of appointment of a director recommended by the Board of Directors of the company, where such company is not required to constitute Nomination and Remuneration Committee.

(iii) ***Action by the company:*** The company shall inform its members regarding the candidature of a person for the office of director in accordance with the manner prescribed in *Rule 13 of the Companies (Appointment and Qualification of Directors) Rules, 2014*. The same is stated below:

At least 7 days before the general meeting, the company shall inform its members of such candidature-

(1) by serving individual notices through electronic mode to such members who have provided their e-mail addresses for communication purposes and in writing to all other members; and

(2) by placing notice of such candidature on its website, if any.

***When there is no need to serve notices individually*:** It shall not be necessary for the company to serve individual notices if it advertises such candidature, not less than 7 days before the meeting:

(a) 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

(b) at least once in English language in an English newspaper circulating in that district.

(iv) ***Refund of Deposit:*** The amount of deposit shall be refunded to such person or, as the case may be, to the member, if the person proposed gets selected as a director or gets more than 25% of the total valid votes cast either on show of hands or on poll.

Note 1: For the purposes of Section 160, the expression 'retiring director' means a director retiring by rotation[12].

Note 2: Not all the directors are retiring directors. Therefore, if an additional director or an alternate director or a nominee director or a director appointed to fill a casual vacancy, is to be appointed as a regular director at the general meeting, the procedure prescribed by Section 160 is required to be followed. Similarly, where a director retires by rotation but instead of re-appointing him, a new person in his place is proposed to be appointed, provisions of Section 160 are attracted.

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[12] Explanation to Section 152 (7).

Clarifications

(1) As per Notification No. G.S.R. 465 (E), dated 5th June, 2015, in case of Nidhis, the amount of deposit for the purpose of Section 160 (1) shall be "ten thousand rupees". In other words, a person (not a retiring director) proposing his candidature as director in Nidhis or some other member proposing such person's candidature shall be required to deposit ₹ 10,000 along with the written notice.

(2) The MCA vide General Circular No. 38/2014, dated 14th October, 2014, has clarified that in case of Section 8 companies, their Board of Directors shall decide as to whether the deposit of ₹ 1,00,000 is to be forfeited or refunded if the person proposed as director fails to secure more than 25% of the valid votes.

Exemptions

Non-applicability of Section 160:

(1) In terms of Notifications No. 463 (E), dated 5th June, 2015, as amended by Notifications No. 582 (E), dated 13th June, 2017, Section 160 shall not apply to:

(a) 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;

(b) A subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by the Governmment company.

(2) In terms of Notifications No. 464 (E), dated 5th June, 2015 as amended by Notifications No. 583 (E), dated 13th June, 2017, similar exemption from Section 160 is applicable to a private company.

(3) In terms of Notifications No. 466 (E), dated 5th June, 2015 as amended by Notifications No. 584 (E), dated 13th June, 2017, similar exemption from Section 160 is also applicable to Section 8 companies whose articles provide for election of directors by ballot.

Note: In all the three cases mentioned above exemption from the application of Section 160 is available only if the concerned company has not committed a default in filing its financial statements under Section 137 or Annual return under Section 92 with the Registrar.

6. APPOINTMENT OF DIRECTOR ELECTED BY SMALL SHAREHOLDERS [SECTION 151]

According to Section 151 of Act, a listed company may have one director elected by the small shareholders. This provision enables the small shareholders to place their representative on the Board of Directors of a listed company so that their voice is also listened effectively.

The term "small shareholders" means a shareholder holding shares of nominal value of not more than ₹20,000 or such other sum as may be prescribed.

Manner of appointment of small shareholders' director and terms and conditions of such appointment are prescribed by *Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014*. These provisions are discussed below:

(i) ***Strength of Small Shareholders required for appointment of their Director:*** A listed company may, upon notice of not less than:

(a) one thousand small shareholders; or

(b) one- tenth of the total number of such shareholders, whichever is lower

have a small shareholders' director elected by the small shareholders.

However, a listed company may opt to have a director representing small shareholders *suo motu* and in such a case the provisions given below in Point (ii), shall not apply for appointment of such director.

(ii) ***Serving of notice by small shareholders:*** The small shareholders intending to propose a person as a candidate for the post of small shareholders' director shall leave a notice of their intention with the company at least fourteen days before the meeting under their signature specifying the name, address, shares held and folio number of the person whose name is being proposed for the post of director and of the small shareholders who are proposing such person for the office of director.

However, if the person being proposed does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.

(iii) ***Statement to be annexed with notice:*** The notice shall be accompanied by a statement signed by the person whose name is being proposed for the post of small shareholders' director stating-

(a) his Director Identification Number (DIN);

(b) that he is not disqualified to become a director under the Act; and

(c) his consent to act as a director of the company.

(iv) ***Small shareholders' director as independent director:*** Such director shall be considered as an independent director. Therefore, he should meet the eligibility criteria pertaining to independent director as given under section 149(6) and should give a declaration of his independence in accordance with section 149 (7) of the Act.

(v) ***Applicability of Section 152:*** The appointment of small shareholders' director shall be subject to the provisions of section 152 **except that**-

(a) such director shall not be liable to retire by rotation;

(b) such director's tenure as small shareholders' director shall not exceed a period of **three consecutive years**; and

(c) on the expiry of the tenure, such director shall not be eligible for re-appointment.

(vi) ***Applicability of Section 164:*** A person shall not be appointed as small shareholders' director of a company, if he is not eligible for appointment in terms of section 164 which specifies the disqualifications for appointment as a director.

(vii) ***Vacation of office:*** A person appointed as small shareholders' director shall vacate the office if -

(a) the director incurs any of the disqualifications specified in Section 164;

(b) the office of the director becomes vacant in pursuance of Section 167[13];

(c) the director ceases to meet the criteria of independence as provided in Section 149 (6).

(viii) ***Maximum number of directorships:*** No person shall hold the position of small shareholders' director in more than two companies at the same time.

However, the second company in which he has been so appointed shall not be in a business which is competing or is in conflict with the business of the first company.

(ix) ***Cooling period:*** A small shareholders' director shall not, for a period of three years from the date on which he ceases to hold office as a small shareholders' director in a company, be appointed in or be associated with such company in any other capacity, either directly or indirectly.

7. APPOINTMENT OF ADDITIONAL DIRECTOR, ALTERNATE DIRECTOR, A DIRECTOR TO FILL CASUAL VACANCY AND NOMINEE DIRECTOR [SECTION 161]

(A) Additional Director [Section 161(1)]: Section 161(1) of the Act provides for the appointment of additional director. According to this section:

(i) The articles of a company may confer on its Board of Directors the power to appoint any person as an additional director at any time.

[13] Section 167 of the Act specifies various grounds, which if attracted, shall make a director liable to vacate his office.

(ii) A person, who fails to get appointed as a director in a general meeting, cannot be appointed as an additional director.

(iii) Additional director shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

With a view to meet urgent requirements of management, the Board of Directors is empowered to appoint any person as an additional director at any time if such power is granted by the articles. The notable point is that it is not Section 161 (1) but the articles which confer such power.

The person to be appointed as additional director should possess DIN and must not be the person who failed to get appointed in a general meeting. This brings to the fore the power of shareholders *i.e.* any person discarded as director at a general meeting by the shareholders cannot get appointed by the Board of Directors through back-door entry. Further, an additional director is not a retiring director. Therefore, his appointment as regular director requires that the provisions of Section 160 are followed.

Term of office of additional director: The term of additional director is limited to the holding of ensuing Annual General Meeting (AGM). Even if the AGM is not held on the last due date, the term ends there itself and it cannot be extended to a date when the AGM, in actuality, shall be held in future after its due date.

(B) Alternate Director [Section 161(2)]: Section 161 (2) of the Act provides for appointment of alternate director. According to this section:

(i) The Board of Directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company, to act as an alternate director for a director during his absence for a period of not less than three months from India.

(ii) No person shall be appointed as an alternate director for an independent director unless he is qualified to be appointed as an independent director under the provisions of this Act.

(iii) An alternate director shall not hold office for a period longer than that permissible to the original director in whose place he has been appointed and shall vacate the office if and when the original director returns to India.

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

The power to appoint an alternate director rests with the Board of Directors. However, such power must be conferred by the articles or by a resolution passed at the general meeting.

An alternate director is appointed in place of a regular director who has gone out of India. The period of absence of such original director from India must be minimum three months or more. A short absence of less than three months does not entitle the Board to appoint an alternate director. Such proposed alternate director should possess DIN.

A person selected for appointment as alternate director must not be the one who is holding any alternate directorship for any other director in the company. In other words, a person who is already an alternate director in the company cannot hold another alternate directorship in that company. Further, the selected person must also not be a director in the same company. Thus, a person already a director cannot at the same time be an alternate director in the same company but a person holding directorship in any other company can be considered for the appointment as alternate director. However, for considering maximum number of directorships of a person under Section 165, the alternate directorship shall also be counted. Thus, a fresh alternate directorship should be taken up by the person concerned only if his already holding of regular as well as alternate directorships does not exceed the maximum limit. Further, he should not be disqualified to hold the office of a director.

In case the original director is an independent director and he leaves for a place outside India for three months or more, the person who is to be appointed in his place as alternate director must be qualified to be appointed as an independent director. In other words, the status of independence as well as other requisites of an independent director must form part of such alternate director who is tipped for appointment in the absence of an independent director.

A 'would be alternate director' is not exempted from furnishing his consent to act as director. Therefore, he must furnish his consent in DIR-2 to the company on or before his appointment and in turn the company shall file his consent with the Registrar in DIR-12.

Term of office of alternate director: The term of office of an alternate director coincides with the permissible term applicable to the original director in whose place he has been appointed. Thus, the term shall not be longer than the term which is permissible to the original director; and as soon as the original director ceases to be a director (death included) the alternate director follows his steps and is required to vacate the office. Further, the alternate director shall vacate the office immediately on the return of original director to India.

It may happen that the term of orginal director expires while he is still outside India. In such a case, the provisions relating to automatic deemed re-appointment as envisaged in Section 152 (7) (b) shall apply to the original director and not to the alternate director appointed in his place. Thus, the original director (and not alternate director) shall be demed as re-appointed at the adjourned AGM if the company does not appoint another person on the expiry of the term of original director.

Appointment of alternate director by original director: The original director who is leaving to a place outside India cannot himself appoint an alternate director in his place. It is the Board which shall make the appointment because the authority for such appointment vests in the Board. Following example will make the situation clear:

Example: Mr. Q, a Director of PQR Limited proceeding on a long foreign tour (period of duration ouside India exceeded three months), appointed Mr. Y as an alternate director to act for him during his absence. The articles of the company provide for appointment of alternate directors. Mr. Q claims that he has a right to appoint alternate director. Advise.

Answer: Under section 161 (2), the Board of Directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company, to act as an alternate director for a director during his absence for a period of not less than three months from India.

From the above provision it is clear that the authority to appoint alternate director has been vested in the board of directors only and that too subject to empowerment by the articles or by a resolution passed by the company in general meeting.

Therefore, Q is not authorized to appoint an alternate director and the appointment of Mr. Y is not valid.

(C) Nominee Director [Section 161(3)]: Section 161(3) of the Act provides for appointment of nominee director. According to this section:

'Subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company.'

Simply stated, a nominee director is not like any other director. He represents the body which makes his nomination for appointment as director in the company. Whenever a company obtains financial assistance from some financial institution or bank, such instituation invariably nominates its representative for safeguarding its interests till the loaned amount is completely repaid. The nominee director is expected to ensure that the terms of loan ageements are religiously complied with all the time by the company concerned which has been granted financial assistance. The Board of Directors (subject to the articles) is empowered to appoint a nominee director and the shareholders cannot interefere with such appointment. Further, by virtue of its shareholding in a Government company, the Central Government or the State Government may also nominate a person for appointment as nominee director and the Board shall have to follow the suit without any hinderance on its part.

(D) Casual Vacancy [Section 161(4)]: Section 161(4) of the Act, provides for appointment of director in casual vacancy. According to this section:

(i) if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board [which shall be subsequently approved by members in the immediate next general meeting][14].

(ii) Any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

The above provisions are discussed as under:

The term 'casual' means a sudden happening *i.e.* something which happened by chance or unexpectedly or unforeseen but not by efflux of time. A casual vacancy results when the office of any director appointed in the general meeting is vacated before the expiry of his term in the normal course. This is not the vacancy created due to the retirement of a director. It is created because of certain other factors that are not linked with retirement like occurrence of death or attraction of disqualification or tendering of resignation or removal, etc. Further, in this case, the term of the office of director because of which the casual vacancy is created does not get expired in the normal course.

A vacancy which was created due to the fact that the elected director declined to assume the office after his appointment at general meeting cannot be said to result in a casual vacancy. In such a case, when there was no assumption of office by the director, how can he vacate it. Thus, there arises no casual vacancy.

Section 161 (4) does not require that articles should expressly empower the Board of Directors for filling a casual vacancy. When a casual vacancy occurs it shall be filled by the Board at its meeting by passing a resolution and not otherwise. [15]The vacancy so filled by the Board shall be approved subsequently by members in the immediate next general meeting. It is to be noted that where articles contain any regulations as regards filling of casual vacancy they need to be followed by the Board; but the subsequent approval of such filling of vacancy by members in the immediate next general meeting is a must.

As we have noticed, the casual vacancy arises when any director appointed in the general meeting vacates his office before the expiry of his term. Thus, such appointment of the director who vacates his office must have been **made in the general meeting** and when the casual vacancy is filled by the Board and subsequently approved by the members in the

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[14] The clause regarding 'approval in the general meeting' inserted in Section 161 (4) by the Companies (Amendment) Act, 2017, w.e.f. 09-02-2018.

[15] The clause regarding 'approval in the general meeting' inserted in Section 161 (4) by the Companies (Amendment) Act, 2017, w.e.f. 09-02-2018.

immediate next general meeting, the matter ends there. Subsequently, if the casual vacancy so filled is again vacated due to some casual occurence, then it cannot be said to be a casual vacancy because it arose against an appointment which was not made in the general meeting. Such type of vacancy needs to be filled by the Board by appointing an additional director.

A director appointed to fill a casual vacancy is not a 'casual director'. He enjoys all the powers as well as is required to bear the responsibilities of the director in whose place he is appointed except that where the earlier director was an 'interested director', his 'interest' cannot be attached to the new director filling the casual vacancy.

In case a company has appointed a woman director because of statutory requirement and an intermittent vacancy is created in the office of such woman director, the Board shall fill such casual vacancy at the earliest but not later than immediate next Board meeting or three months from the date of creation of such vacancy, whichever is later.[16] Similar is the case with an independent director whose intermittent vacancy must be filled at the earliest but not later than immediate next Board meeting or three months from the date of occurrence of such vacancy, whichever is later.[17] However, there is no such urgency so far as filling of any other casual vacancy is concerned (*i.e.* not of a woman director or of an independent director) because if the Board of Directors feels that the affairs of the company can be managed without appointing anybody, then the Board can postpone such appointment

Term of office of a director appointed to fill a casual vacancy: The term of office of a director appointed to fill a casual vacancy continues till such time up to which the term of the director because of whom the casual vacancy was created would have continued. Thus, the person filling the casual vacancy shall hold office up to the date up to which the director in whose place he is appointed would have continued in the office which in other words means 'up to the unexpired term of such director'. The 'continuation clause' is applicable because of the Proviso mentioned under Section 161 (4); but for the application of this 'continuation clause' the appointment made by the Board needs to be approved by the members in the immediate next general meeting.

8. APPOINTMENT OF DIRECTORS TO BE VOTED INDIVIDUALLY [SECTION 162]

Section 162 of the Act prohibits appointment of directors *en bloc* by passing a single resolution. Electing more than one person as directors through a single resolution deprives the shareholders from exercising their choice to reject a specific individual. In such a situation, either they will have to vote against or in favour of all the prospective directors i.e. it shall be difficult for them to reject a

[16] As per Second Proviso to Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

[17] As per Second Proviso to Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014.

particular person as director unless they reject such resolution *in toto*, thus not appointing all the persons specified in that resolution. That is why, Section 162 recquires every individual person to be voted individually for appointment as director. As stated in the *box* below, if certain conditions are satisfied this provision shall not apply to a Government company and its wholly-owned subsidiary. Further, a private company is also exempted from this provision.

In nutshell, provisions of Section 162 are as under:

(i) Two or more directors of a company cannot be elected as directors by a single resolution. It implies that each person shall be appointed as director by a separate resolution.

(ii) *As an exception*, two or more persons can be appointed as directors by a single resolution if a proposal to move such a resolution (*i.e.* appointing two or more persons as directors by a single resolution) has first been agreed to at the general meeting without any vote being cast against it.

Example: A company held its general meeting at its registered office with twenty members present. At the meeting a proposal was moved to appoint three persons as directors by a single resolution. This proposal was agreed to by the seventeen shareholders who voted in its favour but the remaining three members did not vote at all. Thus, no vote was cast against the proposal. In such a situation, the company can appoint three persons as directors by a single resolution. Such single resolution shall be passed by simple majority *i.e.* as an ordinary resolution.

(iii) A resolution moved in contravention of the provision stated in (ii) above shall be void, whether or not objection thereto was raised at the time when it was so moved.

(iv) A motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

Exemptions

Non-applicability of Section 162 of the Act of 2013:

(1) Notifications No. GSR 463 (E), dated 5th June,2015 as amended by Notification No. GSR 582 (E), dated 13-06-2017 states that Section 162 requiring appointment of each person as director by a separate resolution, shall not apply to:

(a) 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;

(b) A subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by that Governmment company.

However, above exemption is applicable only if such Government company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

(2) Similarly, Notifications No. and 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13-06-2017 exempts a private company from the application of Section 162. However, this exemption is applicable only if such private company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

9. OPTION TO ADOPT PRINCIPLE OF PROPORTIONAL REPRESENTATION FOR APPOINTMENT OF DIRECTORS [SECTION 163]

As a general rule, the directors in a company are appointed by simple majority. It implies that the shareholders having voting rights just equal to 51 percent can easily negate the choice of other minority shareholders who have substantial voting rights as high as up to 49 percent in the matter of appointment of directors. Thus, minority shareholders though having sizeable voting rights may not find it possible to appoint even a single director of their own on the Board of Directors. To counter this kind of unpleasant situation which may create confrontation in a company and adversely affect the managerial efficiency, Section 163 chalks out a system by which directors may be appointed by way of proportional representation. The provisions of Section 163 are stated as under:

(i) Section 163 starts with the phrase 'Notwithstanding anything contained in this Act' which implies that this section has overriding effect i.e. it overrides all other provisions of the Companies Act, 2013.

(ii) The articles of a company need to contain provisions for the appointment of directors by proportional representation. The procedure as contained in the articles must be capable enough to enable the minority shareholders to have a proportionate representation on the Board of Directors.

(iii) The articles need to provide for the appointment of not less than two-thirds (*i.e.* minimum 2/3rd or more) of the total number of the directors in accordance with the principle of proportional representation.

(iv) Such appointments to be made in accordance with the principle of proportional representation, may use following methods of voting:

  (a) Voting according to the single transferable vote. It means, a candidate gets elected if he secures the requisite votes fixed as quota; or

  (b) Voting according to a system of 'cumulative voting'; or

(c) Otherwise *i.e.* adoption of any other transparent and effective method of voting if it ensures that the Board shall have fair representation of the minority interest, in case methods stated at (a) or (b) are not adopted.

(v) Such appointments may be made once in every 3 years.

(vi) Casual vacancies of such directors shall be filled as provided in Section 161 (4) *i.e.* such casual vacancy shall be filled as per the provisions of the articles; and if there is no such provision, then the Board of Directors may fill the vacancy through a board resolution. Later on, such appointment may be regularized by the shareholders at the immediately held general meeting.

Exemptions

Non applicability of Section 163: *Section 163 of the Act, shall not apply to:*

(1) 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;

(2) a subsidiary of a Government company, referred to in (1) above, in which the entire paid up share capital is held by that Governmment company.

subject to the condition that such Government company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

[Notifications No. GSR 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13-06-2017]

10. DISQUALIFICATIONS FOR APPOINTMENT OF DIRECTOR [SECTION 164]

Section 164 of the Companies Act, 2013 contains disqualifications of a director. A person shall not be eligible for appointment as a director of a company if he suffers from any of the specified disqualifications. As such, the law does not specify any professional or educational qualifications of a director or requires him to hold requisite number of qualification shares except that as a general rule, any person desiring to become a director should be competent to contract and should have been allotted a Director Identfication Number (DIN).

Various disqualifications are mentioned as under:

(i) Section 164(1) states that a person shall not be appointed as a director if:

(a) he is of unsound mind and stands so declared by a competent court;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced to imprisonment for not less than 6 months and a period of 5 years has not elapsed from the date of expiry of the sentence.

However, in case a person has been convicted of any offence and sentenced in respect thereof to **imprisonment for a period of 7 years or more**, he shall not be eligible to be appointed as a director in any company

(e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

(f) he has not paid any calls in respect of any shares of the company held by him and 6 months have elapsed from the last day fixed for the payment of the call. It is immaterial whether such shares are held individually by him or jointly with others;

(g) he has been convicted of the offence of dealing with related party transactions under section 188 at any time during the last preceding 5 years; or

(h) he has not complied with section 152 (3) which requires a director to have a Director Identification Number (DIN).

[18](i) he has not complied with the provisions of Section 165 (1) relating to holding of specified number of directorships.

(ii) Sub-section (2) of Section 164 prescribes disqualifications which get attached to a person if he is or has been a director of a company which has committed default as under—

(a) his company has not filed financial statements or annual returns for any continuous period of 3 financial years; or

(b) his company has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for 1 year or more.

In both the above cases of default, the director concerned shall not be eligible to be re-appointed as a director of such defaulting company or appointed in some other company for period of 5 years from the date on which the said company has committed default.

However, in case a person is appointed as a director of a company which has committed default as per clause (a) or clause (b) above, he shall not incur the disqualification for a period of six months from the date of his appointment.

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[18] Inserted by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. 02-11-2018.

Exemptions

As per Notification No. GSR 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13th June, 2017, Section 164(2) is not applicable to a Government company provided it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

(iii) According to Section 164 (3), a private company (not being a subsidiary of a public company) is permitted to provide for additional disqualifications through its articles for appointment of a person as a director besides those specified in sub-sections (1) and (2) of section 164. [*refer* points (i) and (ii) above]. Thus, it may specify certain qualifications like a graduate shall only be the director or the prospective director should hold certain number of qualification shares, etc.

Note: In terms of Proviso to Section 164 (3), the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.

(iv) *Disqualification as prescribed by Section 217 (6)(ii):* Section 217 relates to a company which is under investigation. In case any director of such a company has been convicted of an offence under Section 217, the director shall be deemed to have vacated his office on and from the date on which he is so convicted. On such vacation of office he shall be disqualified from holding an office in any company.

11. MAXIMUM NUMBER OF DIRECTORSHIPS [SECTION 165]

Section 165 of the Act provides for the maximum permissible directorships that a person can hold. The provisions are as under:

(i) According to Section 165 (1), a person, after the commencement of the Companies Act, 2013, shall not hold office as director, including any alternate directorship, in more than 20 companies at the same time.

Further, out of the above limit of 20 companies, the maximum number of public companies in which a person can be appointed as a director shall not exceed 10.

It may be noted that the limit of public companies (*i.e.* 10) shall include directorship in private companies that are either holding or subsidiary company of a public company.

However, the limit of directorships of twenty companies shall not include the directorship in a dormant company; as also in a Section 8 company (*refer Exemption mentioned in the box below)*.

Exemptions

Section 165 (1) [refer point no. (i) above] shall not apply to a Section 8 company subject to the condition that such a company has not committed a default in filing its financial statements under Section 137 or Annual return under Section 92 with the Registrar. In other words, a

directorship in a Section 8 company shall not be counted for determining the maximum permissible limit.

[Notification No. 466 (E), dated 5th June, 2015 as amended by Notification No. 584 (E), dated 13th June, 2017] .

(ii) ***Lesser number of directorships than maximum:*** The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as directors. [Section 165(2)]

(iii) ***Prescription of Transition Period of One Year:*** Immediately before the commencement of the Companies Act, 2013 (*i.e.* before 01-04-2014), if a person was holding office as director in more companies than the specified limits, he was required, within one year (*i.e.* by 31-03-2015) to:

(a) choose not more than the specified limit of companies, in which he wished to continue to hold the office of director;

(b) resign his office as director in the other remaining companies; and

(c) intimate the choice made by him to each of the companies in which he was director and to the jurisdictional Registrar. [Section 165(3)]

Any resignation so made was to become effective immediately on the dispatch thereof to the company concerned. [Section 165(4)]

After dispatching the resignation of his office as director/non-executive director or after the completion of the transition period of one year (*i.e.* after 31-03-2015), whichever was earlier, no such person would act as director in more than the specified number of companies. [Section 165(5)]

In other words, after the completion of transition period of one year on 31-03-2015, no person is permitted to hold more directorships than the maximum specified.

(iv) ***Punishment for Contravention:*** According to Section 165 (6)[19], if a person accepts an appointment as a director in contravention of Section 165 (1) *i.e.* holding directorship of more than 20 companies or more than 10 public companies (subject to the exemptions, if any), he shall be liable to a penalty of ₹ 5,000 for every day after the first during which such contravention continues.

12. INDEPENDENT DIRECTORS

The legal provisions regarding independent directors are discussed below:

[19] Penalty clause substituted vide the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. 02-11-2018.

(a) Number of Independent Directors[20]: Following companies are required to appoint specified number of independent directors:

(i) Listed Companies*:* Every listed public company shall have at least one-third of the total number of directors as independent directors. *[Section 149(4)]*

Note: Any fraction contained in such one-third number shall be rounded off as one.

(ii) Other Public Companies: The Central Government is empowered to prescribe certain minimum number of independent directors in case of any class or classes of public companies. Taking a step in this direction, Rule 4 of the *Companies (Appointment and Qualification of Directors) Rules, 2014* has been framed which states that the following class or classes of companies shall have at least two directors as independent directors:

(1)	all such public companies which have paid up share capital of 10 crore rupees or more; or
(2)	all such public companies which have turnover of 100 crore rupees or more; or
(3)	all such public companies which have, in the aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

Requirement of higher number: Due to composition of its audit committee, if a public company covered under the above rule, is required to appoint a higher number of independent directors, such higher number shall be applicable to it.

As per section 177(2) of Act, the Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.

Intermittent vacancy of an independent director: Any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.

Duration of conditions after non-fulfilment of which no appointment required: A company which was obligated to appoint independent directors, shall not be required to make such appointment if it ceases to fulfill any of the three conditions relating to paid-up share capital or turnover or outstanding loans, etc. [as laid down above in Rule 4 (1)] for **three consecutive years**. It shall again be required to appoint independent directors if it starts meeting any of such conditions.

Clairification: *Explanation* to Rule 4 (1) clarifies that the paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

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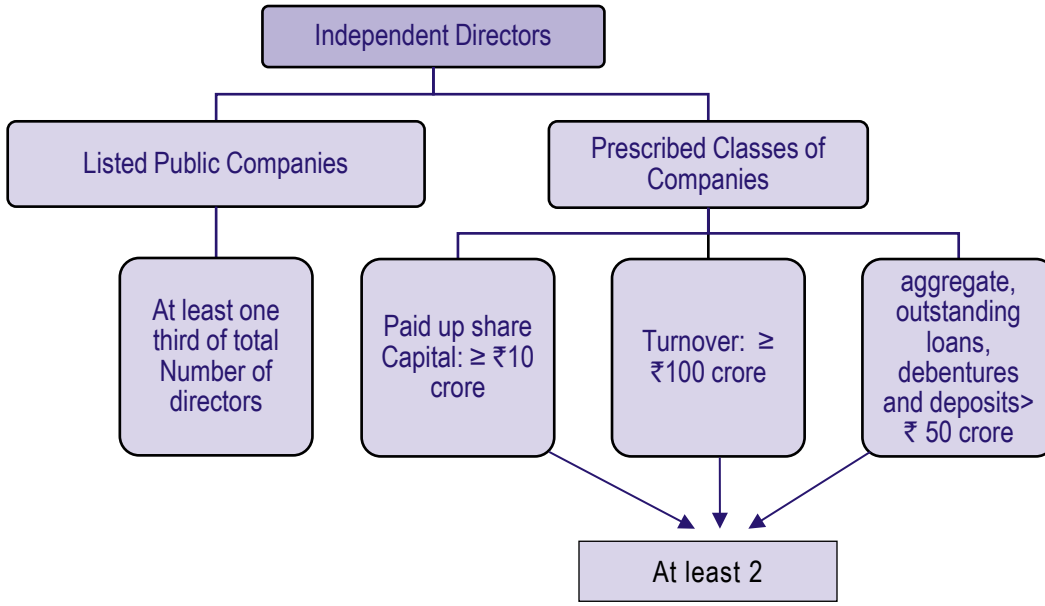
[20] Refer Section 149 (4) and Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Exempted classes of unlisted public companies: According to Rule 4(2)[21], following classes of unlisted public companies shall not be covered under sub-rule (1) of Rule 4:

(a) a joint venture;

(b) a wholly owned subsidiary; and

(c) a dormant company as defined under section 455 of the Act.



If due to composition of audit committee any higher number of independent directors are required, such higher number shall be applicable.

Appointment of independent directors not required: If company ceases to fulfil any of the 3 conditions for 3 consecutive years.

Joint ventures, wholly owned subsidiaries and dormant companies are not covered under Rule 4 (1) which mentions about mandatory appointment of independent directors.

[21] Inserted *vide* the Companies (Appointment and Qualification of Directors) (Amendment) Rules, 2017, w.e.f. 05-07-2017.

(b) Who can become the Independent Director [Section 149(6)]: In relation to a company, an independent director means a director other than a managing director or a whole-time director or a nominee director[22], and who fulfills the following criteria:

(1) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

Exemptions

As per Notification No. G.S.R. 463 (E) dated 5th June, 2015, in case of a Government company, the word "Board' shall be substituted by the words "Ministry or Department of the Central Govermment which is administratively in charge of the company, or, as the case may be, the State Government[23]".

(2) (A) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(B) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(3) who has or had no pecuniary relationship, other than remuneration as such director or having transaction not exceeding ten per cent of his total income or such amount as may be prescribed,with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

Clarifications issued by MCA

(i) As regards '**pecuniary interest in certain transactions'**, the MCA *vide* its General Circular No. 14/2014, dated 09-06-2014 has clarified that in case a transaction entered into by an independent director with the company concerned is at par with any member of the general public and at the same price as is payable/paid by such member of public, **it would not attract the bar of 'pecuniary relationship' under Section 149(6)(c) and therefore, an independent director will not be said to have 'pecuniary relationship' under this Section**, in such cases. This clarification has been issued by the MCA considering the provisions of Section 188 which take away

[22] As per *Explanation* to section 149(7), "**Nominee director**" means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

[23] As per amendment Notification No. GSR 582 (E), dated 13-06-2017, the exceptions, modifications and adaptations mentioned in Notification No. GSR 463 (E), dated 05-06-2015 are applicable to such 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.

transactions in the ordinary course of business at arm's length price from the purview of related party transactions.

(ii) Further, vide above-referred General Circular, it is also clarified after consultation with SEBI that '**pecuniary relationship'** does not include (a) receipt of remuneration from one or more companies by way of fee provided under Section 197 (5); (b) reimbursement of expenses for participation in the Board and other meetings; and (c) profit related commission approved by the members, in accordance with the provisions of the Companies Act, 2013.

Exemptions

As per Notification No. 463 (E), dated 5th June, 2015 as amended by Notification No. 582 (E), dated 13-06-2017, Point No. (3) mentioned above [i.e. Section 149(6)(c)] shall not apply in case of a Government company if it has not committed a default in filing its financial statements under Section 137 or Annual return under Section 92 with the Registrar.

(4) none of whose relatives—

(i) is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year:

However, the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two per cent of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

(ii) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year;

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or

(iv) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two per cent or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (i), (ii) or (iii);

(5) who, neither himself nor any of his relatives—

(A) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed;

However, in case of a relative who is an employee, the restriction under this clause shall not apply for his employment during preceding three financial years;

(B) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

(i) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(ii) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(C) holds together with his relatives 2% or more of the total voting power of the company; or

(D) is a Chief Executive or director, by whatever name called, of any non- profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company; or

(6) who possesses such other qualifications as are prescribed under Rule 5 of the *Companies (Appointment and Qualification of Directors) Rules, 2014 i.e.*:

(a) An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

(b) None of the relatives of an Independent director, for the purposes of sub-clauses (ii) and (iii) of clause (d) of section 149(6),—

(i) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors; or

(ii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company,

for an amount of fifty lakhs rupees, at any time during the two immediately preceding financial years or during the current financial year.

(c) Declaration by Independent Director [Section 149(7)]: Every independent director shall give a declaration that he meets the criteria of independence as provided in Section 149 (6) [refer Point No. (b) above] in the following manner:

(1) at the first meeting of the Board in which he participates as a director; and

(2) thereafter at the first meeting of the Board in every financial year; or

(3) whenever there is any change in the circumstances which may affect his status as an independent director.

(d) Code for independent directors [Section 149(8)]: The company and independent directors shall abide by the provisions specified in Schedule IV to the Companies Act, 2013. As regards independent directors, Schedule IV specifies guidelines for professional conduct, role and functions, duties, manner of appointment and re-appointment, resignation and removal, provisions regarding separate meetings and evaluation mechanism.

(e) Remuneration of Independent Directors [Section 149(9)]: Notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director **shall not be entitled to any stock option** and may receive remuneration by way of-

(1) fee provided under Section 197(5),

(2) reimbursement of expenses for participation in the Board and other meetings and

(3) profit related commission as may be approved by the members.

Entiled to:	Not Entitled to:
Fee provided under section 197(5)	Any stock option
Reimbursement of **expenses** for participation in: (i) Board Meetings (ii) Other Meetings	
Profit related commission as may be approved by the members	

Note: According to Rule 4 of the *Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014*, sitting fee required to be paid to an independent director shall not be less than the sitting fee which is payable to other directors of the company.

(f) Tenure [Section 149(10) & (11)]: These provisions are stated as under:

(i) **(a) Term:** Subject to the provisions of section 152 (Appointment of Directors), an independent director shall hold office for a term **up to five consecutive years** on the Board of a company.

(b) Eligibility for Re-appointment: He shall be eligible for re-appointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

Note: According to First Proviso to Section 169 (1), an independent director re-appointed for second term under Section 149(10) shall be removed by the company only by passing a **special resolution.**

(ii) **Limit on holding of office:** An independent director shall not hold office for more than two consecutive terms.

Cooling period for appointment: However, he shall be eligible for appointment after the expiration of three years of ceasing to be an independent director.

However, during the said period of three years he shall not be appointed in or be associated with the company in any other capacity, either directly or indirectly.

Note: It is clarified that for the purposes of sub-sections (10) and (11) of Section 149, any tenure of an independent director on the date of commencement of the Companies Act, 2013 shall not be counted as a term under those sub-sections.

Clarification issued by MCA

Appointment of 'Independent Directors' for less than 5 years [*Refer Section 149(10) and (11)]*:- In terms of General Circular 14/2014, dated 09-06-2014, it is clarified by MCA that section 149(10) of the Act provides for a term of "upto five consecutive years" for an 'Independent Director'. As such while appointment of an 'Independent Director' for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as a one term under section 149(10) of the Act.

Further, under section 149(11) of the Act, no person can hold office of 'Independent Director' for more than 'two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than ten years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of three years.

(g) Liability [Section 149(12)]: As per section 149(12) of Act, following persons shall be liable for the following acts:

Parties Liable	Liable Acts
(i) an independent director	• acts of omission or commission by a company which had occurred with his knowledge, • attributable through Board processes • with his consent or connivance, or • where he had not acted diligently
(ii) a non-executive director not being promoter or key managerial personnel	

(h) Retirement by rotation [Section 149(13)]: The provisions of retirement of directors by rotation covered under sub-sections (6) and (7) of section 152 shall not be applicable to appointment of independent directors[24].

(i) Independent Director is different from Nominee Director: Appointment of a nominee director cannot be taken as a substitute for appointment of an independent director. Though a nominee director is also independent of the other Board members but this independence does not make him an independent director. He is appointed to safeguard the interest of the respective financial institution to which he belongs. His appointment triggers from the fact that his financial institution has given financial assistance to the company and he remains on the Board till the loan amount is repaid satisfactorily. Nominee director's appointment is mandatory only if the financial institution so desires because of the financial assistance given by it to the company; or any Government requires such appointment to represent its interest.

An independent director is appointed by the prescribed companies mandatorily. He is appointed to promote the confidence of the investing bodies, particularly minority shareholders. In fact, the companies in which his appointment is compulsory are much larger than other companies and therefore, they must always be well managed so that the confidence of the stakeholders is not shaken and their investment remains in safe hands. The appointment of independent director is a robust step in this direction. In the matter of good corporate governance, the regulators fall back upon him. The independent director at all times is required to maintain his independence and where circumstances arise which make him lose his independence, such fact must immediately be brought to the knowledge of the Board. The independent directors are required to hold at least one meeting in a financial year, without the attendance of non-independent directors and members of management.

[24] The provisions of retirement of directors by rotation covered under sub-sections (6) and (7) of Section 152 have been discussed later in the Chapter.

Exemptions

In terms of Notification No.466 (E) dated 5th June, 2015, as amended by Notification No. GSR 584 (E), dated 13-06-2017 a Section 8 Company is exempted from the provisions of sub-sections (4), (5), (6), (7), (8), (9), (10), (11), clause (i) of sub- section (12) and sub- section (13) of Section 149 of the Act, only if such company has not committed a default in filing its financial statements under Secion 137 and Annual Return under Section 92 with the Registrar.

13. MANNER OF SELECTION OF INDEPENDENT DIRECTORS AND MAINTENANCE OF DATA BANK OF INDEPENDENT DIRECTORS [SECTION 150]

Section 150 of the Act and Rule 6 of the *Companies (Appointment and Qualification of Directors) Rules, 2014*, contain provisions regarding the manner of selection of independent directors and maintenance of databank of independent directors. These provisions are stated below:

(i) **Maintenenace of Data Bank of Independent Directors:** According to section 150 (1), an independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, subject to the provisions contained in section 149(6).

Such data bank shall be maintained by any body, institute or association, as may be notified by the Central Government as having the expertise in creation and maintenance of such data bank and put on their website for the use by companies appointing such directors.

Rule 6 of the *Companies (Appointment and Qualification of Directors) Rules, 2014* lays down the provisions for creation and maintenance of databank of persons offering to become independent directors. They are as under:

(a) ***Authorised Agency to create and maintain data bank:*** According to Rule 6 (1), any body, institute or association (referred as "the agency"), which has been [41]authorized in this behalf by the Central Government shall create and maintain a data bank of persons willing and eligible to be appointed as independent director and such data bank shall be placed on the website of the Ministry of Corporate Affairs or on any other website as may be approved or notified by the Central Government.

(b) ***Details to be included in data bank:*** According to Rule 6 (2) the data bank referred to in sub-rule (1) above shall contain the following details in respect of each person included in the data bank to be eligible and willing to be appointed as independent director:

(a) DIN (Director Identification Number);

(b) the name and surname in full;

(c) Omitted;

(d) the father's name;

(e) the date of Birth;

(f) gender;

(g) the nationality;

(h) the occupation;

(i) full Address with PIN Code (present and permanent);

(j) phone number;

(k) e-mail id;

(l) the educational and professional qualifications;

(m) experience or expertise, if any;

(n) any legal proceedings initiated or pending against such person;

(o) the list of limited liability partnerships in which he is or was a designated partner along with –

(i) the name of the limited liability partnership;

(ii) the nature of industry; and

(iii) the duration- with dates;

(p) the list of companies in which he is or was director along with –

(i) the name of the company;

(ii) the nature of industry;

(iii) the nature of directorship – Executive or Non-executive or Managing Director or Independent Director or Nominee Director; and

(iv) duration – with dates.

(ii) **Due diligence to be exercised by the company:** Further, the responsibility of exercising due diligence before selecting a person as an independent director from the data bank, shall lie with the company making such appointment [Proviso to Section 150(1)].

(iii) **Approval of Appointment in general meeting:** The appointment of independent director shall be approved by the company in general meeting as provided in section 152(2) and the explanatory statement annexed to the notice of the general meeting called to consider the

said appointment shall indicate the justification for choosing the appointee for appointment as independent director. [Section 150(2)].

(iv) **Data bank to contain list of willing persons who desire to act as Independent Directors:** The data bank shall create and maintain data of persons willing to act as independent director in accordance with Rule 6 of the *Companies (Appointment and Qualification of Directors) Rules, 2014*. [Section 150(3)]

Sub-rules (3), (4) and (5) of Rule 6 state that any person who desires to get his name included in the databank of independent directors shall make an application to "the agency". The agency may include his name in the databank after charging a reasonable fee. In case of any changes in his particulars, he shall intimate the agency within fifteen days of such change.

Posting on website: The databank posted on the website shall:

(a) be accessible at the specified website;

(b) be substantially identical to the physical version of the data bank;

(c) be searchable on the parameters specified in sub-rule (2);

(d) be presented in a format or formats convenient for both printing and viewing online; and

(e) contain a link to obtain the software required to view or print the particulars free of charge.

(v) **Manner & procedure of selection specified by CG:** The Central Government may prescribe the manner and procedure of selection of independent directors who fulfill the qualifications and requirements specified under section 149 [Section 150(4)]

Exemption

Notification No. 466 (E) dated 5th June, 2015 as amended by Notification No. GSR 584 (E), dated 13-06-2017 has exempted a Section 8 company from the application of Section 150 of the Act, only if such company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

14. DUTIES OF DIRECTORS

Directors appointed in a company have various duties to perform. The foremost duty of the directors is to act honestly and diligently and in the best interest of the company so that the objective of wealth maximization is achieved for the stakeholders. In no case any business opportunity which falls within the ambit of the company be exploited by the directors for their own benefits.

A. Duties as per Section 166*:* Duties of directors, more particularly statutory duties, have been prescribed for the first time in the Statute. Section 166 specifies the following duties which are required to be accomplished by a director:

(i) He shall act in accordance with the articles of the company, subject to the provisions of the the Companies Act, 2013.

(ii) He shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole. Further, he shall act in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

(iii) He shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(iv) He shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

(v) He shall not achieve any undue gain or advantage either to himself or to his relatives, partners, or associates. In case such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

(vi) He shall not assign his office and if any assignment is so made, it shall be void.

The assignment of office has been made invalid because of the fact that the shareholders have elected a particular person as director for the management of their company. If such person assigns his office to some other person, the shareholders may not have faith in the other person; and therefore, a person who does not command the faith of the shareholders cannot be given the responsibility to manage the company. In other words, it is required of the original director to carry out his duties of directorship on his own without assigning them to some other person. Delegation of duties to other staff members, wherever permitted, is not akin to assignment of office.

Punishment for not accomplishing statutory duties: If any director of the company contravenes the provisions of Section 166, such director shall be punishable with fine which shall not be less than ₹ 1,00,000 but which may extend to ₹ 5,00,000.

B. Some Other Duties[25]*:* They are described as under:

(i) ***To file various documents****:* It is the duty of the directors to file various documents required to be filed with the Registrar within the specified time limits. Similarly, wherever required, the requisite documents must also be filed with other statutory bodies.

[25] This list of duties is not exhaustive.

(ii) ***To convene General Meetings:*** As and when required, Annual General Meeting (AGM)[26] and extraordinary general meetings (EGMs)[27] need to be convened by the directors.

(iii) ***To attend Board Meetings:*** Board meetings is the platform where collective decisions are taken for managing the company profitably. It is statutorily required of a company to hold at least four board meetings every year[28] and the gap between two board meetings must not exceed 120 days. However, a company may, as per the exigencies, hold more meetings than statutorily required and every director is duty-bound to attend them. A director, though, may not attend all the Board meetings held in a year but in case he remains absent from all such meetings held within a period of twelve months either with or without seeking leave of absence, he shall be deemed to have vacated his office[29].

(iv) ***To disclose interest[30]:*** In the ordinary course, it is required of a director that his interest should not clash with the interests of the company *i.e.* he should not get himself benefitted from a transaction, the profit of which belongs to the company. If it happens and a director gets interested in a transaction belonging to the company, it his duty to disclose such interest at the very first Board meeting he attends after becoming interested in the transaction. Thereafter, such interest should be disclosed in the first board meeting held in every financial year. In case there is any change in the disclosure already made by the director, such change needs to be brought in the knowledge of other directors in the first board meeting which he attends after occurring of such change. A detailed disclosure of interest and punishment for non-disclosure is discussed at the appropriate place.

(v) ***To approve the annual financial statements[31]:*** Before seeking auditor's report, the annual financial statements *i.e.* balance sheet, statement of profit and loss, cash flow statement, etc. including consolidated financial statements, if any, are required to be approved by the directors.

(vi) ***To approve and attach Board Report[32]:*** A report by the Board of Directors containg requisite particulars on the affairs of the company including Directors' Responsibility Statement is required to be attached with the financial statements after its approval.

(vii) ***To appoint first Auditors[33]:*** It is the duty of directors to appoint first auditors of the company.

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[26] Refer Section 96.
[27] Refer Section 100.
[28] Refer Section 173 (1). A company, if specifically exempted, may hold lesser number of Board Meetings in a year.
[29] Refer Section 167 (1) (b).
[30] Refer Section 184.
[31] Refer Section 134.
[32] Refer Section 134.
[33] Refer Section 139.

15. VACATION OF OFFICE OF DIRECTOR [SECTION 167]

Section 167 of the Act contains provisions detailing out as to when the office of a director shall become vacant. As soon as, any such event occurs, the director is required to demit the office of director of the company. These provisions are given as under:

(i) According to Section 167 (1), the office of a director shall become vacant in case:

(a) he incurs any of the disqualifications specified in section 164;

[34]However, if he incurs disqualification under section 164(2), the office of the director shall become vacant in all the companies, except the company which is in default under that sub-section;

(b) he absents himself from all the meetings of the Board of Directors held during a period of 12 months with or without seeking leave of absence of the Board;

(c) he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;

(d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184;

(e) he becomes disqualified by an order of a court or the Tribunal;

(f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced to imprisonment for 6 months or more.

Exception: The office shall not be vacated by the director in case of orders referred to in clauses (e) and (f)—

(i) for thirty days from the date of conviction or order of disqualification;

(ii) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or

(iii) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of;

(g) he is removed in pursuance of the provisions of the Companies Act, 2013 like when he is required to vacate office for disqualification incurred under Section 217 (6) (ii) *i.e.* conviction for committing an offence under Section 217 ;

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[34] Inserted by the Companies (Amendment) Act, 2017, w.e.f. 07-05-2018.

(h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

Provision of additional ground for vacation by a private company: According to Section 167(4), a private company may provide any other ground for the vacation of the office of a director in addition to those specified above, through its articles.

(ii) ***Punishment:*** Section 167 (2) prescribes punishment in case of contravention. Thus, if a person functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in Section 167 (1), he shall be punishable with imprisonment up to one year or with minimum fine of ₹ 1,00,000 extendable to ₹ 5,00,000, or with both.

(iii) ***All the Directors vacating the office:*** Section 167 (3) mentions about the eventuality when all the directors of a company vacate their offices under any of the disqualifications specified in Section 167 (1). In that case, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

16. RESIGNATION OF DIRECTOR [SECTION 168]

Provisons regarding resignation of directors have been included in the Companies Act, 2013 for the first time. Section 168 read with Rule 15 and Rule 16 of the *Companies (Appointment and Qualification of Directors) Rules, 2014* deal with resignation of a director as under:

(i) A director may resign from his office by giving a notice in writing to the company.

(ii) The Board shall on receipt of such notice take note of the same.

(iii) The company shall within 30 days from the date of receipt of notice of resignation from a director, intimate the Registrar in *Form DIR-12* and post the information on its website, if any.

(iv) The company shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company.

(v) Such director may also forward a copy of his resignation along with detailed reasons for the resignation to the Registrar within 30 days from the date of resignation in Form *DIR-11* along with the prescribed fee.

Signing and Filing of Form DIR-11 in case of a Foreign Director[35]: In case a company has already filed Form DIR-12 with the Registrar, a foreign director of such company resigning from his office may authorise in writing a practising chartered accountant or cost accountant

[35] Proviso to Rule 16 inserted by the Companies (Appointment and Qualification of Directors) (Amendment) Rules, 2015, w.e.f. 19-01-2015.

in practice or company secretary in practice or any other resident director of the company to sign Form DIR-11 and file the same on his behalf intimating the reasons for the resignation.

Clarification: The MCA vide General Circular No. 3/15, dated 3rd March, 2015 has clarified that in the event of deactivation of Digital Signature Certificate (DSC) following *en masse* resignation of all the directors of a company before appointment of new directors in their places, where Form DIR-12 cannot be filed by a company due to lack of an authorized signatory director, the Registrars of Companies within their respective jurisdictions are authorized, on request from the stakeholders, and after due examinalion, to allow any one of the resigned director who was an authorized signatory director for the purpose of filing DIR-12 only along with additional fees, as applicable and subject to compliance of other provisions of Companies Act, 2013.

Effective date of resignation: The resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later. However, the director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure.

All the Directors tendering resignation: In case all the directors of a company resign from their offices, or vacate their offices under section 167, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in general meeting.

17. REMOVAL OF DIRECTORS

A director of a company may be removed before completion of his term as director. Removal of directors is discussed under the following heads:

(I) Removal by the shareholders [Section 169];

(II) Removal by the Tribunal [Section 242].

I. Removal of Director by the Shareholders

Section 169 of the Act contains provisions for removal of directors by the shareholders. The way shareholders are empowered to appoint a director, in the same way they can also remove a director. The procedure of removal according to this section is stated below:

(i) ***Requirement of Ordinary Resolution[36]:*** A company may, by **ordinary resolution**, remove a director before the expiry of the period of his office **except the following:**

(a) when a director is appointed by the Tribunal under Section 242.

[36] As per Section 169 (1).

[37](b) when as per Section 163, two-thirds or more of the total number of directors are appointed according to the principle of proportional representation, then such directors cannot be removed.

For example, if a company has eight directors, of which six were appointed according to the principle of proportional representation, then in such a case, only two directors which were not appointed following the system of proportional representation, can only be removed by the shareholders.

(ii) ***Requirement of Special Resolution in case of removal of re-appointed independent director:*** An independent director re-appointed for second term under Section 149(10) shall be removed by the company only by passing a **special resolution**[38]**.**

Note: Under both the clauses (i) and (ii) above, the director to be removed shall be given a reasonable opportunity of being heard before his removal.

(iii) ***Special Notice[39]:*** A special notice as per Section 115 shall be required for proposing any resolution to remove a director.

Special notice under Section 115 is required to be signed by: (i) members holding not less than 1% of total voting power; or (ii) members holding shares on which at least ₹ 5,00,000 has been paid in the aggregate.

Such notice shall be sent by the members not earlier than three months but at least 14 days before the meeting at which the resolution is desired to be moved.

(iv) ***Action by the company[40]:*** On receipt of the special notice of a resolution to remove a director, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting.

(v) ***Representation by the director[41]:*** In case the director concerned makes a written representation to the company and requests that it should be notified to members, the company shall, if the time permits it to do so,-

(a) state the fact of the representation having been made by the director in any notice of the resolution given to members of the company; and

(b) send the representation to every member of the company to whom notice of the meeting is sent (whether before or after receipt of the representation by the company).

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[37] As per Second Proviso to Section 169 (1).
[38] Proviso Section 169(1) inserted *vide* the Companies (Removal of Difficulties) Order, 2018, w.e.f. 21-02-2018.
[39] As per Section 169 (2).
[40] As per Section 169 (3).
[41] As per Section 169 (4); stands enforced w.e.f. 01-06-2016.

In case, the representation is not sent as aforesaid due to insufficient time or for the company's default, the director may without prejudice to his right to be heard orally require that the representation shall be read out at the meeting.

Representation of director need not be sent[42]: It is provided the representation need not be sent out and read out at the meeting if, on the application either of the company or of any other aggrieved person, the Tribunal is satisfied that the rights of representation are being abused to secure needless publicity for defamatory matter.

Further, the Tribunal may order the director concerned (notwithstanding that he is not a party to it) to make payment in whole or in part of the costs incurred by the company on the application so made to the Tribunal.

(vi) ***Filling of vacancy[43]:*** The vacancy resulting from the aforesaid removal if he had been appointed by the company in general meeting or by the Board, may be filled in by the appointment of another director at the same meeting at which the director is removed, provided special notice of the proposed appointment has been given.

Non-Filling of vacancy[44]: If the vacancy is not filled in the same meeting as above, then it may be filled as a casual vacancy provided that the director who was so removed from office shall not be reappointed as a director.

(vii) ***Period of holding of office by new director[45]:*** A director so appointed shall hold office for the remaining period for which the director who has been removed would have held office if he had not been removed.

(viii) ***Payment of compensation[46]:*** A person so removed as director shall not be deprived of his rights to compensation or damages payable to him in respect of the premature termination of the directorship, or terms of his appointment as director or of any appointment terminating with that as a director. The restrictions imposed by Section 202 are also to be kept under consideration while making payment of compensation for loss of office of ditrectorship.

(ix) ***No restriction imposed by Section 169***[47]: Nothing in Section 169 shall be taken as derogating from any power to remove a director under any other provisions of the Companies Act, 2013.

In other words, Section 169 does not impose any restriction on any other power available under some other provisions of the Companies Act, 2013 which allows removal of a director.

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[42] As per Proviso to Section 169 (4).
[43] As per Section 169 (5).
[44] As per Section 169 (5).
[45] As per Section 169 (7).
[46] As per Section 169 (8) (a).
[47] As per Section 169 (8) (b).

II. Removal of Director by the Tribunal

According to Section 242, a director may be removed by the Tribunal where an application has been made to it under Section 241 for prevention of oppression and mismanagement in the company. The Tribunal is also empowered to terminate, set aside or modify any agreement between the company and any of its directors on such terms and conditions which in the opinion of Tribunal are just and equitable.

According to Section 243, a director so removed as per the order of Tribunal shall not be entitled to claim any compensation for loss of his office. Further, he shall not be offered appointment as director for a period of five years from the date of the order without first seeking the leave of the Tribunal.

18. REGISTER OF DIRECTORS AND KEY MANAGERIAL PERSONNEL AND THEIR SHAREHOLDING [SECTION 170]

A company is required to maintain a register of directors and key managerial personnel and their shareholding under Section 170 of the Act. These provisions are as under:

Every company shall keep at its registered office a register containing the prescribed particulars of its directors and key managerial personnel. The prescribed particulars shall include details of securities held by each of them in the company or its holding, subsidiary, subsidiary of its holding companies or associate companies. In this respect Rule 17 of *the Companies (Appointment and Qualification of Directors) Rules, 2014*, is relevant. It prescribes the following particulars to be included in the Register:

(a) Director Identification Number (optional for key managerial personnel);

(b) present name and surname in full;

(c) any former name or surname in full;

(d) father's name, mother's name and spouse's name(if married) and surnames in full;

(e) date of birth;

(f) residential address (present as well as permanent);

(g) nationality (including the nationality of origin, if different);

(h) occupation;

(i) date of the board resolution in which the appointment was made;

(j) date of appointment and reappointment in the company;

(k) date of cessation of office and reasons therefor;

(l) office of director or key managerial personnel held or relinquished in any other body corporate;

(m) membership number of the Institute of Company Secretaries of India in case of Company Secretary, if applicable; and

(n) Permanent Account Number (mandatory for key managerial personnel if not having DIN);

In addition to the above details, the company shall also include in the Register the details of securities held by them in the company, its holding company, subsidiaries, subsidiaries of the company's holding company and associate companies relating to:

(a) the number, description and nominal value of securities;

(b) the date of acquisition and the price or other consideration paid;

(c) date of disposal and price and other consideration received;

(d) cumulative balance and number of securities held after each transaction;

(e) mode of acquisition of securities ;

(f) mode of holding – physical or in dematerialized form; and

(g) whether securities have been pledged or any encumbrance has been created on the securities.

Filing of Return in Form DIR-12 with the Registrar: Section 170 (2) read with Rule 18 of the Companies (Appointment and Qualification of Directors) Rules, 2014 requires a company to file a return in Form DIR-12 in respect of its directors and the key managerial personnel after paying the prescribed fee as under:

(a) within 30 days from the appointment; and

(b) within 30 days of any change taking place.

Exemption

Section 170 of the Companies Act, 2013 shall not apply to a Government company in which the entire share capital is held by the Central Government, or by any State Government or Governments or by the Central Government or by one or more State Government subject to the condition that such Government company has not committed a default in filing its financial statements under Section 137 or Annual return under Section 92 with the registrar. [Notification No. G.S.R. 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13-06-2017].

19. MEMBERS' RIGHT TO INSPECT [SECTION 171]

The members of the company have a right to inspect the register of directors and key managerial personnel under Section 171 of the Act. Accordingly:

(i) The register of directors and key managerial personnel shall be open for inspection during **business hours**. The members shall have the right to take extracts therefrom and copies thereof on request and the same will be provided to them within 30 days free of cost. [Refer Section 171(1)(a)]

(ii) The register shall also be kept open for inspection at every annual general meeting of the company and shall be made accessible to any person attending the meeting. [Refer Section 171(1)(b)]

(iii) ***Registrar to order in case of refusal:*** If any inspection during business hours is refused, or if any copy required as above is not sent within thirty days from the date of receipt of such request, the Registrar shall on an application made to him order immediate inspection and supply of copies. [Refer Section 171(2)]

Exemptions

Section 171 shall not apply to a Government company in which the entire share capital is held by the Central Government, or by any State Government or Governments or by the Central Government or by one or more State Government subject to the condition that such Government company has not committed a default in filing its financial statements under Section 137 or Annual return under Section 92 with the registrar. [Notification No. G.S.R. 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13-06-2017].

20. PUNISHMENT [SECTION 172]

Section 172 of the Act provides that if a company contravenes any of the provisions of Chater XI containg Sections 149 to 171 and for which no specific punishment is provided therein, the company and every officer of the company who is in default shall be punishable with minimum fine of ₹ 50,000 extendable to ₹ 5,00,000.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. In addition to a listed company, which other company is required to appoint a woman director-

   (a) a company having paid–up share capital of ₹ one hundred crore

   (b) a company having turnover of ₹ three hundred crore

   (c) a company meeting both the parameters mentioned at (a) and (b)

   (d) a company meeting any one of the parameters *i.e.* either (a) or (b)

2. An independent director who has tendered resignation from the Board shall be replaced by a new independent director within ---------- from the date of such resignation.

   (a) one month

   (b) two months

   (c) three months

   (d) four months

3. A shareholder holding shares of nominal value of not more than ---------- is a small shareholder.

   (a) ₹ 5,000

   (b) ₹10,000

   (c) ₹15,000

   (d) ₹ 20,000

4. A person appointed as a director is required to give his written consent in Form DIR-2 ---------- to the company.

   (a) on or before his appointment as director

   (b) within 10 days of his appointment as director

   (c) within 20 days of his appointment as director

   (d) None of the above

5. In case the articles of a public company do not provide for the retirement of all directors at every annual general meeting, not less than --------- of the total number of directors shall be liable to retire by rotation.

   (a) one-third

(b) two-thirds

(c) one-fourth

(d) one-half

6. An independent director shall hold office for a term up to ---------- on the Board of a company.

(a) three consecutive years

(b) four consecutive years

(c) five consecutive years

(d) None of the above

7. Every company is required to furnish Director Identification Numbers of all its directors to the Registrar within ---------- of the receipt of intimation regarding DIN from the directors.

(a) ten days

(b) fifteen days

(c) twenty days

(d) thirty days

8. The amount of ₹ 1,00,000 deposited by a proposed director (other than a retiring director) shall be refunded to him if he gets more than ---------- of the total valid votes cast either on show of hands or on poll.

(a) 10%

(b) 15%

(c) 25%

(d) None of the above

9. An additional director appointed by the Board of Directors shall continue to hold the office up to the due date of the next ----------

(a) Board meeting

(b) Annual general meeting

(c) Extra-ordinary general meeting

(d) None of the above

10. A person is permitted to hold office as director (including any alternate directorship) in maximum twenty companies of which maximum number of public companies in which he can be appointed as director shall not exceed ----------.

(a) Five

(b) Eight

(c) Ten

(d) Twelve

Descriptive Questions

Question 1

The Articles of Association of Rajasthan Toys Private Limited provide that the maximum number of Directors in the company shall not exceed 10. Presently, the company has 8 directors. Its Board of Directors desires to increase the number of directors from 8 to 16. Advise whether under the provisions of the Companies Act, 2013, the Board can do so.

Question 2

ADJ Limited has 10 directors on its board. Two of the directors have retired by rotation at an Annual General Meeting. The place of retiring directors is not so filled up and the meeting has also not expressly resolved 'not to fill the vacancy'. Since the AGM could not complete its business, it is adjourned till the same day in the next week, at the same time and place. At this adjourned meeting also the place of retiring directors could not be filled up, and the meeting has also not expressly resolved 'not to fill the vacancy'.

Referring to the provisions of the Companies Act, 2013, decide:

(i) Whether in such a situation the retiring directors shall be deemed to have been re-appointed at the adjourned meeting?

(ii) What will be your answer in case at the adjourned meeting, the resolutions for re-appointment of these directors were lost?

(iii) Whether such directors can continue in case the directors do not call the Annual General Meeting?

Question 3

Prince Ltd. desires to appoint an additional director on its Board of directors. The Articles of the company confer upon the Board to exercise the power to appoint such a director. As such M is appointed as an additional director. In the light of the provisions of the Companies Act, 2013, examine:

(i) Whether M can continue as director if the annual general meeting of the company is not held within the stipulated period and is adjourned to a later date?

(ii) Can the power of appointing additional director be exercised at the Annual General Meeting by the members?

(iii) As the Company Secretary of the company what checks would you make after M is appointed as an additional director?

Question 4

The Board of directors of XYZ Ltd. filled up a casual vacancy caused by the death of Mr. P by appointing Mr. C as a director on 3rd April, 2019 which was subsequently approved by the members in the immediate next general meeting. Unfortunately Mr. C expired on 15th May, 2019 after working about 40 days as a director. The Board now wishes to fill up the casual vacancy by appointing Mrs. C in the forthcoming meeting of the Board. Advise the Board in this regard keeping in view the provisions of the Companies Act, 2013.

Question 5

Mr. John is a director of MNC Ltd., which had accepted deposits from public. The financial position of MNC Ltd. took a southward turn and became bad to worse and ultimately, it failed to repay the deposits which fell due for payment on 10th April, 2018 and such repayment has not been made till 5th May, 2019. Another company JKL Ltd. wants to appoint the said Mr. John as its director at its annual general meeting to be held on 6th May, 2019. You are required to state with reference to the provisions of the Companies Act, 2013 whether Mr. John can be appointed as a director of JKL Ltd.

Question 6

XYZ Limited is an unlisted public company having a paid-up share capital of twenty crore rupees as on 31st March, 2019 and a turnover of one hundred fifty crore rupees during the year ended 31st March, 2019. The total number of directors is thirteen.

Referring to the provisions of the Companies Act, 2013 answer the following:

(i) State the minimum number of independent directors that the company should appoint.

(ii) How many independent directors are to be appointed in case XYZ Limited is a listed company?

ANSWER/SOLUTION

Answer to MCQ

1. (d) **Hint:** Second proviso to section 149(1) of the Companies Act, 2013 along with Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014

2. (c) **Hint:** Section 149(4) of the Companies Act, 2013 along with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014

3. (d) **Hint:** Section 151 of the Companies Act, 2013

4. (a) **Hint:** Section 152(5) of the Companies Act, 2013 along with Rule 8 of the Companies (Appointment and Qualification of Directors) Rules, 2014

5. **(b)** **Hint:** Section 152(6) of the Companies Act, 2013

6. **(c)** **Hint:** Section 149(10) & 149(11) of the Companies Act, 2013

7. **(b)** **Hint:** Section 157 of the Companies Act, 2013

8. **(c)** **Hint**: Section 160 of the Companies Act, 2013

9. **(b)** **Hint:** Section 161(1) of the Companies Act, 2013

10. **(c)** **Hint:** Section 165 of the Companies Act, 2013

Answer to Descriptive Questions

1. Under Section 149 (1) of the Companies Act, 2013 every company shall have a Board of Directors consisting of individuals as directors and shall have a minimum number of 3 directors in the case of a public company, 2 directors in the case of a private company, and one director in the case of a One Person Company. The maximum number of directors shall be 15.

The First Proviso to Section 149 (1) states that a company may appoint more than 15 directors after passing a special resolution.

From the provisions of section 149 (1) as above, though the minimum number of directors may vary depending on whether the company is a public, private or a one person company, the maximum number of directors is same for all types of companies *i.e.* 15 directors.

In the given case since the number of directors is proposed to be increased from 8 to 16, the company will be required to comply with the following provisions:

(i) Alter its Articles of Association as per the provisions of Section 14 of the Act by passing a special resolution, so as to increase the number of directors in the Articles from 10 to 16;

(ii) Also take approval for increasing the maximum number of directors from 8 to 16 by means of a special resolution passed by the members at a duly convened general meeting.

2. **Retiring director – When to be deemed director?**

In accordance with the provision of the Companies Act, 2013, as contained in section 152(7)(a) which provides that if at the annual general meeting at which a director retires and the vacancy is not so filled up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned to same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

Section 152(7)(b) further provides that if at the adjourned meeting also, the place of the retiring is not filled up and that meeting also has not expressly resolved not to fill the vacancy,

the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless at the adjourned meeting or at the previous meeting a resolution for the re-appointment of such director was put and lost or he has given a notice in writing addressed to the company or the Board of Directors expressing his desire not to be re-elected or he is disqualified.

Therefore, in the given circumstances answers to the asked questions shall be as under:

(i) In the first case, applying the above provisions, the retiring directors shall be deemed to have been re-appointed.

(ii) In the second case, where the resolutions for the reappointment of the retiring directors were lost, the retiring directors shall not be deemed to have been re-appointed.

(iii) Section 152(6)(c) states that 1/3rd of the rotational directors shall retire at every AGM. Accordingly, the directors will retire as soon as the AGM is held on its due date. Further, as per Section 96 (dealing with Annual General Meeting), every company other than a One Person Company is required to hold an Annual General Meeting in each year. Hence, it is necessary for the company to hold the AGM, where the directors liable to retire by rotation shall retire. In case AGM is not held till the last date on which it should have been held, the term of retiring directors ends on this last date and it can not be extended till the new date when the AGM shall be held. As the calling of the AGM is the duty and responsibility of the directors, they by omitting to call the AGM on its due date cannot take advantage of their own fault and by that means cannot extend their own continuance in the office for any period of their choice and as long as the holding of the next AGM does not take place.

3. Section 161(1) of the Companies Act, 2013 provides that the articles of association of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director at the general meeting, as an additional director at any time and such director will hold office upto the date of the next annual general meeting or the last date on which such annual general meeting should have been held, whichever is earlier.

(i) M cannot continue as director till the adjourned annual general meeting, since he can hold the office of directorship only up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier. Such an additional director shall vacate his office latest on the date on which the annual general meeting should have been held under Section 96 of the Companies Act, 2013. He cannot continue in the office on the ground that the meeting was not held or it could not be called within the time prescribed.

(ii) The power to appoint additional directors vests with the Board of Directors and not with the members of the company. The only condition is that the Board must be conferred such power by the articles of the company.

(iii) As a Company Secretary, I would put the following checks in place in respect of M's appointment as an additional director:

(a) He must have got the Directors Identification Number (DIN).

(b) He must furnish the DIN and a declaration that he is not disqualified to become a director under the Companies Act, 2013.

(c) He must give his written consent in Form DIR-2 on or before his appointment as director and such consent stands filed with the Registrar within 30 days of his appointment.

(d) His appointment is made by the Board of Directors.

(e) His name is entered in the statutory records as required under the Companies Act, 2013.

4. Section 161(4) of the Companies Act, 2013 provides that if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall be subsequently approved by members in the immediate next general meeting.

Further, any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

In view of the above provisions, in the given case, the appointment of Mr. C in place of the deceased director Mr. P was in order. In normal course, Mr. C could have held his office as director up to the date to which Mr. P would have held the same.

However, Mr. C expired on 15th May, 2018 and again a vacancy has arisen in the office of director owing to death of Mr. C who was appointed by the board and approved by members to fill up the casual vacancy resulting from P's demise. Vacancy arising on the Board due to vacation of office by the director appointed to fill a casual vacancy in the first place, does not create another casual vacancy as section 161 (4) clearly mentions that such vacancy is created by the vacation of office by any director appointed by the company in general meeting. Hence, the Board cannot fill the vacancy arising from the death of Mr. C who was appointed to fill a casual vacancy.

The Board may however appoint Mrs. C as an additional director under section 161 (1) of the Companies Act, 2013 provided the articles of association authorise the board to do so, in which case Mrs. C will hold the office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

5. Section 164 (2) (b) of the Companies Act, 2013 states that where a person is or has been a director of a company which has failed to repay its deposit on due date and such failure

continues for one year or more, then such person shall not be eligible to be appointed as a director of any other company for a period of five years from the date on which such company, in which he is a director, failed to repay its deposits.

In the instant case, MNC Ltd., has failed to repay its deposit on due dates and the default continues for more than one year. Hence, Mr. John will not be eligible to be appointed as a director of JKL Ltd.

6. **(i)** According to Rule 4 of the *Companies (Appointment and Qualification of Directors) Rules, 2014*, the following class or classes of companies shall have at least 2 directors as independent directors:

(1) the Public Companies having paid up share capital of 10 crore rupees or more; or

(2) the Public Companies having turnover of 100 crore rupees or more; or

(3) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

In the present case, XYZ Limited is an unlisted public company having a paid-up capital of ₹20 crores as on 31st March, 2019 and a turnover of ₹150 crores during the year ended 31st March, 2019. Accordingly, as per Rule 4 it must have at least 2 directors as independent directors.

(ii) According to Section 149(4) of the Companies Act, 2013, every listed public company shall have at least one-third of the total number of directors as independent directors. The Explanation to Section 149(4) specifies that any fraction contained in such one-third numbers shall be rounded off as one.

In the present case, XYZ Limited is a listed company and the total number of directors is 13. Hence, in this case, XYZ Limited must have at least 5 directors (1/3 of 13 is 4.33 rounded as 5) as independent directors.

Explanation to Rule 4 of the *Companies (Appointment and Qualification of Directors) Rules, 2014* clarifies that for the purpose of this Rule the paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

In the present case, it is mentioned that paid up capital of XYZ Limited is ₹20 crore as on 31st March, 2019 and turnover is ₹150 crore during the year ended 31st March, 2019. It is, therefore, assumed that 31st March, 2019 is the last date of latest audited financial statements.

CHAPTER 2

APPOINTMENT AND REMUNERATION OF MANAGERIAL PERSONNEL

LEARNING OUTCOMES

After studying this chapter, the students would be able to:

- Understand the provisions relating to appointment of Managing Director, Whole Time Director and Manager.
- Know the provisions regarding appointment of Key Managerial Personnel (KMPs).
- Understand the concept of maximum managerial remuneration and managerial remuneration payable in case of absence or inadequacy of profits.
- Calculation of profits for the purpose managerial remuneration and recovery of managerial remuneration in certain cases.
- Explain the concepts of compensation for loss of office of Managing or Whole Time Director or Manager
- Know about the functions of Company Secretary and requirements for Secretarial Audit.

1. INTRODUCTION

This Chapter deals with the appointment of managerial personnel and managerial remuneration payable to them as per the applicable provisions of the Companies Act, 2013, Rules made thereunder and Schedule V.

MEANING OF CERTAIN TERMS

"Chief Executive Officer" [Section 2(18)] means an officer of a company, who has been designated as such by it.

"Chief Financial Officer" [Section 2(19)] means a person appointed as the Chief Financial Officer of a company.

"Company Secretary" or "secretary" [Section 2(24)] means a company secretary as defined in clause (*c*) of sub-section (1) of Section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under the Companies Act, 2013.

"Company secretary in practice" [Section 2(25)] means a company secretary who is deemed to be in practice under sub-section (2) of Section 2 of the Company Secretaries Act, 1980.

"Key managerial personnel" [Section 2(51)], 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.

"Manager" [Section 2(53)] means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

According to the above definition, a manager is an individual person. Such person is given the charge of whole or substantially the whole of managing the affairs of a company. Therefore, a person appointed as manager to head one of the sections of the company (say, marketing department) cannot be said to be a 'manager' within the meaning of Section 2 (53). A manager functions under the superintendence, control and direction of the Board of Directors.

It is not necessary that a manager should also be a director of the company though there is no restriction in designating a director as manager of the company. It is not permitted by Section 196

(1) for a company to appoint both managing director and manager at the same time. The simple reason behind this restriction is that when a person is entrusted with whole or substantially the whole of management, how can there be appointed another person for the same purpose. Moreover, due to overlapping of authorities between two powerful persons, the affairs of a company shall not be conducted the way they should, leading to mismanagement.

Managing Director [Section 2(54)] means a director who is entrusted with substantial powers of management of the affairs of the company by:

(i) virtue of the articles of a company, or

(ii) an agreement with the company, or

(iii) a resolution passed in its general meeting, or by its Board of Directors,

and includes a director occupying the position of the managing director, by whatever name called.

Explanation to Section 2(54) clarifies that substantial powers of the management shall not be deemed to include the power to do such administrative acts of a routine nature when so authorised by the Board such as:

(i)	the power to affix the common seal of the company to any document, or
(ii)	to draw and endorse any cheque on the account of the company in any bank, or
(iii)	to draw and endorse any negotiable instrument, or
(iv)	to sign any certificate of share, or
(v)	to direct registration of transfer of any share.

Thus, excluding the above administrative acts of a routine nature, the managing director enjoys substantial powers of conducting and managing the business of the company as per its memorandum and articles of association.

From the above definition, it emerges that a managing director needs to be a director in the first place. It is immaterial whether he is appointed as additional director or rotational director or non-rotational director. However, as soon as he ceases to be a director, he shall also cease to be a managing director.

It is not necessary that a director who occupies the position of the managing director needs to be called 'managing director'. He may be called by whatever name. The essential pre-requisite is that the director must be entrusted with substantial powers of management of the affairs of the company excluding routine administrative acts as entrusted by the Board. If such is the case, the director is a managing director, by whatever name called. It may be noted that Section 196 (1) prohibits a company to appoint both managing director and manager at the same time. However, it shall be apt if a person is designated as a Managing Director instead of manager.

The Board of Directors exercises control over the managing director. Thus, powers as managing director are exercisable according to the directions of the Board.

Whole Time Director (WTD) [Section 2(94)]: WTD includes a director in the whole-time employment of the company.

As the definition suggests WTD is a director. Also, he is in the whole-time employment of the company *i.e.* he is a full-time employee who is required to devote his time in totality for the management of the company. A person who is not a director in the company cannot be employed as whole-time director.

Remuneration [Section 2 (78)]: 'Remuneration' means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

2. APPOINTMENT OF MANAGING DIRECTOR, WHOLE TIME DIRECTOR OR MANAGER [SECTION 196]

Section 196 of the Act contains the provisions for appointment of Managing Director, Whole Time Director or Manager. According to this section:

(i) A company shall not appoint or employ a managing director and a manager at the same time. [Section 196(1)]

In other words, no company is permitted to appoint a manager if a managing director is already appointed and *vice-versa.* However, there can be both MD and whole-time director in a company.

(ii) **Tenure [section 196(2)]:**

(a) No company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding **five years** at a time.

(b) It is further provided that no re-appointment shall be made earlier than one year before the expiry of his term.

Example : 'X' was appointed as Managing Director for life by the Articles of Association of a private company which was incorporated on 1st June, 2019. Examine whether 'X' can be appointed as Managing Director for life?

Answer: Section 196(2) of the Companies Act, 2013 lays down that no company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding five years at a time. No concession or exception is allowed by the Act to private companies. Hence, 'X' cannot be appointed as Managing Director for life by the private company concerned.

(iii) **Eligibility Conditions for Appointment:** For appointing a person as a Managing Director, whole-time director or manager, firstly he shall not be disqualified for appointment as a director under section 164.

As per section 196(3), no company shall appoint or continue the employment of any person as managing director, whole-time director or manager who-

(a) is below the age of 21 years or has attained the age of 70 years.

Requirement of Special Resolution for appointment of a person above the age of 70 years: There is a relaxation in case of a person above the age of 70 years. Accordingly, where a person has attained the age of seventy years, he may still be appointed to such office if a special resolution is passed in this respect. In such a case, the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

Government approval required if no Special Resolution is passed[1]: Further, where no such special resolution is passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made.

In other words, approval of the Central Government is required if special resolution could not be passed. The significance of this provision lies in the fact that because majority of the members were in favour of such appointment, their wish should not be turned down simply due to non-passing of special resolution. Thus, the appointment can be regularized by seeking approval of the Central Government, which, if satisfied, can accord such approval.

(b) is an undischarged insolvent or has at any time been adjudged as an insolvent; or

(c) has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or

(d) has at any time been convicted by a court of an offence and sentenced for a period of **more than six months**.

(e) ***Additional eligibility conditions for appointment as per Schedule V:*** Part I of Schedule V[2] to the Companies Act, 2013, has prescribed additional eligibility conditions for appointment as managing director or whole-time director or a manager without seeking approval from the Central Government. They are stated as under:

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[1] Second Proviso to Section 196 (3) (a) inserted by the Companies (Amendment) Act, 2017, w.e.f. 12-09-2018.

[2] Heading of Part I of Schedule V reads as 'Conditions to be fulfilled for the appointment of a Managing or Whole-time director of a manager without the approval of the Central Government'.

(1) he had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under 19 Acts[3] as specified under Part I of Schedule V.

(2) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA).

However, where the Central Government has given its approval to the appointment of a person convicted or detained under para (1) or para (2), as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval.

[4](3) he has completed the age of twenty-one years and has not attained the age of seventy years.

However, where he has attained the age of seventy years; and where his appointment is approved by a special resolution passed by the company in general meeting, no further approval of the Central Government shall be necessary for such appointment.

(4) he is resident of India.

Explanation I clarifies that resident in India includes a person who has been staying in India for a continuous period of not less than twelve months

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[3] The 19 Acts are:
(*i*) the Indian Stamp Act, 1899.
(*ii*) the Central Excise Act, 1944.
(*iii*) the Industries (Development and Regulation) Act, 1951.
(*iv*) the Prevention of Food Adulteration Act, 1954.
(*v*) the Essential Commodities Act, 1955.
(*vi*) the Companies Act, 2013.
(*vii*) the Securities Contracts (Regulation) Act, 1956.
(*viii*) the Wealth-tax Act, 1957.
(*ix*) the Income-tax Act, 1961.
(*x*) the Customs Act, 1962.
(*xi*) the Competition Act, 2002.
(*xii*) the Foreign Exchange Management Act, 1999.
(*xiii*) the Sick Industrial Companies (Special Provisions) Act, 1985.
(xiv) the Securities and Exchange Board of India Act, 1992.
(xv) the Foreign Trade (Development and Regulation) Act, 1922.
(xvi) the Prevention of Money-Laundering Act, 2002.
(xvii) the Insolvency and Bankruptcy Code, 2016.
(xviii) the Goods and Services Tax Act, 2017.
(xix) the Fugitive Economic Offenders Act, 2018.

[4] This condition is also specified by Section 196 (3) and mentioned earlier.

immediately preceding the date of his appointment as a managerial person and who has come to stay in India, -

(a) for taking up employment in India; or

(b) for carrying on a business or vacation in India.

Explanation II clarifies that the condition above shall not apply to the companies in Special Economic Zones (SEZ).

However, a person, being a non-resident in India shall enter India only after obtaining a proper Employment Visa from the concerned Indian mission abroad. For this purpose, such person shall be required to furnish, along with the visa application form:

- profile of the company,
- the principal employer, and
- terms and conditions of such person's appointment.

(iv) **Procedure of Appointment [Section 196(4)]*:***

(1) *Approval by Board and Shareholders:* Subject to the provisions of section 197 and Schedule V, a managing director, whole-time director or manager shall be appointed, and the terms and conditions of such appointment and remuneration payable shall be-

(i) approved by the Board of Directors at a meeting; and

(ii) approved by shareholders by a resolution at the next general meeting of the company.

(2) *Approval by Central Government:* In case such appointment is at variance to the conditions specified in Part I of Schedule V, the appointment shall be approved by the Central Government.

Note: Form MR-2 has been prescribed by Rule 7 of the *Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014* in which application for seeking approval from the Central Government shall be made within ninety days of such appointment of MD or WTD or manager in the company.

(3) *Inclusion of certain disclosures in Notice:* The notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any.

(4) *Filing of Return:* A return in the prescribed form[5] along with the prescribed fee shall be filed with the Registrar within sixty days of such appointment.

(v) **Validity of Acts [Section 196(5)]**: Subject to the provisions of this Act, where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall be deemed to be valid.

Example: A Managing Director is appointed in the board meeting held on 20th May, 2019. General meeting was to be held on 17th June, 2019 for approval of such appointment. Before the holding of general meeting, the Managing Director executed an agreement with another company of considerable importance on 3rd June, 2019. The general meeting was held accordingly on 17th June, 2019 but did not approve the appointment of Managing Director. Whether the executed agreement by Managing Director is valid?

Answer: Yes, the agreement is valid. Acts done by the Managing Director from 20th May, 2019 to 17th June, 2019 *i.e.* up to the non-approval of his appointment by the shareholders at the general meeting, shall be valid subject to the provisions of the Companies Act, 2013.

Exemptions	
(i)	*In case of a **Government Company**, Section 196 (2), (4) and (5) shall not apply. However, for availing the exemption, such Government Company must not have committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. (Notification No. G.S.R. 463 (E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582 (E), dated 13-06-2017).*
(ii)	*In case of **private companies** Section 196 (4) and (5) shall not apply provided such private company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. (Notification No. G.S.R. 464 (E) dated 5th June, 2015 as amended by Notification No. G.S.R. 583 (E) dated 5th June, 2015).*

3. APPOINTMENT OF KEY MANAGERIAL PERSONNEL [SECTION 203]

Section 203 of the Act, and Rule 8 as well as Rule 8A of *the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014* contain the provisions for appointment of Key Managerial Personnel in the prescribed companies.

[5] Rule 3 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribes Form No. MR-1.

(i) Appointment of Key Managerial Personnel [Section 203(1)]: Every company belonging to the prescribed class or classes of companies shall have the following whole time key managerial personnel:

(a) Managing Director, or Chief Executive Officer or Manager and in their absence, a Whole-time Director;

(b) Company Secretary; and

(c) Chief Financial Officer.

According to **Rule 8** following companies shall have whole-time key managerial personnel:

(a) every listed company; and

(b) every other public company having a paid-up share capital of ₹ 10 crore or more.

Requirement of Company Secretary in certain other companies: According to Rule 8A[6], a company other than a company covered under Rule 8 above, which has a paid up share capital of ₹ 5 crore or more shall have a **whole-time company secretary**.

In other words, it is now mandatory for every other company to have a whole-time company secretary if its paid up share capital is ₹ 5 crores or more.

(ii) Prohibition on individual to be appointed as Chairperson as well as Managing Director or Chief Executive Officer at the same time [Proviso to Section 203(1)]:

An individual shall not be appointed or reappointed as the Chairperson of the company, in pursuance of the articles of the company, as well as the Managing Director or Chief Executive Officer (CEO) of the company at the same time unless, —

(a) the articles of such a company provide otherwise; or

(b) the company does not carry multiple businesses. [First proviso to Section 203(1)]

However, above-mentioned prohibition shall not apply to such class of companies which is engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government. [refer Second proviso to Section 203(1)]

In other words, a person appointed as Chairperson of a company cannot be appointed as MD or CEO at the same time of that company. This prohibition is not applicable in the following cases:

- Where the articles of such company provide otherwise *i.e*. they allow the Chairperson to be appointed as MD or CEO.

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[6] Inserted by the Companies (Appointment and Remuneration of Managerial Personnel) (Amendment) Rules, 2014 w.e.f. 09-06-2014.

- Where the company belongs to the prescribed class of companies (*refer Box below*); is engaged in multiple businesses; and has appointed Chief Executive Officer for each such business.

Notified Public Companies: *The MCA vide Notification No. S.O. 1913 (E) dated 25th July, 2014 has notified that public companies having paid-up share capital of ₹ 100 crore or more and annual turnover of ₹ 1,000 crores or more which are engaged in multiple businesses and have appointed Chief Executive Officer for each such business shall be the class of companies for the purposes of the second proviso to sub-section (1) of section 203.*

Explanation- *For the purpose of this notification, the paid-up share capital and the annual turnover shall be decided on the basis of the latest audited balance sheet.*

(iii) Conditions for Appointment:

(a) *Requirement of Board Resolution*[7]*:* Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board. The resolution shall contain the terms and conditions of the appointment including the remuneration. [refer Section 203 (2)]

(b) *Bar on multiple appointments:* A whole-time key managerial personnel shall not hold office in more than one company at the same time **except in its subsidiary company.** [Section 203 (3)]

However, key managerial personnel shall not be disentitled from being a director in any company with the permission of the Board. [refer Proviso to Section 203 (3)]

(iv) Managing Director or Manager in more than one company [Third Proviso to Section 203(3)]: If a person is MD or manager in some other company it is permissible for a company to appoint him as its managing director. The *modus operandi* is as under:

(a) The person so appointed or employed as managing director should be managing director or manager of one, and of not more than one, other company.

(b) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting.

(c) Further, specific notice of such meeting, and of the resolution to be moved thereat has been given to all the directors then in India.

(v) Filling of Vacancy of Key Managerial Personnel (KMP) [Section 203(4)]: If the office of any whole-time KMP is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

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[7] Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 requires passing of Board Resolution at a meeting of the Board if a key managerial personnel is appointed (or removed).

[8](vi) **Penalty for non-compliance [Section 203(5)]:**

(a) **Company:** If any company makes any default in complying with the provisions of this section, such company shall be liable to a penalty of ₹ 5 Lacs.

(b) **Director and KMP**: Every defaulting director and KMP shall be liable to a penalty of ₹ 50,000. Where the default is a continuing one, they shall be liable with a further penalty of ₹ 1,000 for each day after the first during which such default continues but not exceeding ₹ 5 Lacs.

Exemptions

In case of Government companies, after sub-section (4) of Section 203, the following sub-section shall be inserted vide Notification No. G.S.R. 463 (E), dated 5th June, 2015 as amended by Notification No. G.S.R. 582 (E), dated 13th June, 2017, namely:

"(4A) The provisions of sub-section (1), (2), (3) and (4) of this section shall not apply to a managing director or Chief Executive Officer or manager and in their absence, a whole-time director of the Government company."

The sub-section (4A) shall be applicable to a Government company only if it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

4. FUNCTIONS OF COMPANY SECRETARY [SECTION 205]

The provisions of Section 205 of the Act are stated as under:

(i) Functions to be performed by Company Secretary: According to Section 205 (1) and Rule 10 of the *Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014,* a Company Secretary shall perform the following functions:

(a) to report to the Board about compliance with the provisions of the Companies Act, 2013, the rules made thereunder and other laws applicable to the company;

(b) to ensure that the company complies with the applicable secretarial standards;

(c) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;

(d) to facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;

(e) to obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Companies Act, 2013;

[8] Substituted by the Companies (Amendment) Ordinance, 2019, w.r.e.f. **2-11-2018.**

(f) to represent before various regulators, and other authorities under the Companies Act, 2013 in connection with discharge of various duties under the said Act;

(g) to assist the Board in the conduct of the affairs of the company;

(h) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and

(i) to discharge such other duties as have been specified under the Companies Act, 2013 or the Rules made thereunder; and

(j) such other duties as may be assigned by the Board from time to time.

Clarification: The expression "secretarial standards" means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government. Under Section 118 (10) of the Act, the Central Government has approved SS-1 (Secretarial Standard on Meetings of the Board of Directors) and SS-2 (Secretarial Standard on General Meetings).

(ii) No effect on duties and functions of certain important functionaries: According to Section 205 (2), the provisions contained in Section 204 relating to the 'secretarial audit for bigger companies' and Section 205 relating to the 'functions of company secretary' shall not affect the duties and functions of the Board of Directors, Chairperson of the company, Managing Director or Whole-time Director under this Act, or any other law for the time being in force.

In other words, these important functionaries of the company cannot be absolved of their duties and functions simply because a secretarial audit has been conducted or certain functions have been assigned to the company secretary. They shall always remain responsible to the company and in no way their responsibility shall be reduced.

5. CONSIDERATION OF CERTAIN PARAMETERS BY A COMPANY WHILE FIXING LIMIT WITH REGARD TO REMUNERATION IN CASE OF INADEQUATE PROFITS

Section 200 of the Act is instructive in nature. According to this section, a company needs to take care of certain parameters and may adopt an administrative ceiling as it may deem fit within the statutory ceiling with regard to fixing of managerial remuneration where it has inadequate or no profits. However, effective from 12-09-2018[9], in such cases the company is not required to seek any approval from the Central Government.

Section 200 states that notwithstanding anything contained in this Chapter, a company may, while according its approval under Section 196 to any appointment or to any remuneration under Section

[9] Words 'the Central Government' omitted from Section 200 by the Companies (Amendment) Act, 2017, w.e.f. 12-09-2018.

197 in respect of cases where the company has inadequate or no profits, fix the remuneration within the limits specified in this Act, at such amount or percentage of profits of the company, as it may deem fit.

While fixing such remuneration the company shall have regard to:

(a)	the financial position of the company;
(b)	the remuneration or commission drawn by the individual concerned in any other capacity;
(c)	the remuneration or commission drawn by him from any other company;
(d)	professional qualifications and experience of the individual concerned;
(e)	any other matters as may be prescribed. In this respect, Rule 6 of the *Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014*, prescribes that the company shall have regard to the following matters: (i) the Financial and operating performance of the company during the three preceding financial years. (ii) the relationship between remuneration and performance. (iii) the principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other directors on the board and employees or executives of the company. (iv) whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference. (v) the securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

6. OVERALL MAXIMUM MANAGERIAL REMUNERATION AND MANAGERIAL REMUNERATION IN CASE OF ABSENCE OR INADEQUACY OF PROFITS [SECTION 197]

Section 197 of the Act, lays down the provisions relating to overall maximum managerial remuneration payable by every public company and the managerial remuneration payable by it in case of absence or inadequacy of profits. Section 197 read with Schedule V to the Companies Act, 2013 defines maximum remuneration payable to KMPs. This section does not apply to a private company. These provisions are discussed as under:

(i) Overall Maximum Managerial Remuneration[10] [Section 197(1)]

(a) The overall managerial remuneration to the Directors including managing director, whole time director and manager in respect of any financial year is summarized as below:

S. No.	Conditions	Maximum remuneration in any financial year	When remuneration can be exceeded as referred to in column (b)
	(a)	(b)	(c)
(i)	Overall limit applicable to managerial remuneration	11% of the net profits of the company for that financial year ***Note:*** Net profits are to be calculated in accordance with Section 198 except that the remuneration payable to the directors shall not be deducted from the gross profits.	Subject to the provisions of Schedule V, the company in general meeting may authorise exceeding the overall limit of 11%.
(ii)	If there is one Managing director/ Whole time director/ manager	5% of the net profits of the company for that financial year	This limit of 5% may be exceeded with the approval of the company in general meeting by passing a Special Resolution.
(iii)	If there is more than one Managing Director/ Whole time director/ manager	10% of the net profits	This limit of 10% may be exceeded with the approval of the company in general meeting by passing a Special Resolution.
(iv)	Remuneration payable to directors who are neither Managing Directors nor Whole time directors	1% of the net profits of the company if there is a Managing Director or a Whole time director	This limit of 1% may be exceeded with the approval of the company in general meeting by passing a Special Resolution.

[10] Section I of Part II of Schedule V headed as 'REMUNERATION PAYABLE BY COMPANIES HAVING PROFITS' states that 'subject to the provisions of Section 197, a company having profits in a financial year may pay remuneration to a managerial personnel or persons not exceeding the limits specified in such section'.

(v)	Remuneration payable to directors who are neither Managing Directors nor Whole time directors	3% of the net profits of the company provided there is no Managing Director or Whole time director	This limit of 3% may be exceeded with the approval of the company in general meeting by passing a Special Resolution.

When to take approval in general meeting in case of default [11]**:** It is to be noted that where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, prior approval of such person (as applicable) shall have to be obtained by the company before obtaining the approval in the general meeting.

Exclusion of sitting fees: Section 197(2) provides that above percentages shall be exclusive of any fees payable to directors under section 197(5).

(b) Section 197(8) provides that the net profits shall be computed in the manner laid down in section 198. This stipulation is already covered by Section 197 (1) which further provides that the remuneration of the directors shall not be deducted from the gross profits.

(ii) No profits or inadequate profits [Section 197(3) & (11)]

(a) If in any financial year, a company has no profits or its profits are inadequate, the company shall not pay by way of remuneration any sum (exclusive of sitting fees) to its directors, including any managing or whole- time director or manager except in accordance with the provisions of Schedule V.

(b) In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule.

It is immaterial whether such provision which purports to increase or has the effect of increasing the remuneration payable to directors is contained in the memorandum or articles of the company, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its Board.

SECTION II OF PART II OF SCHEDULE V- Remuneration payable by companies having no profit or inadequate profit

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person not exceeding the limits under (A) and (B) given below:

[11] As per Third Proviso to Section 197 (1). This Proviso was inserted by the Companies (Amendment) Act, 2017 w.e.f. 12-09-2018.

Limits under (A):

(1)		(2)
Where the effective capital is (in ₹)		**Limit of yearly remuneration payable shall not exceed (in ₹)**
(i)	Negative or less than 5 crores	60 lakhs
(ii)	5 crores and above but less than 100 crores	84 lakhs
(iii)	100 crores and above but less than 250 crores	120 lakhs
(iv)	250 crores and above	120 lakhs plus 0.01% of the effective capital in excess of 250 crores:

However, the remuneration in excess of above limits may be paid if the resolution passed by the shareholders is a special resolution.

Explanation- It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

Thus, if a managerial person is employed for a part of the year, the remuneration payable to him shall be pro-rated.

Limits under (B):

In case of a managerial person who is functioning in a **professional capacity**, remuneration as per item (A) may be paid, if such managerial person:

- is not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures *(i.e. does not hold any shares subject to the deeming provision below);*

  Note: "Statutory Structure" means any entity which is entitled to hold shares in any company formed under any statute.

- is not having any, direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date of appointment;

- possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates:

Deeming provision as to the holding of shares: It is provided that any employee of a company holding shares of the company not exceeding 0.5% of its paid-up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock

Option Plan or by way of qualification shall be deemed to be a person not having any interest in the capital of the company.

Applicable conditions for payment of remuneration: The limits specified under items (A) and (B) above shall apply, if-

(i) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under Section 178 (1), also by the Nomination and Remuneration Committee;

(ii) the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, and in case of default, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company **before obtaining the approval in the general meeting**;

(iii) an ordinary resolution or a special resolution, as the case may be, has been passed for payment of remuneration as per item (A) or a special resolution has been passed for payment of remuneration as per item (B), at the general meeting of the company for a period **not exceeding three years**.

(iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely:

I. General information:

(1) Nature of industry

(2) Date or expected date of commencement of commercial production

(3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus

(4) Financial performance based on given indicators

(5) Foreign investments or collaborations, if any.

II. Information about the appointee:

(1) Background details

(2) Past remuneration

(3) Recognition or awards

(4) Job profile and his suitability

(5) Remuneration proposed

(6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be with respect to the country of his origin)

(7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

III. Other information:

(1) Reasons of loss or inadequate profits

(2) Steps taken or proposed to be taken for improvement

(3) Expected increase in productivity and profits in measurable terms

IV. Disclosures: The following disclosures shall be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the Financial statement:

(i) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;

(ii) details of fixed component and performance linked incentives along with the performance criteria;

(iii) service contracts, notice period, severance fees; and

(iv) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

(iii) Determination of Remuneration [Section 197(4)]

(a) The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either

(i) by the articles of the company, or

(ii) by a resolution or,

(ii) if the articles so require, by a special resolution, passed by the company in general meeting, and

(b) The remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

(c) Any remuneration for services rendered by any such director in other capacity shall not be so included if—

(1) the services rendered are of a professional nature; and

(2) in the opinion of the Nomination and Remuneration Committee, if the company is covered under Section 178 (1), or in the opinion of the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

Simply stated, the Board of Directors cannot determine the remuneration payable to the directors. The remuneration shall be determined (subject to the provisions of Section 197) by the articles or by a resolution or if required by the articles, by passing a special resolution.

However, besides remuneration, a director may be paid some other remuneration if he provides professional services to the company and further, in the opinion of the Nomination and Remuneration Committee (if the company has formed such committee) or in the opinion of the Board of Directors (where no such committee exists) the director possesses the requisite qualification for practicing his profession.

Example: Star Health Specialties Ltd. owns a Multi-Specialty Hospital in Chennai. Dr. Hamilton, a practicing Heart Surgeon, has been appointed by the company as its director and it wants to pay him fee, on case to case basis, for surgery performed on the patients at the hospital. A question has arisen whether payment of such fee to him would amount to payment of managerial remuneration to a director subject to any restriction under the Companies Act, 2013.

Answer: In the given case, Dr. Hamilton has been appointed as a director. He has to be paid a fee for surgeries performed by him. It is to be noted that such payment is permissible under Section 197(4) which states that the remuneration payable to the directors including managing or whole-time director or manager shall be inclusive of the remuneration payable for the services rendered by him in any other capacity except the following:

(a) the services rendered are of a professional nature; and

(b) in the opinion of the Nomination and Remuneration Committee (if applicable) or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

The company, therefore, can pay extra remuneration to Dr. Hamilton like professional fee for surgeries performed by him in his professional capacity; and such payment shall not be construed as managerial remuneration under the Act.

(iv) Sitting Fees to Directors [Section 197(5)]:

(a) A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board subject to the conditions imposed by Rule 4 of the *Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014* as under:

- The sitting fees shall not exceed ₹ one lakh rupees per meeting of the Board or committee thereof. [As per Rule 4]
- The sitting fee payable to the Independent Directors and Women Directors shall not be less than that payable to other directors. [As per Proviso to Rule 4]

Note: According to Section 197 (2), the percentages mentioned under Section 197 (1) shall be **exclusive of any sitting fees** payable to directors for attending meetings of the Board or committee thereof or for any other purpose whatsoever as may be decided by the Board.

(b) ***Scale of fees may differ:*** Different fees for different classes of companies and fees in respect to independent directors may be such as may be prescribed.

Example: The Articles of Association of a listed company have fixed payment of sitting fee for each Meeting of Directors subject to a maximum of ₹ 30,000. In view of the increased responsibilities of the independent directors of listed companies, the company proposes to increase the sitting fee to ₹ 45,000 per meeting. Advise the company about the requirement under the Companies Act, 2013 to give effect to this proposal.

Answer: Section 197(5) of the Companies Act, 2013 provides that a director may receive remuneration by way of fee for attending the Board/Committee meetings or for any other purpose as may be decided by the Board provided that the amount of such fees shall not exceed the prescribed amount. As per Rule 4 of the *Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014* the amount of sitting fees payable for attending meetings of the Board or Committees thereof may be decided by the Board but such sitting fees shall not exceed ₹ 1 lakh per meeting. Further, the sitting fee payable to an independent director shall not be less than that payable to other directors.

From the above, it is clear that sitting fees can be increased from ₹ 30,000 to ₹ 45,000 per meeting by passing a resolution in the Board Meeting and altering the Articles of Association by passing a Special Resolution. When sitting fees stands increased for other directors, it shall automatically be increased in case of independent directors because the latter cannot be paid less than that payable to former.

(v) Mode of payment of Remuneration [Section 197(6)]: A director or manager may be paid remuneration as under:

(i) by way of a monthly payment; or

(ii) at a specified percentage of the net profits of the company; or

(iii) partly by one way and partly by the other.

The term used in Section 197 (6) is 'director' which may be taken to mean all types of directors *i.e.* MD or whole-time director or executive/non-executive director. Further, remuneration can be paid on monthly basis or on the basis of specified percentage of the net profits. Even, a combination of both the methods may also be adopted.

(vi) Remuneration of Independent Directors[12]: Notwithstanding anything contained in any other provision of this Act, but subject to the provisions of sections 197 and 198, an independent director **shall not be entitled to any stock option** and may receive remuneration by way of-

(1) fee (*i.e.* sitting fee) provided under Section 197(5),

Note: According to Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, sitting fee required to be paid to an independent director shall not be less than the sitting fee which is payable to other directors of the company.

(2) reimbursement of expenses for participation in the Board and other meetings, and

(3) profit related commission as may be approved by the members.

Entitled to:	Not Entitled to:
Fee provided under section 197(5)	Any stock option
Reimbursement of **expenses** for participation in: (i) Board Meetings (ii) Other Meetings	
Profit related commission as may be approved by the members	

(vii) Refund of excess remuneration if paid to a director [Section 197(9) and (10)]: If any director draws or receives excess remuneration than the limit prescribed by Section 197 or without approval required under this section:

- he shall refund such sums to the company within two years or such lesser period as may be allowed by the company; and
- Until such sum is refunded, he shall hold it in trust for the company.

Waiver, whether possible: The company shall not waive the recovery of any sum refundable to it under Section 197 (9). However, the waiver is possible only if it is approved by the company by passing a special resolution within two years from the date the sum becomes refundable.

[12] As per Section 149 (9) of the Act.

When to take approval of waiver in case of default [13]**:** It is to be noted that where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of such person respectively shall be obtained by the company before obtaining approval of such waiver by a special resolution.

(viii) Disclosure in Board's Report by a Listed Company [Section 197(12) and Rule 5]:

(a) Every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and other details as prescribed under Rule 5 of the *Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.*

(b) According to Rule 5 (1) every listed company shall disclose in the Board's report:

(i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year; this disclosure is also prescribed by Section 197 (12)

(ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or manager, if any, in the financial year;

(iii) the percentage increase in the median remuneration of employees in the financial year;

(iv) the number of permanent employees on the rolls of company;

(v) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration; and

(vi) affirmation that the remuneration is as per the remuneration policy of the company.

Meaning of median: (i) The expression "median" means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one;

(ii) if there is an even number of observations, the median shall be the average of the two middle values.

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[13] As per Proviso to Section 197 (10). This Proviso was inserted by the Companies (Amendment) Act, 2017 w.e.f. 12-09-2018.

(c) According to Rule 5 (2) the board's report shall include a statement showing the **names of the top ten employees** in terms of remuneration drawn and the **name of every employee, who**-

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than one crore and two lakh rupees *i.e.* ₹ 1.02 crores;

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than eight lakh and fifty thousand rupees per month;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

(d) According to Rule 5 (3), the statement referred to in Rule 5 (2) [refer para (c) above] shall also indicate some particulars of the above employees like designation, remuneration received, nature of employment, qualification and experience, date of commencement of employment, age, last employment held by such employee before joining the company, the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of Rule 5 (2) [refer para (c) (iii) above], and whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager.

(ix) Premium paid in respect of Insurance taken for indemnification [Section 197(13)]:

Section 197 (13) deals with taking of insurance by a company on behalf of its MD, WTD, manager, CEO, CFO or CS and whether to treat the premium paid on such insurance as remuneration or not.

(a) ***When premium is not to be treated as part of remuneration:*** Where any insurance is taken by a company on behalf of its Managing Director (MD), Whole-time director (WTD), manager, Chief Executive Officer (CEO), Chief Financial Officer (CFO) or Company Secretary (CS) for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

(b) ***When premium is to be treated as part of remuneration:*** However, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

(x) Remuneration/Commission permissible from holding/subsidiary company [Section 197(14)]:

If any director who is a managing or whole-time director receives any commission from the company, he shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to the provisions of Section 197.

However, the requirement is that such fact must be disclosed by the company in the Board's report.

(xi) Penalty for non-compliance [Section 197(15)]: Non-compliance with the provisions of Section 197 gives rise to following penalty:

- *Defaulting person:* liable to a penalty of ₹ one lakh.
- *Company:* liable to a penalty of ₹ five lakhs.

(xii) Auditors' report to contain a statement regarding remuneration [Section 197(16)]: The auditor of the company shall, in his report under section 143, make a statement regarding remuneration as under:

- whether the remuneration paid by the company to its directors is in accordance with the provisions of Section 197;
- whether remuneration paid to any director is in excess of the limit laid down under Section 197; and
- give such other details as may be prescribed.

(xiii) Application pending with Central Government as on 12-09-2018 [Section 197(17)]: On and from the commencement of the Companies (Amendment) Act, 2017, any application made to the Central Government under the provisions of Section 197 [as it stood before such commencement *i.e.* before 12-09-2018], which is pending with that Government shall abate, and the company shall, within one year of such commencement, obtain the approval in accordance with the provisions of this section, as so amended.

In other words, in case of pendency of any application as on 12-09-2018, the company shall obtain the approval from the Central Government according to the amended Section 197 within one year from this date.

Exemptions/Modifications

(i) In case of **Government Companies**, Section 197 shall not apply. However, for availing the exemption, such Government Company must not have committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. *(Notification No. G.S.R. 463 (E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582 (E), dated 13-06-2017).*

(ii) In case of **Nidhis**, second proviso to sub-section (1) of section 197 shall apply with the modification that the remuneration of a director who is neither managing director nor whole-time director or manager for performing special services to the Nidhis specified in the articles of association may be paid by way of monthly payment subject to the approval of the company in general meeting and also to the provisions of section 197:

Provided that no approval of the company in general meeting shall be required where,-

(a) a Nidhi does not have a managing director or a whole-time director or a manager;

(b) the remuneration payable during a financial year to all the directors of the Nidhi does not exceed ten per cent. of the net profits of such Nidhi or fifteen lakh rupees, whichever is less; and

(c) a remuneration payable under clause (b) is approved by a special resolution passed in this behalf by the Nidhi.

***Note**: While availing the above modification, the Nidhis shall ensure that the interests of their shareholders are protected. (Notification No. G.S.R. 465 (E) dated 5th June, 2015)*

7. RECOVERY OF MANAGERIAL REMUNERATION IN CERTAIN CASES [SECTION 199]

Section 199 of the Act provides for recovery of managerial remuneration in certain cases.

This may happen where a company is required to re-state its financial statements for any period due to **fraud or non-compliance** with any requirement under the Companies Act, 2013 and the rules made thereunder.

When this happens, the company is duty-bound to recover from any past or present Managing Director (MD) or Whole-time director (WTD) or manager or Chief Executive Officer (CEO) (by whatever name called) who received the excess remuneration (including stock option) during the period for which the financial statements are required to be re-stated.

The excess remuneration to be recovered shall be the difference between actual amount of remuneration received by such person and the remuneration that would have been payable to him as per restatement of financial statements.

It may be noted that the recovery of remuneration does not prejudice (*i.e.* impair) any liability that may be incurred under the provisions of the Companies Act, 2013 or any other law for the time being in force. In other words, the defaulting person because of whom fraud or non-compliance took place and the financial statements were made incorrectly at that time, even though has repaid excess

remuneration, shall not be escaped from any liability that may be incurred under the provisions of the Companies Act, 2013 or any other law.

8. CALCULATION OF PROFITS [SECTION 198]

According to Section 198 of the Act, net profits for any financial year for the purpose of managerial remuneration payable under section 197 shall be calculated as follows:

(i) Credit shall be given for the sums specified in Section 198(2)

Add: Bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

(ii) Credit shall not be given for those sums specified in Section 198(3)

Less: (if credited to the P & L A/c for arriving at profit before tax)

(a) profits, by way of premium on shares or debentures of the company, which are issued or sold by the company [14][unless the company is an investment company as referred to in clause (a) of the Explanation to section 186];

(b) profits on sales by the company of forfeited shares;

(c) profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof;

(d) profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets:

Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written- down value;

(e) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

[15](f) any amount representing unrealised gains, notional gains or revaluation of assets.

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[14] Inserted by the Companies (Amendment) Act, 2017, w.e.f. 12-09-2018.
[15] Inserted by the Companies (Amendment) Act, 2017, w.e.f. 12-09-2018.

(iii) In making the computation aforesaid, the following sums specified under Section 198(4) shall be deducted,

(a) all the usual working charges;

(b) directors' remuneration;

(c) bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis;

(d) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;

(e) any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;

(f) interest on debentures issued by the company;

(g) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;

(h) interest on unsecured loans and advances;

(i) expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature;

(j) outgoings inclusive of contributions made under section 181;

(k) depreciation to the extent specified in section 123;

(l) the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained;

(m) any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract;

(n) any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m);

(o) debts considered bad and written off or adjusted during the year of account.

(iv) In making the computation aforesaid, the following sums specified under Section 198(5) shall not be deducted:

(a) income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of sub-section (4);

(b) any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4);

(c) loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value;

(d) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

9. FORMS OF, AND PROCEDURE IN RELATION TO, CERTAIN APPLICATIONS [SECTION 201]

Section 201 of the Act contains provisions which need to be followed for seeking approval from the Central Government if an application is made under Section 196[16] for the appointment of a person as Managing Director who has attained the age of seventy years but in whose case the appointment could not be regularised by passing a special resolution though votes cast in favour of the motion exceeded the votes cast against the motion. Non-passing of special resolution as before also contravenes Schedule V. Accordingly, for regularizing the appointment the company would apply to the Central Government for approval based on the fact that majority of the shareholders are in favour of such appointment as they find this appointment to be most beneficial to the company. It may be noted that now no approval is required for managerial remuneration in any case.

The process for seeking approval as given in Section 201 and Rule 7 of the *Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014* is stated as under:

(i) **Making of Application for Approval:** Every application made to the Central Government under Section 196 shall be in Form No. MR-2 as prescribed by Rule 7 and shall be accompanied by the specified fee. Rule 7 also requires that every such application shall be made to the Central Government within a period of ninety days from the date of such appointment.

(ii) **General Notice to Members:** Before any application is made by a company to the Central Government under section 196, a general notice to the members of the company shall be issued by or on behalf of the company, indicating the nature of the application proposed to be made.

[16] More precisely under Second Proviso to Section 196 (3) (a) which is effective from 12-09-2018 and which was inserted by the Companies (Amendment) Act, 2017.

(iii) **Publication of Notice:** Such notice shall be published:

- at least once in a newspaper in the principal language of the district in which the registered office of the company is situate and circulating in that district; and
- at least once in English in an English newspaper circulating in that district.

(iv) **Attaching of Notice with the Application:** The copies of the notices, together with a certificate by the company as to the due publication thereof, shall be attached to the application.

10. COMPENSATION FOR LOSS OF OFFICE OF MANAGING OR WHOLE-TIME DIRECTOR OR MANAGER [SECTION 202]

Section 202 of the Act contains provisions for compensation for loss of office of Managing Director or Whole-time director or manager as under:

(i) **Payment when arises:** A company may make payment to a Managing Director (MD) or Whole-time director (WTD) or manager, but not to any other director, by way of:

- compensation for loss of office, or
- as consideration for retirement from office, or
- in connection with such loss or retirement.

(ii) **Prohibition on payment of compensation:** No payment of compensation shall be made in the following cases:

(a) where the director resigns from his office as a result of the reconstruction of the company, or of its amalgamation with any other body corporate/bodies corporate, and is **appointed** as the managing or whole-time director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation;

(b) where the director resigns from his office otherwise than on the reconstruction of the company or its amalgamation as aforesaid in (a) *i.e.* resigns on his own;

(c) where the office of the director is vacated under sub-section (1) of section 167[17];

(d) where the company is being wound up, whether by an order of the Tribunal or voluntarily, provided the winding up was due to the negligence or default of the director;

(e) where the director has been guilty of fraud or breach of trust or of gross negligence or gross mismanagement in relation to the conduct of the affairs of the company or any subsidiary company or holding company thereof; and

[17] Various grounds of vacation of office covered by Section 167 (1) are mentioned in an earlier Chapter.

(f) where the director has instigated, or has taken part directly or indirectly in bringing about, the termination of his office.

(iii) **Quantum of compensation payable:** The compensation payable to such Managing Director or Whole-time director or manager shall not exceed the remuneration he would have earned if he would have been in office for the **remainder of his term or three years**, whichever is shorter. In other words, if the remaining period of his term in the office is more than three years the compensation shall be restricted to three years only; otherwise it is to be paid for the remainder of his term.

Calculation of compensation: The compensation shall be calculated on the basis of the **average remuneration** earned by him during a period of three years immediately preceding the date on which he ceased to hold such office, or where he held the office of less than three years, then for such shorter period.

(iv) **No compensation if company is being wound up:** No such payment of compensation can be made if winding up of the company is commenced whether:

- before the date on which he has ceased to hold office; or
- within 12 months after the date on which he has ceased to hold office,

if the assets on winding up (after deducting expenses on winding up) are not sufficient to repay the shareholders the capital, including premiums if any, contributed by them.

Note: Section 202 does not prohibit the payment to a managing director or whole-time director, or manager, of any remuneration for services rendered by him to the company in **any other capacity**.

11. SECRETARIAL AUDIT FOR BIGGER COMPANIES [SECTION 204]

Section 204 of the Act contains provisions for secretarial audit for bigger companies. These provisions are discussed as under:

(i) Which companies to get conducted secretarial audit: Section 204(1) requires the following types of companies to get conducted secretarial audit:

(a) every listed company; and

(b) a company belonging to the other prescribed class of companies. In this respect Rule 9 (1) *of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014* prescribes following companies for the purpose of secretarial audit:

(a)	Every public company having a paid-up share capital of ₹ 50 crore or more; **or**
(b)	Every public company having a turnover of ₹ 250 crore or more.

(ii) **Who is authorised to give secretarial audit report:** According to Section 204 (1), a company secretary in practice is authorised to give Secretarial Audit Report. Such Report shall be in Form No.MR - 3[18].

(iii) **Annexing of secretarial audit report**: A company shall annex the secretarial audit report so obtained with its Board's report made in terms of section 134 (3).

(iv) **Duty of the company as regards secretarial audit:** The company is duty-bound to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company [Section 204(2)].

(v) **Duty of the Board of Directors:** The Board of Directors, in the Board's Report prepared under section 134(3) shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report [Section 204 (3)].

(vi) **Penalty for contravention:** If a company or any officer of the company or the company secretary in practice, contravenes the provisions of Section 204, then

(a)	the company; or
(b)	every officer of the company; or
(c)	the company secretary in practice,

who is in default, shall be punishable with minimum fine of ₹ 1 Lac extendable to ₹ 5 Lacs. [Section 204(4)]

12. A. PART II OF SCHEDULE V [SECTIONS I TO V] - MANAGERIAL REMUNERATION

B. PART III OF SCHEDULE V – PROVISIONS APPLICABLE TO PARTS I AND II

C. PART IV OF SCHEDULE V – EXEMPTION BY CENTRAL GOVERNMENT

A. PART II OF SCHEDULE V [SECTIONS I TO V] – Managerial Remuneration

(i) **SECTION I- Remuneration payable by companies having profits:** Subject to the provisions of Section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in such section.

Note: Refer Provisions of Section 197 discussed earlier.

[18] Form prescribed by Rule 9 (2) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

(ii) SECTION II- Remuneration payable by companies having no profit or inadequate profit [Discussed earlier u/s Section 197(3)]

(iii) SECTION III— Remuneration payable by companies having no profit or inadequate profit in certain special circumstances: In the following circumstances a company may pay remuneration to a managerial person in excess of the amounts provided in Section II above:

(a) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.

(b) where the company—

(i) is a newly incorporated company, for a period of seven years from the date of its incorporation, or

(ii) is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction for a period of five years from the date of sanction of scheme of revival, or

(iii) is a company in relation to which a resolution plan has been approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 for a period of five years from the date of such approval,

it may pay any remuneration to its managerial persons.

(c) where remuneration of a managerial person exceeds the limits in Section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this Section shall be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:

(i) except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;

(ii) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (4) of section 196.

(iii) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

(iv) SECTION IV— Perquisites not included in managerial remuneration:

1. A managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III:

   (a) Contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961;

   (b) Gratuity payable at a rate not exceeding half a month's salary for each completed year of service; and

   (c) Encashment of leave at the end of the tenure.

2. In addition to the perquisites specified in paragraph 1 of this section, an expatriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II or Section III:

   (a) *Children's education allowance*: In case of children studying in or outside India, an allowance limited to a maximum of ₹ 12,000 per month per child or actual expenses incurred, whichever is less. Such allowance is admissible up to a maximum of two children.

   (b) *Holiday passage for children studying outside India or family staying abroad*: Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India, with the managerial person.

   (c) *Leave travel concession*: Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

Explanation I.—For the purposes of Section II of this Part, "**effective capital**" means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case

of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

Explanation II.—

(a) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment;

(b) In any other case the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

Explanation III.— For the purposes of this Schedule, ''family'' means the spouse, dependent children and dependent parents of the managerial person.

Explanation IV.— The Nomination and Remuneration Committee while approving the remuneration under Section II or Section III, shall—

(a) take into account, financial position of the company, trend in the industry, appointee's qualification, experience, past performance, past remuneration, etc.;

(b) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

Explanation V.— For the purposes of this Schedule, "negative effective capital" means the effective capital which is calculated in accordance with the provisions contained in Explanation I of this Part is less than zero.

Explanation VI.— For the purposes of this Schedule:—

(A) *Omitted*

(B) "Remuneration" means remuneration as defined in clause (78) of Section 2 and includes reimbursement of any direct taxes to the managerial person.

(v) SECTION V—Remuneration payable to a managerial person in two companies:

Subject to the provisions of sections I to IV, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

B. PART III OF SCHEDULE V - Provisions applicable to Parts I and II

1. The appointment and remuneration referred to in Part I and Part II of this Schedule shall be subject to approval by a resolution of the shareholders in general meeting.

2. The auditor or the Secretary of the company or where the company is not required to appoint a Secretary, a Secretary in whole-time practice shall certify that the requirement of this Schedule have been complied with and such certificate shall be incorporated in the return filed with the Registrar under sub-section (4) of section 196.

C. PART IV OF SCHEDULE V: Exemption by Central Government

The Central Government may, by notification, exempt any class or classes of companies from any of the requirements contained in this Schedule.

Clarification

The MCA vide General Circular No. 07/2015 dated 10th April, 2015 has clarified that a managerial person who has been appointed in accordance with provisions of Schedule XIII of the Companies Act, 1956, may continue to receive remuneration for his remaining term in accordance with terms and conditions approved by the company as per relevant provisions of Schedule XIII of the Companies Act, 1956 even if the part of his/her tenure falls after 1st April, 2014.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. The appointment of a whole-time company secretary is mandatory when the paid-up share capital of a company is ₹ ----------.

(a) Two crores

(b) Three crores

(c) Five crores

(d) Ten crores

2. A whole-time key managerial personnel of a company can hold office in another company if the other company is:

(a) its holding company

(b) its subsidiary company

(c) its associate company

(d) a small company

3. Board of Directors of Centra Tech Limited desires to appoint Nipun, aged 22 years as the Managing Director of the company. Nipun is currently a director and the son of Ramesh, the immediate Managing Director who expired in a car accident. State whether Nipun can be appointed as Managing Director.

(a) Yes; since he is above the age of 21 years

(b) No; since he has not attained the age of 25 years

(c) Since he has not attained the age of 25 years, permission of Registrar of Companies is to be obtained for his appointment as MD

(d) Since he has not attained the age of 25 years, permission of Central Government is to be obtained for his appointment as MD

4. Maximum sitting fees per meeting that can be paid to a director of a company shall not exceed ₹ ----------

(a) 1,00,000

(b) 2,00,000

(c) 2,50,000

(d) 3,00,000

5. In addition to a listed company which other public company is required to have whole-time key managerial personnel?

(a) which has paid-up share capital of ₹ 2 crores

(b) which has paid-up share capital of ₹ 3 crores

(c) which has paid-up share capital of ₹ 4 crores

(d) which has paid-up share capital of ₹ 10 crores

6. Is it permissible for whole-time key managerial personnel of a company to hold the office of director in any company?

(a) Yes; but with the permission of his Board of Directors

(b) Yes; but with the permission of shareholders accorded by passing an ordinary resolution

(c) Yes; but with the permission of shareholders accorded by passing a special resolution

(d) Yes; but with the permission of shareholders accorded by passing an ordinary resolution which is further ratified by the concerned Registrar of Companies

7. Total managerial remuneration payable by a public company to its directors (including MD, WTD and manager) in any financial year shall not exceed ---------- of its net profits for that financial year.

(a) Five percent

(b) Seven percent

(c) Ten percent

(d) None of the above

8. Due to non-compliance of certain requirements under the Companies Act, 2013 not amounting to fraud, a company was required to re-state its financial statements for the financial year 2016-17 during the current year. After the financial statements were re-stated it was found that the Managing Director (MD) of that period, who is now retired, was paid excess remuneration to the extent of ₹ 5,00,000. State whether such excess amount is recoverable.

(a) Nothing can be recovered from the ex-MD

(b) Excess amount shall be recovered irrespective of whether at present he is MD or not

(c) Only 50% of excess amount is recoverable because no fraud is involved

(d) Only 25% of excess amount is recoverable because no fraud is involved

9. The five directors of a non-listed public company are being paid ₹ 40,000 each as sitting fees for every meeting. The two independent directors of this company shall also be paid not less than ---------- each as sitting fees per meeting.

(a) ₹ 40,000

(b) 25% of ₹ 40,000

(c) 50% of ₹ 40,000

(d) 75% of ₹ 40,000

10. A Whole-time director can be appointed or re-appointed for a term not exceeding ---------- at a time.

(a) Two years

(b) Three years

(c) Five years

(d) Seven years

Descriptive Questions

Question 1

Advise Super Specialties Ltd. in respect of the following proposals under consideration of its Board of Directors:

(i) Appointment of Managing Director who is above the age of 70 years;

(ii) Payment of commission of 4% of the net profits per annum to the directors of the company;

(iii) Payment of remuneration of ₹ 40,000 per month to the whole-time director of the company which is running in loss and having an effective capital of ₹ 95.00 lacs.

Question 2

Mr. X, a Director of MJV Ltd., was appointed as Managing Director on 1st April, 2015. One of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule V. For the financial year ended 31st March, 2017, the company suffered heavy losses. The company was not in a position to pay any remuneration but he was paid ₹ 50 lacs for the year. The effective capital of the company is ₹150 crores. Referring to the provisions of Companies Act, 2013, as contained in Schedule V, examine the validity of the above payment of remuneration to Mr. X.

Question 3

Mr. Doubtful was appointed as Managing Director of Carefree Industries Ltd. for a period of five years with effect from 1.4.2016 on a salary of ₹ 12 lakhs per annum with other perquisites. The

Board of Directors of the company came to know about certain questionable transactions entered into by Mr. Doubtful and therefore, terminated his services as Managing Director from 1.3.2019. Mr. Doubtful termed his removal as illegal and claimed compensation from the company. Meanwhile the company paid a sum of ₹ 5 lakhs on ad hoc basis to Mr. Doubtful pending settlement of his dues. Discuss whether:

(i) The company is bound to pay compensation to Mr. Doubtful and, if so, how much.

(ii) The company can recover the amount of ₹ 5 lakhs paid on the ground that Mr. Doubtful is not entitled to any compensation, because he is guided by corrupt practices.

Question 4

International Technologies Limited, a listed company, being managed by a Managing Director proposes to pay the following managerial remuneration:

(i) Commission at the rate of five percent of the net profits to its Managing Director, Mr. Kamal.

(ii) The directors other than the Managing Director are proposed to be paid monthly remuneration of ₹ 50,000 and also commission at the rate of one percent of net profits of the company subject to the condition that overall remuneration payable to ordinary directors including monthly remuneration payable to each of them shall not exceed two percent of the net profits of the company. The commission is to be distributed equally among all the directors.

(iii) The company also proposes to pay suitable additional remuneration to Mr. Bhatt, a director, for professional services rendered as software engineer, whenever such services are utilized.

You are required to examine with reference to the provisions of the Companies Act, 2013 the validity of the above proposals.

ANSWER/SOLUTION

Answers to MCQs

1. **(c)** **Hint**: Section 203 of the Companies Act, 2013 along with Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

2. **(b)** **Hint:** Section 203(3) of the Companies Act, 2013

3. **(a)** **Hint:** Section 196(3) of the Companies Act, 2013

4. **(a)** **Hint**: Section 197(5) of the Companies Act, 2013 along with Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

5. **(d)** **Hint**: Section 203(1) of the Companies Act, 2013 along with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

6. **(a)** **Hint**: proviso to section 203(3) of the Companies Act, 2013

7. **(d)** **Hint**: Section 197(1) of the Companies Act, 2013

8. **(b)** **Hint:** Section 199 of the Companies Act, 2013

9. **(a)** **Hint:** Proviso to Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

10. **(c)** **Hint:** Section 196(2) of the Companies Act, 2013

Answer to Descriptive Questions

1. **(i)** Under the proviso to section 196 (3) of the Companies Act, 2013, a person who has attained the age of seventy years may be employed as managing director, whole-time director or manager by the approval of the members by a special resolution passed by the company in the general meeting and the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

However, where no such special resolution is passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made.

In the given situation, Super Specialties Ltd. can employ a person who is above the age of 70 years as its Managing Director, if the above-mentioned legal procedure is followed. Thus, the appointment can be regularised by passing a special resolution and if that is not done but the votes cast in favour of the motion exceed the votes, if any, cast against the motion, the approval of Central Government is required to be obtained.

(ii) Under section 197 (1) the limit of total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of that company for that financial year computed in the manner laid down in section 198. Further, the third proviso to section 197 (1) provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed one per cent. of the net profits of the company, if there is a managing or whole-time director or manager; or three per cent of the net profits in any other case.

Therefore, in the given case, the commission of 4% is beyond the limit specified, and the same should be approved by the members by passing a special resolution.

(iii) If, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including managing or whole time director or manager, any remuneration exclusive of any fees payable to directors except in accordance with the provisions of Schedule V. Section II of Part II of schedule V provides that where in any financial year during the currency of tenure of a managerial

person, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person not exceeding ₹ 60 lacs for the year if the effective capital of the company is negative or up to₹ 5 crores.

In the given situation, the proposed remuneration of ₹ 40,000 per month (*i.e.* ₹ 4,80,000 per annum) can be paid to the whole-time director of the company which is running in loss because the remuneration is less than permissible ₹ 60 lacs.

2. Under Section II of Part II of Schedule V to the Companies Act, 2013, the remuneration payable to managerial personnel is linked to the effective capital of the company. Schedule V states that where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person not exceeding ₹ 120 Lakhs in the year in case the effective capital of the company is between ₹ 100 crores and 250 crores. However, the remuneration in excess of ₹ 120 Lakhs may be paid if the resolution passed by the shareholders is a special resolution.

From the foregoing provisions as contained in Schedule V, the payment of ₹ 50 lacs in the year of loss as remuneration to Mr. X is less than ₹ 120 lacs which is otherwise permissible when the effective capital of the company is between ₹ 100 crores and 250 crores. Thus, payment of ₹ 50 lacs being made to Mr. X is within the prescribed limit and can be validly made to him.

3. According to Section 202 of the Companies Act, 2013, compensation can be paid only to a Managing Director, Whole-time Director or Manager. Amount of compensation cannot exceed the remuneration which he would have earned if he would have been in the office for the unexpired term of his office or for 3 years whichever is shorter. No compensation shall be paid, if the director has been found guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company.

In light of the above provisions of law, the company is not liable to pay any compensation to Mr. Doubtful, if he has been found guilty of fraud or breach of trust or gross negligence in the conduct of affairs of the company. But, it is not proper on the part of the company to withhold the payment of compensation on the basis of mere allegations. The compensation payable by the company to Mr. Doubtful would be ₹ 25 Lacs calculated at the rate of ₹ 12 Lacs per annum for unexpired term of 25 months.

Regarding *ad-hoc* payment of ₹ 5 Lacs, it will not be possible for the company to recover the amount from Mr. Doubtful in view of the decision in case *of Bell vs. Lever Bros. (1932) AC 161* where it was observed that a director was not legally bound to disclose any breach of his fiduciary obligations so as to give the company an opportunity to dismiss him. In that case the Managing Director was initially removed by paying him compensation and later on it was discovered that he had been guilty of breaches of duty and corrupt practices and that he could have been removed without compensation.

4. International Technologies Limited, a listed company, being managed by a Managing Director proposes to pay the following managerial remuneration:

(i) **Commission at the rate of 5% of the net profits to its Managing Director, Mr. Kamal**: Part (i) of the Second Proviso to Section 197(1), provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to any one managing director or whole time director or manager shall not exceed 5% of the net profits of the company and if there is more than one such director then remuneration shall not exceed 10% of the net profits to all such directors and manager taken together.

In the present case, since the International Technologies Limited is being managed by a Managing Director, the commission at the rate of 5% of the net profit to Mr. Kamal, the Managing Director is allowed and no approval of company in general meeting is required.

(ii) The directors other than the Managing Director are proposed to be paid monthly remuneration of ₹ 50,000 and also commission at the rate of 1 % of net profits of the company subject to the condition that overall remuneration payable to ordinary directors including monthly remuneration payable to each of them shall not exceed 2 % of the net profits of the company: Part (ii) of the Second Proviso to Section 197(1) provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to directors who are neither managing directors nor whole time directors shall not exceed-

(A) 1% of the net profits of the company, if there is a managing or whole-time director or manager;

(B) 3% of the net profits in any other case.

In the present case, the maximum remuneration allowed to directors other than managing or whole-time director is 1% of the net profits of the company because the company is managed by a managing director. Hence, if the company wants to fix directors' remuneration at not more than 2% of the net profits of the company, the approval of the company in general meeting is required by passing a special resolution.

(iii) The company also proposes to pay suitable additional remuneration to Mr. Bhatt, a director, for professional services to be rendered by him as software engineer, whenever such services are utilized by the company:

(1) According to section 197(4), the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either

(i) by the articles of the company, or

(ii) by a resolution or,

(iii) if the articles so require, by a special resolution, passed by the company in general meeting, and

(2) the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

(3) Any remuneration for services rendered by any such director in other capacity shall not be so included if—

(i) the services rendered are of a professional nature; and

(ii) in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

Hence, in the present case, the additional remuneration payable to Mr. Bhatt, a director, for professional services rendered by him as software engineer will not be included in the maximum managerial remuneration. Accordingly, such additional remuneration shall be allowed but opinion of Nomination and Remuneration Committee needs to be obtained.

Also, the International Technologies Limited (a listed company) shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as are prescribed under Rule 5 of the *Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014*.

CHAPTER 3

MEETINGS OF BOARD AND ITS POWERS

LEARNING OUTCOMES

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

- Understand the procedure and requirements of convening a Board meeting.
- Know about the requisite quorum for the conduct of Board meetings.
- Understand the concept of Audit Committee, Nomination and Remuneration Committee, and Stake-holders Relationship Committee of the Board.
- Explain the powers and restrictions imposed on the powers of Board.
- Know about the various provisions relating to contributions to be made by companies to charitable funds, political parties, National Defence Fund, etc.
- Explain the provisions relating to disclosure of interest by directors, restrictions on loan to directors and loans and investments made by a company.
- Understand about the related party and the related party transactions.
- Know about the payment to directors for loss of office, etc. in connection with transfer of undertaking, property or shares.

1. INTRODUCTION

The shareholders in general meetings and the directors acting collectively as a Board conduct the affairs of a company. Therefore, directors frequently meet to discuss various matters relating to the management and administration of the affairs of the company in the interest of the shareholders, the company and the public at large including society and economy and more particularly, the environment. The modern practice is to confer upon the directors the right to exercise all powers of the company in which they are appointed as directors except for those matters, which by law are required to be exercised by the company in general meetings through the shareholders. The Board of directors oversees management of the company to ensure that the interests of the shareholders are protected and the goal of wealth maximization is achieved.

The provisions related to meetings of Board and its powers are dealt with under Sections 173 to 193 of the Companies Act, 2013 (in short, the 'Act') and the relevant Rules. This Chapter discusses the laws relating to convening of Board meetings, requisite quorum for the conduct of the meetings, various committees of the Board, powers of the Board and the restrictions imposed on them, disclosure of interest by directors, loan and investment, related party transactions, etc.

2. MEETINGS OF BOARD [SECTION 173]

Section 173 of Act contains provisions which deal with Meetings of the Board. This section requires the directors upon whose shoulders the management of the company rests to meet and inter-act regularly. The aim is to ensure that the powers which vest in the directors should be exercised collectively and every director should have the knowledge of the decisions taken for the smooth conduct of the business operations. The provisions of Section 173 are discussed hereunder:

(i) Frequency of Board Meetings [Section 173 (1)][1]:

(a) **First Board meeting:** Every company shall hold the first meeting of the Board of Directors **within 30 days** of the date of its Incorporation.

(b) **Subsequent Board meetings**: Every company shall hold minimum of 4 meetings every year but the gap between two consecutive board meetings shall not be **more than 120 days.**

Example: In case a company conducted its Board meeting on 2nd April, 2019, then the next meeting must be held within 120 days of this date *i.e.* ideally before 31st July, 2019; and, by 31st December, 2019, the company must conduct minimum four such meetings (including the

[1] As per Para 2.1 of Revised Secretarial Standards-1 (SS-1), the company shall hold at least four Meetings of its Board in each Calendar Year with a maximum interval of one hundred and twenty days between any two consecutive Meetings.

meetings which have already been conducted in the year 2019). The Board meetings may go beyond four also in a calendar year depending upon the urgency of any business.

(ii) Exemptions to Certain Companies [Section 173(5)]:

In case of a **One Person Company (OPC), small company and dormant company,** the provision regarding conducting of **four** Board meetings every year is **not applicable.** These entities are required to conduct **one Board meeting in each half of a calendar year** and the gap between the two meetings must **not be less than 90 days**. This is the minimum requirement and if so done, they shall be deemed to have complied with the provisions of Section 173.

OPC having only one director: One more exemption is given to One Person Company which has only one director on its Board of Directors. Such OPC shall not be required to hold even a single Board meeting during the year. Thus, it is totally exempted from the provisions of Section 173 (5)[2].

Modifications in respect of Section 8 companies and Private companies

*1. Vide Notification No. G.S.R. 466 (E) dated 5th June, 2015 as amended by Notification No. G.S.R. 584 (E) dated 13h June, 2017, Section 173 (1) shall apply to a **Section 8 company** only to the extent that the Board of Directors of such a company shall hold at least one meeting within every six calendar months. This is subject to the conditions that the company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

*2. Vide Notification No. GSR 464 (E), dated 5-6-2015, as amended by Notification No. GSR 583 (E), dated 13-6-2017, in case of **private companies**, for sub-section (5) of Section 173, the following sub-section shall be substituted:*

"(5) A One Person Company, small company, dormant company and a private company (if such private company is a start-up) shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than ninety days:

Provided that nothing contained in this sub-section and in section 174 shall apply to One Person Company in which there is only one director on its Board of Directors."

The above substitution is effective subject to the conditions that the private company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

[2] Refer Proviso to Section 173 (5).

(iii) Participation by Directors in Board Meetings:

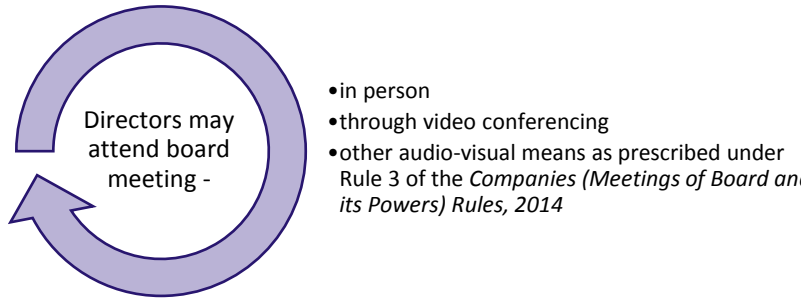
(a) **Means to attend Board Meetings:** Section 173(2) of the Act allows the directors of a company to attend Board meetings in the following manner:

(i) in person *i.e.* through physical presence; or

(ii) through video conferencing; or

(iii) through other prescribed audio-visual means.

Thus, the directors besides meeting in person, are also permitted to meet through electronic mode *i.e.* video conferencing or other prescribed audio-visual means. The same is depicted through following diagram:



Meaning of the term "video conferencing or other audio-visual means": It refers to audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting. *[as per Explanation to Rule 3]*

Essentials of audio-visual means: According to Section 173 (2), the audio-visual means should be capable of-

- recording and recognising the participation of the directors; and
- recording and storing the proceedings of such meetings along with date and time.

Matters which cannot be dealt with in a meeting through electronic mode[3]**:** The Central Government may, by notification, specify matters which shall not be dealt with in a meeting through video conferencing and other audio-visual means. In this respect, Rule 4 specifies the following matters which shall **not** be considered in any meeting held through video conferencing or other audio-visual means:

(i) the approval of the annual financial statements;

[3] As per First Proviso to Section 173 (2).

(ii) the approval of the Board's report;

(iii) the approval of the prospectus;

(iv) the Audit Committee Meetings for consideration of financial statement including consolidated financial statement if any, to be approved by the board under sub-section (1) of Section 134 of the Act, and

(v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Note: It is provided[4] that where there is quorum in a meeting through physical presence of directors, any other director may participate through video conferencing or other audio-visual means in such meeting on those matters also **which are not permitted** to be dealt with in a meeting through video conferencing or other audio-visual means. These matters are enumerated above.

(b) Procedural points relating to meetings of Board that are held through video conferencing or other audio-visual means: The procedural points as given in Rule 3 of *the Companies (Meetings of Board and its Powers) Rules, 2014,* are as under:

Sl. No.	Procedural points relating to meetings of Board that are held through video conferencing or other audio-visual means	For convening and conducting the Board meetings
1.	Every Company shall make necessary arrangements	to avoid failure of video or audio-visual connection
2.	The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care-	(A) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures; (B) to ensure availability of proper video conferencing or other audio-visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorized participants

[4] As per Second Proviso to Section 173 (2) and Rule 4 of the *Companies (Meetings of Board and its Powers) Rules, 2014*.

		at the Board meeting; (C) to record proceedings and prepare the minutes of the meeting; (D) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year. (E) to ensure that no person other than the concerned director is attending or have access to the proceedings of the meeting through video conferencing mode or other audio-visual means; (F) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting; However, the differently abled persons may make a request to the Board to allow a person to accompany him.
3.	Notice of the meeting and the further process	(A) Notices shall be sent to all the directors in accordance with the provisions of Section 173 (3); (B) Notices shall inform the directors regarding the options available to them to participate through video conferencing mode or other audio-visual means, along with all the necessary information to enable the directors to participate through such mode; (C) A director intending to participate through video conferencing mode or other audio-visual means shall communicate his intention to the Chairperson or the company secretary of the company; (D) If a director intends to participate through video conferencing or other audio-visual means, he shall give prior intimation to that effect, to enable the company to make suitable arrangements in this behalf; (E) Any director who intends to participate

		in the meeting through electronic mode may intimate about such participation at the beginning of the calendar year and such declaration shall be valid for one year; However, such declaration shall not debar him from participation in the meeting in person in which case he shall intimate the company sufficiently in advance of his intention to participate in person; (F) In the absence of any such intimation (*i.e.* participation through video conferencing mode or other audio-visual means) from the director, it shall be assumed that he will attend the meeting in person.
4.	Process of roll call at the Board Meeting	At the commencement of the meeting, a roll call shall be taken by the Chairperson. At this point, every director participating through video conferencing or other audio-visual means shall state, for the record, the following namely: (a) name; (b) the location from where he is participating; (c) that he has received the agenda and all the relevant material for the meeting; and (d) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in clause (b);
5.	After the roll call	The Chairperson or the Company Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting with the permission of the Chairperson and confirm that the required quorum is complete.
6.	Counting for quorum and ensuring of quorum	A director participating in a meeting through video conferencing or other audio-visual means shall be counted for the purpose of

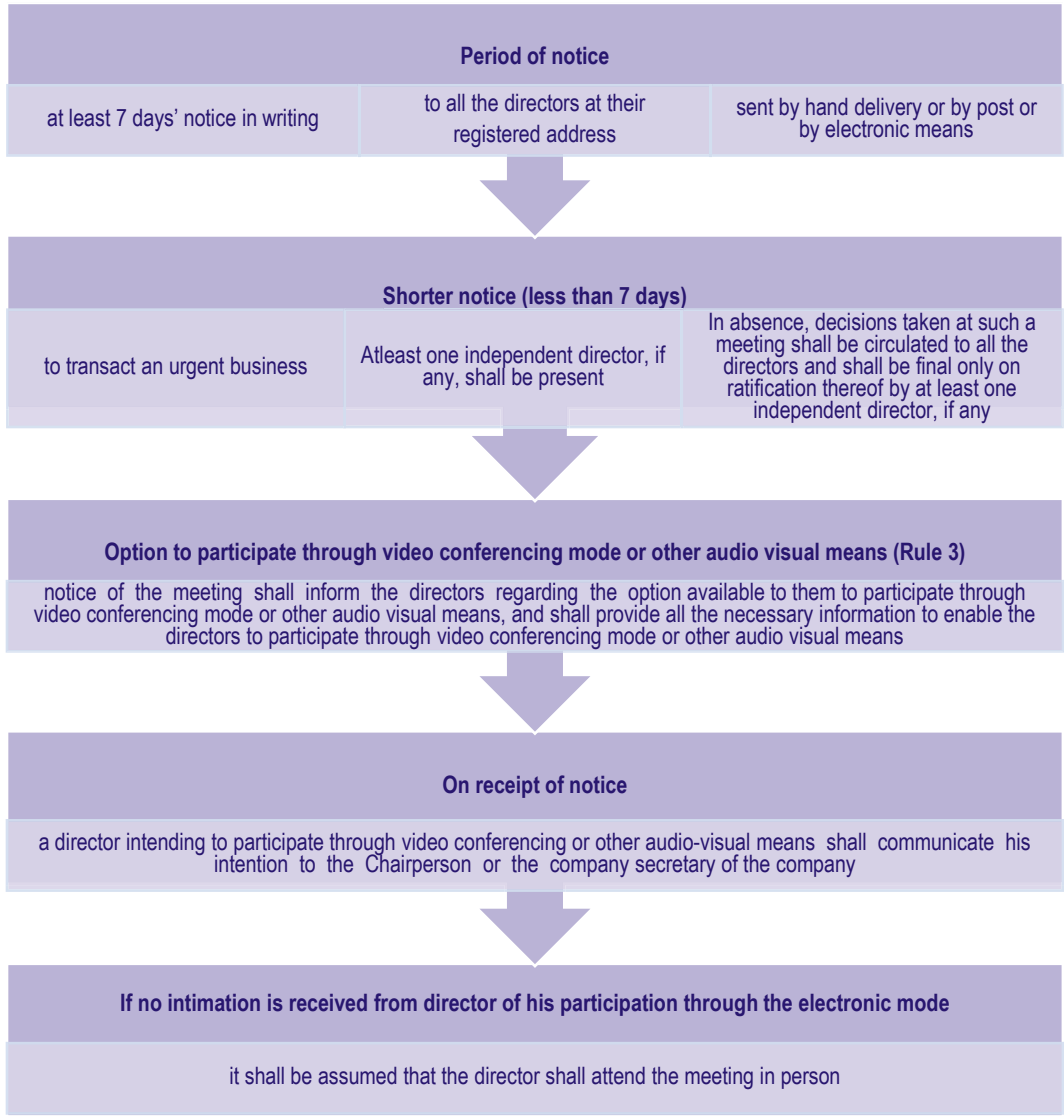
		quorum. He shall not be counted if he is to be excluded for any items of business under any provisions of the Act or the rules. The Chairperson shall ensure that the required quorum is present throughout the meeting.
7.	Scheduled venue of the meeting as mentioned in the notice convening the meeting	Scheduled venue shall be deemed to be the venue of the meeting which is conducted through video conferencing or other audio-visual means authorized under these rules and all recordings at such meeting shall be deemed to have been made at that place.
8.	Signing of Statutory Registers placed at the scheduled venue of the meeting	The statutory registers shall be deemed to have been signed by the directors participating through electronic mode, if they have given their consent to this effect and it is so recorded in the minutes of the meeting.
9.	Identification of participant	Every participant shall identify himself for the record before speaking on any item of business on the agenda.
10.	Statement interrupted or garbled	If a statement of a director in the meeting through video conferencing or other audio-visual means is interrupted or garbled, the Chairperson or Company Secretary shall request for a repeat or reiteration.
11.	Objection against a motion	If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.
12.	No access to unauthorized person	From the commencement of the meeting till its conclusion, no person except the Chairperson, Directors, Company Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.

13.	Summary of decision on each agenda item	At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, who dissented from the decision taken by majority.
14.	Preservation of draft minutes	Draft minutes shall be preserved till their confirmation. Further, the minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio-visual means.
15.	Circulation of draft minutes of the meeting	The draft minutes of the meeting shall be circulated among all the directors within 15 days of the meeting either in writing or in electronic mode as may be decided by the Board.
16.	Confirmation or written comments about the accuracy of recording of the proceedings	Every director who attended the meeting, whether personally or through video conferencing or other audio-visual means, shall confirm or give his comments in writing, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, **within seven days** or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.
17.	After completion of meeting	Minutes shall be entered in the minute book signed by the Chairperson

Requirement of attending all the Board Meetings:

Is it necessary for all the directors to attend all the Board meetings of the company held during a year? Apparently, the answer is no because it shall be illogical to expect from every director to attend each and every meeting but as they are the guardians of the company they must try their best to attend as many Board meetings as possible. However, a continuous absence is also detrimental if we look at Section 167 (1) (b) which states that a director shall be required to vacate his office if he absents himself from all the meetings of the Board of Directors held during a period of 12 months with or without seeking leave of absence of the Board.

(iv) Notice of the Board meeting [Section 173 (3)]:



(v) Penalty for failure to give notice: Section 173(4) prescribes a penalty of ₹ 25,000 in respect of every officer[5] of the Company whose duty is to give notice under Section 173 and who has failed to do so.

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[5] According to Secretarial Standard 1 (SS-1), any Director of a company may, at any time, summon a Meeting of the Board, and the Company Secretary or where there is no Company Secretary, any person authorised by the Board in this behalf, on the requisition of a Director, shall convene a Meeting of the Board, in consultation with the Chairman or in his absence, the Managing Director or in his absence, the Whole-time Director, where there is any, unless otherwise provided in the Articles.

Example: The Board of Directors of Infotech Consultants Limited, registered in Kolkata, proposes to hold the next board meeting in the month of May, 2019.They seek, your advice in respect of the following matters:

(i) Can the board meeting be held in Chennai through video conferencing, when all the directors of the company reside at Kolkata?

(ii) Is it necessary that the notice of the board meeting should specify the nature of business to be transacted?

Answer:

(i) No provision in the Companies Act, 2013 requires that the board meetings must be held at a particular place. Accordingly, there is no difficulty in holding the current board meeting at Chennai through video conferencing even if all the directors of the company reside at Kolkata and the registered office is also situated at Kolkata. However, it is to be seen that the legal requirements as prescribed by Section 173 (2) and Rule 3 of the of *the Companies (Meetings of Board and its Powers) Rules, 2014* are meticulously followed.

(ii) Section 173 (3) of the Companies Act, 2013 provides for the giving of notice of every board meeting of not less than seven days to every director of the company. There is no provision in the Act laying down the contents of the notice. Hence, it may be construed that notice may be interpreted as intimation of the meeting and may not necessarily include Agenda of the meeting. However, considering the importance of board meetings and the responsibilities placed on the directors for decisions taken at the meetings, it is inevitable for them to be properly prepared and informed about the items to be discussed at the board meetings.

In view of the above and as a matter of good secretarial practice, the Agenda, setting out the business to be transacted at the Meeting, and Notes on Agenda should be given to the Directors at least seven days before the date of the board meeting, unless the Articles prescribe a longer period. Usually, the articles of a company make it mandatory to do so in almost all cases.

As the board meeting is being conducted through video conferencing, Rule 3 (3) (b) of the *Companies (Meetings of Board and its Powers) Rules, 2014* requires that the notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio-visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio-visual means.

Example: XYZ Ltd. is a foreign collaborator in ABC Ltd. incorporated in India under the Companies Act, 2013. The foreign collaborator holds 49% of the shareholding. The Board meetings of ABC Ltd are usually held in India and sometimes meetings of the Board are called at a very short notice for which there is a provision in the Articles of Association that during such situations, notices of the meetings of the Board can be sent by e-mail. State in this connection whether such a provision in the Articles of Association of ABC Ltd. is valid.

Answer: In terms of the proviso to section 173(3) of the Companies Act, 2013 a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting. No exception is made for any class or classes of companies.

Further, under section 173(3) a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

If we examine the above provision, it is amply clear that the notice is allowed to be sent, *inter-alia,* by electronic means also. Hence, the sending of notice by e-mail is a permissible mode of delivery and can be resorted to without any hinderance. In case Articles contain such a provision, there is no illegality involved even if there is a foreign collaborator in the company.

Therefore, in the given case the shorter notice by e-mail is legally permitted. It is to be noted that there should be the presence of quorum and at least one independent director at the meeting. The provision of the Articles in this regard is not so relevant since the position is quite clear in the Act itself.

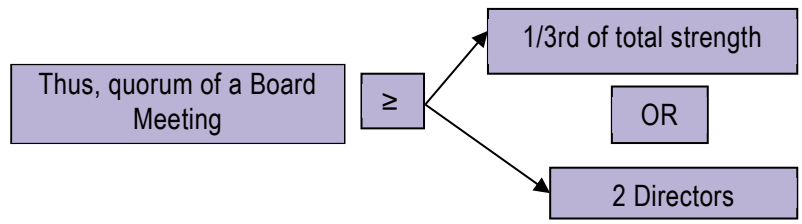
3. QUORUM FOR MEETINGS OF BOARD [SECTION 174]

A quorum is the minimum number of directors who must attend the proceedings in order to transact business validly at a duly convened Board meeting. The directors must not be disqualified to participate in the meeting. Unless the quorum is present at the meeting, it shall not be deemed to have been properly held.

Section 174 of the Companies Act, 2013 contains provisions in respect of quorum required for the meetings of the Board of Directors. These provisions are discussed as under:

(i) **Quorum for a Board Meeting [Section 174 (1)]:** In respect of quorum for Board meeting following points are noteworthy:

- The quorum for a Board Meeting shall be **one-third of its total strength or two directors,** whichever is **higher.**
- While calculating the quorum, any fraction of a number shall be rounded off as one.
- The total strength shall not include those directors whose places are vacant.
- The quorum needs to be present throughout the meeting.



It may be noted that the articles of a company cannot specify a quorum which is less that prescribed by Section 174 (1). However, there is no bar in fixing a higher quorum than required statutorily.

Modification

In case of a Section 8 Company, Section 174 (1) stands modified to state that quorum shall be either eight members or 25% of its total strength whichever is less, provided that the quorum shall not be less than two members.

The above modification is applicable subject to the condition that the Section 8 company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. [Notification No. G.S.R.466 (E), dated 5th June, 2015 as amended by the Notification No. G.S.R.584 (E), dated 13th June, 2017.]

(ii) **Participation through electronic means to be counted for Quorum:** The directors who participate by video conferencing or other audio-visual means shall also be counted for the purpose of determining the quorum at the meeting **unless** they are to be excluded for any items of business under any provisions of the Act or the rules[6].

(iii) **In case when there is vacancy in the Board [Section 174 (2)]:** In case there is any vacancy in the Board (*i.e.* strength is less than that mentioned in the Articles), the continuing directors may act irrespective of such vacancy.

However, the problem will arise when due to such vacancy/ies the number of directors is reduced below the quorum fixed by the Companies Act, 2013.

If this is the situation, the continuing directors or director may act for the following purposes only and nothing else:

(a) to increase the number of directors to that fixed for the quorum *i.e.* appoint additional director; or

(b) to summon a general meeting of the company.

(iv) **Quorum in case of interested directors [Section 174 (3)]:** Where at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of Directors, the quorum shall be the number of non-interested directors who are present at the meeting; but their number must not be less than two. While calculating the quorum, any fraction of a number shall be rounded off as one.

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[6] As per Explanation to Rule 3 (5) (a) of *the Companies (Meetings of Board and its Powers) Rules,* 2014.

Meaning of Interested Director: The term "Interested director" for the purposes of Section 174 (3) means a director within the meaning of Section 184 (2).

According to Section 184(2) **"interested director"** means every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—

(a) with a body corporate in which such director or such director in association with any other director, holds **more than two per cent** shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or

(b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be.

Exception

In case of 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, the provisions of Section 174 (3) shall apply with the exception that the interested director may participate in such meeting after disclosure of his interest pursuant to Section 184. [Notification No. G.S.R. 464(E) dated 5th June 2015 as amended by Notification No. G.S.R. 583 (E) dated 13th June, 2017]

(v) **Adjournment of meeting which could not be held for want of quorum:** As we have noticed that a Board meeting cannot be validly held if there is no quorum present. Thus, where a meeting of the Board could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned to the same day at the same time and place in the next week or if that day is a national holiday, till the next succeeding day, which is not a national holiday, at the same time and place.

(vi) **Exemption to OPC:** According to Proviso to Section 173 (5), the provisions of Section 174 relating to quorum are not applicable to such One Person Company (OPC) which has only one director on its Board.

Example: Discuss the following situations with respect to the quorum.

(a) There are 9 directors in a company and out of which 2 offices of the directors have fallen vacant.

(b) There are total 15 directors in a company and during discussion on a particular item, 13 of the directors happen to be 'interested' within the meaning of section 184(2) of the Companies Act, 2013.

Answer

(a) According to section 174(1) of the Companies Act, 2013, quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded of as one) or

two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant. Therefore, where total number of directors is 9 and 2 offices of the directors have fallen vacant, the total strength comes to seven. In this case 1/3 of 7 = 2 1/3 directors which will be rounded off as 3 which is higher than 2. Therefore, 3 directors would constitute the quorum for the Board meetings.

(b) Under section 174(3) of the Companies Act, 2013, if at any time the number of the interested directors exceeds or is equal to two thirds of the total strength of the Board of Directors, the number of the directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum.

In the given situation, there are total 15 directors and the Board meeting commences with all of them. During the meeting, an item comes up for discussion in respect of which 13 directors happen to be 'interested directors'. In spite of the fact that the interested directors are more than two-thirds, minimum two non-interested directors who are present at the meeting shall constitute the quorum and they can validly transact that particular item of business in view of Section 174 (3).

Example: A meeting of the Board of 'No Holiday Ltd' was held on a holiday on account of Ganesh Chaturthi. However due to lack of quorum, the proceedings of the meeting could not be held and therefore the Chairman of the meeting with the consent of the majority decided that the Board meeting be adjourned to next week on the same day. However, the date fixed for the adjourned meeting happened to be a Sunday. Whether the adjourned meeting of the Board can be held on a Sunday.

Answer: When a board meeting is adjourned due to lack of quorum, then under section 174(4) the adjourned meeting can be held on the same day at the same time and place in the next week or if that day is a national holiday, till the next succeeding day, which is not a national holiday, at the same time and place, unless the Articles provide otherwise.

Since Section 174(4) specifies exclusion of only a national holiday, any original/adjourned/committee meetings can be held on Sundays and other holidays. In view of this provision, the adjourned meeting of the Board of 'No Holiday Ltd' can be held on Sunday without involvement of any illegality.

4. PASSING OF RESOLUTION BY CIRCULATION [SECTION 175]

Section 175 of the Act and Rule 5 of the *Companies (Meetings of Board and its Powers) Rules, 2014*, contain provisions for passing of resolutions by circulation. Normally, a board meeting is conducted to pass resolutions. There are certain matters, which according to the provisions of the Companies Act, 2013, can only be considered and decided at the duly convened board meetings and therefore, they cannot be implemented through passing resolutions by circulation. However, in cases where the matter is not that much important and therefore, does not require its consideration

at a board meeting though consent of directors is required to implement that matter or the calling of board meeting is a lengthy and costly affair keeping in view the urgent implementation of certain decisions, the company may, in respect of such matters, resort to passing of resolutions by circulation. As a matter of fact, all such matters which do not require consideration at a board meeting can be decided through resolutions which are passed by circulation.

The provisions of Section 175 and Rule 5 are discussed as under:

(i) Requirements to pass resolution by circulation [Section 175 (1)]: A resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation in case:

the resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or members of the committee, as the case may be,

at their addresses registered with the company in India,

by hand delivery or by post or by courier, or through such electronic means as may be prescribed, and

and has been approved by a majority of the directors or members, who are entitled to vote on the resolution.

Rule 5 provides that a resolution in draft form may be circulated to the directors together with the necessary papers for seeking their approval, by electronic means which may include e-mail or fax.

(ii) When a resolution cannot be passed by circulation [Proviso to Section 175 (1)]: If at least 1/3rd of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the chairperson shall put the resolution to be decided at a meeting of the Board (instead of being decided by circulation).

(iii) Noting of passed resolution in next meeting [Section 175 (2)]: A resolution that has been passed by circulation shall have to be necessarily noted in the next meeting of board or the committee thereof, as the case may be, and made part of the minutes of such meeting.

Example: In respect of certain matter which did not require to be decided at a board meeting, PQR Ltd. thought it prudent to pass resolution thereof by circulation. Accordingly, a draft resolution was circulated among all the six directors by e-mail. Three directors did not give their consent and desired that the resolution was required to be decided at a meeting. Would they succeed?

Answer: Proviso to Section 175 (1) states that where minimum 1/3rd of the total number of directors require that any resolution under circulation must be decided at a meeting, the Chairperson shall put the resolution to be decided at a meeting of the Board. In the given case, one-half of the total number of directors (*i.e.* three out of six) require that the resolution must be decided at a Board meeting.

Since their counting is more than one-third of total strength, the Chairperson needs to take the call and put the resolution to be decided at a duly convened meeting of the Board.

5. AUDIT COMMITTEE, VIGIL MECHANISM AND PUNISHMENT [SECTION 177 AND SECTION 178 (8)]

A. AUDIT COMMITTEE

Section 177 of the Act and Rules 6 and 6A of the *Companies (Meetings of Board and its Powers) Rules, 2014*, contain provisions in respect of Audit Committee. These provisions are described as under:

(i) Companies required to constitute an Audit Committee [Section 177 (1) and Rule 6]: Following companies are required to constitute an Audit Committee:

(a) every listed public company;

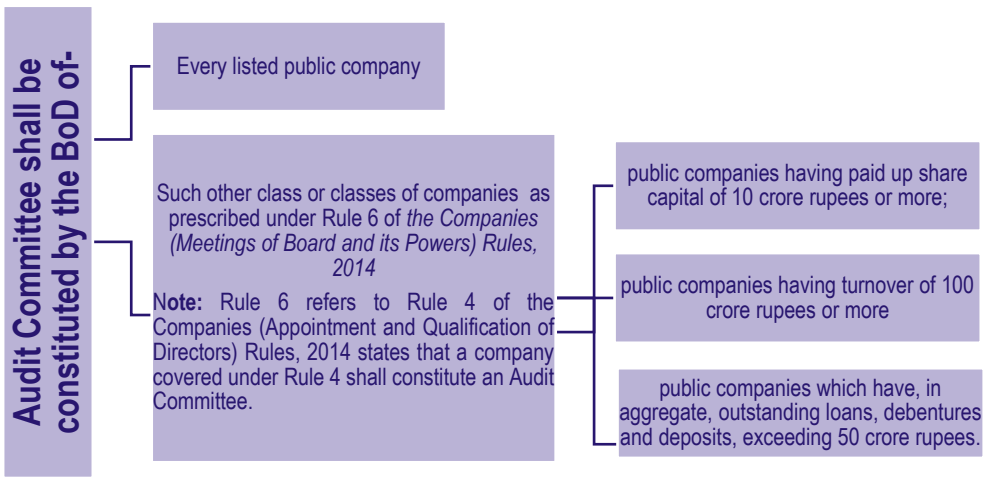
(b) public companies having paid up share capital of 10 crore rupees or more;

(c) public companies having turnover of 100 crore rupees or more;

(d) public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

Note: The public companies stated at points (b), (c) and (d) are the classes of companies which are prescribed by Rule 6 of the *Companies (Meetings of Board and its Powers) Rules, 2014* and are required to constitute an Audit Committee.

In fact, Rule 6 requires that the companies prescribed in Rule 4 of *the Companies (Appointment and Qualification of Directors) Rules, 2014* are the companies which shall constitute an Audit Committee.



Companies not required to constitute an Audit Committee: Following unlisted companies are not covered by Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014; and therefore, are not required to constitute an Audit Committee:

(a) a joint venture;

(b) a wholly owned subsidiary; and

(c) a dormant company as defined under Section 455 of the Act.

When a company ceases to constitute an Audit Committee: A company which was obligated to constitute an Audit Committee, shall not be required to constitute such Audit Committee if it ceases to fulfill any of the three conditions relating to paid-up share capital or turnover or outstanding loans, etc. [as laid down in Third Proviso to Rule 4 (1)[7]] for **three consecutive years**. It shall again be required to constitute an Audit Committee if it starts meeting any of such conditions.

Clarification: *Explanation* to Rule 4 (1)[8] clarifies that the paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

(ii) Composition of an Audit committee: According to Section 177 (2), the Audit Committee shall consist of a minimum of 3 directors with independent directors forming a majority.

Further, it is required that the majority of members of the Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.

Vide Notification No. G.S.R. 466 (E), dated 05-06-2015 as amended by Notification No. G.S.R. 584 (E), dated 13-06-2017, in case of Section 8 Companies, the requirement of Section 177 (2) i.e. while constituting an Audit Committee, the 'Independent Directors' shall form a majority, shall not apply provided such a company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.

(iii) Disclosure of composition of Audit Committee [Section 177(8)]: The Board's report under Section 134 (3) shall disclose the composition of an Audit Committee.

In case, where the Board had not accepted any recommendation of the Audit Committee, the same shall also be disclosed in the Board's report along with the reasons therefor.

(iv) Responsibilities of the Audit Committee: According to Section 177 (4), every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, *inter alia*, include,-

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[7] Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014
[8] Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014

(a) recommendation for appointment, remuneration and terms of appointment of auditors of the company;

In case of 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, for the words "recommendation for appointment, remuneration and terms of appointment" used in Section 177 (4) (i), the words "recommendation for remuneration" shall be substituted - Notification No. G.S.R. 463 (E), dated 05.06.2015 as amended by Notification No. G.S.R. 582 (E), dated 13.06.2017.

(b) review and monitor the auditor's independence and performance, and effectiveness of audit process;

(c) examination of the financial statement and the auditors' report thereon;

(d) approval or any subsequent modification of transactions of the company with related parties. The provisos to this clause are stated below:

Omnibus approval: It is provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as prescribed under Rule 6A (refer the Box below);

Conditions prescribed under Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014 for Omnibus Approval for Related Party Transactions on Annual Basis

According to Rule 6A, all related party transactions shall require approval of the Audit Committee. The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to the following conditions:

(1) The Audit Committee shall, after obtaining approval of the Board of Directors, specify the criteria for making the omnibus approval which shall include the following:

(a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;

(b) the maximum value per transaction which can be allowed;

(c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;

(d) review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;

(e) transactions which cannot be subject to the omnibus approval by the Audit Committee.

(2) The Audit Committee shall consider the following factors while specifying the criteria for making omnibus approval: -

(a) repetitiveness of the transactions (in past or in future);

(b) justification for the need of omnibus approval.

(3) The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.

(4) The omnibus approval shall contain or indicate the following: -

(a) name of the related parties;

(b) nature and duration of the transaction;

(c) maximum amount of transaction that can be entered into;

(d) the indicative base price or current contracted price and the formula for variation in the price, if any; and

(e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

However, where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval **for such** transactions subject to their value not exceeding rupees one crore per transaction.

(5) Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year.

(6) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

(7) Any other conditions as the Audit Committee may deem fit.

If no approval accorded: It is further provided that in case of a transaction (which is not a transactions referred to in section 188), where Audit Committee does not approve such transaction, it shall make its recommendations to the Board.

Voidable transaction: In case of a transaction which does not involve an amount exceeding one crore rupees and which is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and if it is not ratified by the Audit Committee **within three months** from the date of the transaction, such transaction shall be voidable at

the option of the Audit Committee. In case such transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.

Non-applicability to a transaction between a holding and its wholly owned subsidiary company: It is also provided that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in Section 188, between a holding company and its wholly owned subsidiary company.

(e) scrutiny of inter-corporate loans and investments;

(f) valuation of undertakings or assets of the company, wherever it is necessary;

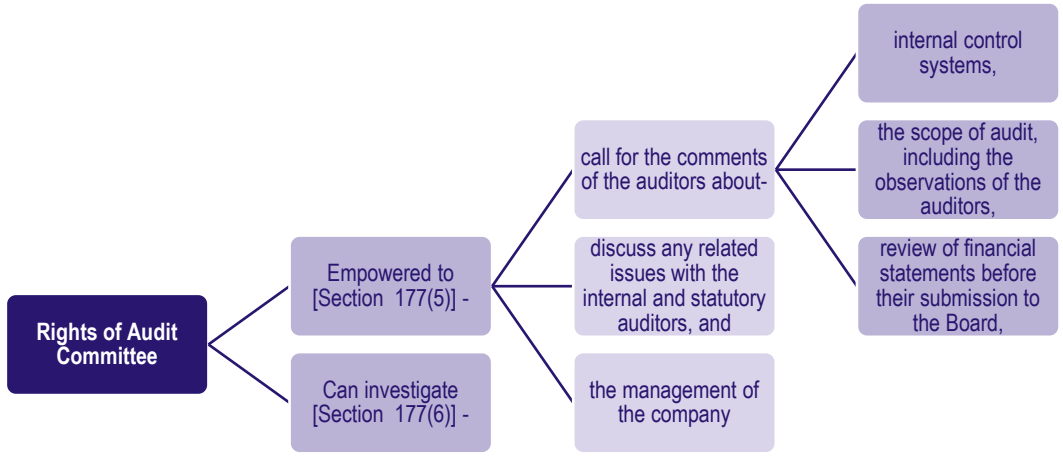
(g) evaluation of internal financial controls and risk management systems;

(h) monitoring the end use of funds raised through public offers and related matters.

(v) Rights of the Audit Committee:

(a) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors. It shall have right to review the financial statements before their submission to the Board. It may also discuss any related issues with the internal and statutory auditors and the management of the company. [Section 177(5)]

(b) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company. [Section 177(6)]



(vi) Right to be heard before the Audit Committee: The **auditors** of a company and the **key managerial personnel** shall have a right to be heard in the meetings of the Audit Committee when it considers the **auditor's report** but shall not have the right to vote. [Section 177(7)]

B. VIGIL MECHANISM

A 'vigil mechanism' is formed for the directors and employees who may report genuine concerns. Not all the companies but only the prescribes ones are required to establish 'vigil mechanism'. The provisions contained in Section 177 (9) and (10) and Rule 7 of the *Companies (Meetings of Board and its Powers) Rules, 2014* govern the concept of 'vigil mechanism'. These are stated below:

(i) Formation of Vigil Mechanism: According to Section 177(9), a vigil mechanism shall be formed by:

(a) Every listed company, and

(b) Prescribed classes of companies as per Rule 7, which are:

(1) the Companies which accept deposits from the public;

(2) the Companies which have borrowed money from banks and public financial institutions in excess of 50 crore rupees.

(ii) Purpose of Vigil Mechanism [Section 177 (9)]: A vigil mechanism is formed for the directors and employees who may report genuine concerns in the manner prescribed in Rule 7.

(iii) Vigil Mechanism to ensure adequate safeguards: According to Section 177 (10), the vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the Chairperson of the Audit Committee in appropriate or exceptional cases.

(iv) Establishment of Vigil Mechanism and Manner of Reporting: The provisions of Rule 7 in this respect are stated as under:

(1) ***Users of Vigil Mechanism:*** The directors and employees of the company can use the system of vigil mechanism for reporting their genuine concerns.

(2) ***Companies having Audit Committee:*** The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the audit committee and if any of the members of the committee have a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand.

(3) ***Companies having no Audit Committee:*** In case of other companies, the Board of Directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism. Other directors and employees may report their concerns to such nominated director.

(4) ***Adequate safeguards against victimisation:*** As stated in Section 177 (10), the vigil mechanism shall provide for adequate safeguards against victimisation of employees and directors who avail of it.

(5) ***Direct access in exceptional cases:*** As stated in Section 177 (10), the employees and directors who avail of vigil mechanism may have direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee, as the case may be, in exceptional cases.

(6) ***Action against repeated frivolous complaints:*** In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.

(v) Disclosure of details of vigil mechanism [Section 177 (10)]: It is imperative for the company to disclose the details of the establishment of vigil mechanism on the website of the company and in Board's report.

C. PUNISHMENT FOR CONTRAVENTION OF SECTION 177 [Section 178(8)]: In case of contravention of Section 177, the punishment shall be as under:

Sl. No.	Who is liable	Quantum of penalty
(a)	Company	punishable with fine which shall be minimum ₹ 1 lakh and maximum up to ₹ 5 lakh rupees.
(b)	Every defaulting officer	• punishable with imprisonment for a term extending up to 1 year, or • with fine which shall be minimum ₹ 25,000 and maximum up to ₹ 1 lakh, or • with both.

Note: In the case of a listed company, the formation, composition, responsibilities and rights of Audit Committee shall be governed by SEBI (LODR) Regulations issued under the SEBI Act, 1992.

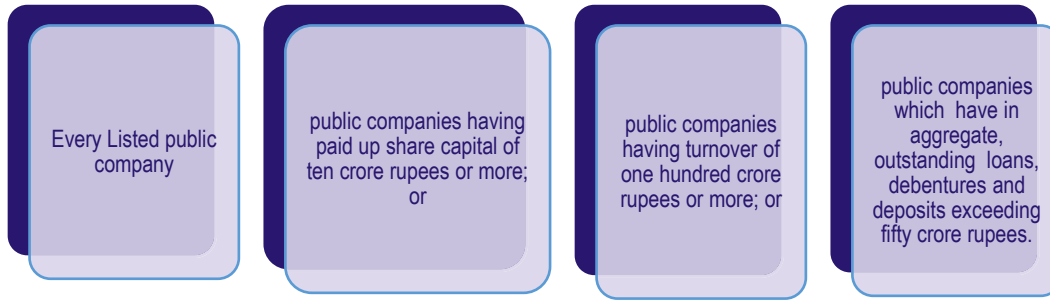
6. NOMINATION AND REMUNERATION COMMITTEE AND STAKEHOLDERS RELATIONSHIP COMMITTEE AND PUNISHMENT [SECTION 178]

Section 178 of the Act, contains provisions in respect of Nomination and Remuneration Committee as well as Stakeholders Relationship Committee.

A. NOMINATION AND REMUNERATION COMMITTEE (NRC)

Sub-sections (1) to (4) of Section 178 and Rule 6 of the *Companies (Meetings of Board and its Powers) Rules, 2014* lay down the provisions in respect of the Nomination and Remuneration Committee as under:

(i) **Formation of Nomination and Remuneration Committee:** Section 178 (1) read with Rule 6 state that the Board of directors of every listed public company and a company covered under Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, shall constitute a Nomination and Remuneration Committee. Following diagram depicts the prescribed companies which are required to constitute the Nomination and Remuneration Committee:



Companies not required to constitute a Nomination and Remuneration Committee: Following unlisted companies are not covered by Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014; and therefore, are not required to constitute a Nomination and Remuneration Committee:

(a) a joint venture;

(b) a wholly owned subsidiary; and

(c) a dormant company as defined under Section 455 of the Act.

When a company ceases to constitute a Nomination and Remuneration Committee: A company which was obligated to constitute a Nomination and Remuneration Committee, shall not be required to constitute such Committee if it ceases to fulfill any of the three conditions relating to paid-up share capital or turnover or outstanding loans, etc. [as laid down in Third Proviso to Rule 4 (1)[9]] for **three consecutive years**. It shall again be required to constitute a Nomination and Remuneration Committee if it starts meeting any of such conditions.

Clarification: *Explanation* to Rule 4 (1)[10] clarifies that the paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

(ii) **Composition of Nomination and Remuneration Committee:**

(a) The NRC shall consist of 3 or more non-executive directors out of which not less than one-half shall be independent directors.

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[9] Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014

[10] Rule 4 (1) of the Companies (Appointment and Qualification of Directors) Rules, 2014

(b) The Chairperson (whether executive or non-executive) of the company shall not chair such a committee. However, he may be appointed as a member of the committee.

(iii) Functions of the Nomination and Remuneration Committee: The various functions of NRC shall be as under:

(a) ***Formulation of criteria for qualifications, etc.:*** The NRC shall formulate the criteria for determining qualifications, positive attributes and independence of a director [Sub section (3)].

(b) ***Recommendation of Policy regarding remuneration:*** The NRC shall recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees [Sub section (3)].

(c) ***Recommendation for appointment and removal:*** The NRC shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal. [Sub-section (2)]

Note: The expression **''senior management''** means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, ncluding the functional heads.

(d) ***Manner for effective evaluation of performance:*** The NRC shall specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.

(e) ***Parameters for formulation of Policy:*** According to Section 178(4), the Nomination and Remuneration Committee shall, while formulating the policy under Section 178 (3) ensure that—

- the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;
- relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and
- remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

(f) ***Disclosure regarding policy:*** It is imperative that such policy [*i.e.* policy formulated under Section 178 (3)] shall be placed on the **website** of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the **Board's report**.

(iv) Attending of general meetings [Section 178 (7)]: The Chairperson or in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

Note: In the case of a listed company, formation, composition, responsibilities and rights of Nomination and Remuneration Committee shall be governed by SEBI (LODR) Regulations issued under SEBI Act, 1992. According to the listing agreement, the members of the NRC shall be non-executive directors and the Chairperson needs to be an independent director.

Modification

In case of 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, Sub-sections (2), (3) and (4) of Section 178, shall not apply except with regard to appointment of 'senior management' and other employees. - Notification No. G.S.R. 463 (E), dated 05-06-2015 as amended by Notification No. G.S.R. 582 (E), dated 13-06-2017.

B. STAKEHOLDERS RELATIONSHIP COMMITTEE (SRC)

Formation and functioning of SRC: Section 178 (5) and (6) lay down the provisions relating to the formation, constitution and functioning of the Stakeholders Relationship Committee as under:

Sl. No.	Section	With respect to	Provisions says
(i)	178 (5)	Formation and constitution of Stakeholders Relationship Committee (SRC)	The Board of Directors of a company which consists of **more than 1000** shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee.
(ii)	178 (5)	Chairperson of Stakeholders Relationship Committee (SRC)	SRC shall be headed by a Chairperson who shall be a non-executive director. Further, SRC shall consist of such other members as may be decided by the Board.
(iii)	178 (6)	Objective of the Stakeholders Relationship Committee (SRC)	SRC shall consider and resolve the grievances of security holders of the company. It shall protect the interests of

			all security holders and not merely of the equity investors.
(iv)	178 (7)	Chairperson/other authorised member to attend general meetings	The Chairperson of each of such committees or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.

C. PENALTY FOR CONTRAVENTION [Section 178(8)]: In case of contravention of provisions of Section 178, the penalty shall be as under:

Sl. No.	Who is liable	Quantum of penalty
(a)	Company	punishable with fine which shall be minimum ₹ 1 lakh and maximum up to ₹ 5 lakh rupees.
(b)	Every defaulting officer	• punishable with imprisonment for a term extending up to 1 year, or • with fine which shall be minimum ₹ 25,000 and maximum up to ₹ 1 lakh, or • with both.

No contravention if SRC is unable to resolve in good faith: It is to be noted that inability to resolve or consider any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of Section 178; and therefore, no penalty shall be attracted. [refer Proviso to Section 178 (8)].

Note: In the case of a listed company, formation, composition, responsibilities and rights of Stakeholder Relationship committee shall be governed by SEBI (LODR) Regulations issued under SEBI Act, 1992.

Exemption

Section 178 of the Act shall not apply to a Section 8 company provided it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar - Notification No. G.S.R. 466 (E), dated 05-06-2015 as amended by Notification No. G.S.R. 584 (E), dated 13-06-2017.

7. POWERS OF THE BOARD [SECTION 179]

Section 179 of the Act and Rule 8 of the *Companies (Meetings of Board and its Powers) Rules, 2014* lay down the provisions in respect of powers of the Board. They are described as under:

(i) **BoD is entitled to exercise the same powers as the company is authorised:** According to Section 179 (1), the Board shall be entitled to exercise all such powers as the company is authorised to exercise; and to do all such acts and things which the company is authorised to do.

In fact, the Board of Directors of a company enjoy wide-ranging powers; virtually all the powers for managing the affairs of the company except where the given matters require approval of shareholders in general meetings. In other words, the Board is empowered to exercise all such powers which shall secure the interests of the company and the shareholders.

(ii) **Placing of restrictions on exercising of powers by the Board [Provisos to Section 179 (1)]:**

(a) The exercise of powers by the Board of Directors is not unbridled or unrestricted. It is provided that while exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in the Companies Act, 2013, or in the memorandum or articles, or in any regulations which are not inconsistent with the Act or memorandum or articles and are duly made thereunder. This will include regulations made by the company in general meeting.

(b) Further, the Board shall not exercise any power or do any act or thing which is directed or required, whether under the Companies Act, 2013 or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.

(iii) **Prospective effect of regulation made in general meeting [Section 179 (2)]:** Any regulation made by the company in general meeting shall not invalidate any prior act of the Board which would have been valid if that regulation had not been made.

Thus, a regulation made by a company in general meeting cannot have retrospective effect and therefore, cannot invalidate prior acts of the Board if they were otherwise validly executed earlier.

(iv) **Powers of Board to be exercised by means of resolutions [Section 179 (3)]:** Following powers are required to be exercised by the Board of Directors by means of the resolutions passed at a duly convened Board meeting:

(a) to make calls on shareholders in respect of money unpaid on their shares;

(b) to authorise buy-back of securities under Section 68;

(c) to issue securities, including debentures, whether in India or outside India;

(d) to borrow monies;

Note: By way of *Explanation II,* it is clarified that in respect of dealings between a company and its bankers, the exercise of the power by the company specified in clause (d) above shall

mean the arrangement made by the company with its bankers for the **borrowing of money** by way of overdraft or cash credit or otherwise. This does not refer to the actual day-to-day operation on overdraft, cash credit or other accounts by means of which the arrangement so made is actually availed of.

(e) to invest the funds of the company. *(Section 186 (5) requires this power to be exercised by a Board resolution which is passed with the consent of all the directors present at the Board meeting)*;

(f) to grant loans or give guarantee or provide security in respect of loans. *(Section 186 (5) requires this power to be exercised by a Board resolution which is passed with the consent of all the directors present at the Board meeting)*;

Exemption

*In respect of a Section 8 Company which has not committed a default in filing its financial statements under Section 137 or Annual Return under section 92 with the Registrar, the matters referred to in clauses (d), (e), and (f) of Sub-section (3) of Section 179 may be decided by the Board by **circulation** instead of at a meeting.*

[Notification No. GSR 466 (E), dated 05-06-2015 as amended by Notification No. GSR 584 (E), dated 13-06-2017]

(g) to approve financial statement and the Board's report;

(h) to diversify the business of the company;

(i) to approve amalgamation, merger or reconstruction;

(j) to take over a company or acquire a controlling or substantial stake in another company;

(k) other matters as prescribed in Rule 8 of *the Companies (Meetings of Board and its Powers) Rules, 2014.* These matters, also to be exercised only by means of resolutions passed at the meetings of the Board, are:

(1) to make political contributions;

(2) to appoint or remove key managerial personnel (KMP);

(3) to appoint internal auditors and secretarial auditor.

Note: It is to be noted that the above list is not exhaustive. There are certain other powers which are also to be exercised by the Board of Directors at a duly convened board meeting. Some of them are as under:

- Making of contributions to political parties under Section 182

- Filling of casual vacancy under Section 161 (4) when the office of a director appointed in the general meeting falls vacant before the expiry of his term in the normal course.
- Approving of transactions with related parties as provided under Section 188.
- Giving of loans or making of investment in the shares of other body corporates as provided under Section 186. In this case, besides passing the resolution at a board meeting, consent of all the directors present at the meeting is also required.
- Appointing a person as a managing director who is also holding office of managing director or manager in another company as provided under Section 203. This power is to be exercised with the consent of all the directors present at the meeting.

(v) **Permission to BoD to delegate some of its powers [First Proviso to Section 179 (3)]**: The Board may, by a resolution passed at a meeting, delegate the powers specified in clauses (d) to (f) above (*i.e.* borrowing of monies, investing of funds and granting of loans or giving of guarantee or providing of security in respect of loans). The delegation may be made on such conditions as may be specified and to the following:

1. any committee of directors,
2. the managing director,
3. the manager or any other principal officer of the company, or
4. the principal officer of the branch office (if the company has a branch office).

(vi) Imposing of restrictions and conditions by the shareholders [Section 179 (4)]: The company through the general meeting has powers to impose restrictions and conditions on the exercise by the Board of any of the powers specified in Section 179.

In other words, shareholders of a company are very much in their right to impose restrictions and conditions on the powers of the Board of Directors. The shareholders may exercise the powers of imposing restrictions by passing resolutions at the general meetings and may also make regulations (having only retrospective effect) curtailing the extent of powers exercisable by the Board.

As we know, the Board of Directors are fully empowered to manage day-to-day affairs of the company. The shareholders cannot impose their will on the Board; they cannot interfere and instruct the Board to discharge certain powers in a particular manner unless there are reasons to do so. In the following representative cases, however, the shareholders are empowered to exercise the powers of the Board:

(a) **when directors are acting *malafide* *i.e.*** their conduct is such that they are acting for their own benefits at the expense of the interests of the company. Thus, when directors are wrong-doers and their personal interest conflicts with their duty towards the company, the majority shareholders shall take decisions to undo the wrong done by the directors.

(b) **when all the directors are interested in a particular transaction** and therefore, incompetent to act due to absence of quorum. In such a case, shareholders shall decide through majority in the general meeting whether to entertain that transaction or not.

(c) **when there happens to be deadlock in the management** because the directors are not on talking terms or unwilling to act; thus paving way for the shareholders to ensure running of the company

(vii) Exemption to banking companies [Second Proviso to Section 179 (3)]: In respect of banking companies following exemptions are provided:

(a) **the acceptance of deposits of money by a banking company in the ordinary course of its business from the public** which is repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise shall not be deemed to be a borrowing of monies within the meaning of Section 179;

(b) further**, the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe** shall not be deemed to be a making of loans by a banking company within the meaning of Section 179.

Note: By way of *Explanation I*, it is clarified that clause (d) above (*i.e.* to borrow monies) shall not apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act. Thus, in such cases of borrowings by a banking company, there is no need to obtain sanction by means of a resolution passed at a duly convened Board meeting. This is practical also to provide such exemption, keeping in view the business of a banking company.

8. RESTRICTIONS ON POWERS OF BOARD [SECTION 180]

The powers of the Board of Directors of a company are not unrestricted or uncontrollable as Section 180 portrays. This Section contains directive provisions which direct that the powers in respect of specified matters shall be exercised by the Board subject to the certain restrictions *i.e.* in such cases the exercise of powers by the Board shall be restricted as per law. Section 180 is not applicable to a private company.

(i) **Matters in respect of which powers shall be exercised after obtaining consent by a special resolution:** According to Section 180 (1), following are the matters in respect of which the Board shall exercise the powers with the consent of the company by a **special resolution** and not on its own simply by passing a Board resolution at a Board meeting:

(a) To **sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company** or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings. In

other words, out of multiple undertakings of a company even if one is sold, leased or disposed of, either wholly or substantially, the consent by special resolution shall be required.

Imposition of conditions by the shareholders: According to Section 180 (4), any special resolution passed by the company consenting to the transaction of sell, lease, etc., may stipulate certain conditions and if so, the same need to be specified in such resolution. Among others, the conditions shall be regarding the use, disposal or investment of the sale proceeds which may result from the transactions.

Section 180 (4) not to be taken as authorization for reduction in capital: It is provided that sub section (4) shall not be deemed to authorise the company to effect any reduction in its capital. Such reduction must be effected in accordance with the provisions contained in the Companies Act, 2013.

No need for special resolution if selling, leasing, etc. is part of ordinary business of the company: According to Section 180 (3) (b), the restriction in the form of special resolution is not attracted to the sale or lease of any property of the company where its ordinary business consists of such selling or leasing.

Clean title of the buyer, etc. [Section 180 (3) (a)]: In respect of a buyer who buys or in respect of other person who takes on lease (*i.e.* lessee) any property, investment or undertaking as is referred to in Section 180 (1) (a) in **good faith**, his title shall not be affected despite the fact that the directors resorted to selling or leasing without first obtaining the consent of the company by a special resolution.

Note 1: The expression **"undertaking"** means an undertaking in which the investment of the company **exceeds twenty per cent** of its **net worth**[11] as per the audited balance sheet of the preceding financial year or an undertaking which generates **twenty per cent** of the total income of the company during the previous financial year.

Note 2: The expression **"substantially the whole of the undertaking"** in any financial year shall mean **twenty per cent or more** of the value of the undertaking as per the audited balance sheet of the preceding financial year.

Note 3: In case the provisions of Section 110 of the Act apply to the company which is resorting to sale of the whole or substantially the whole of its undertaking in terms of Section 180 (1) (c), it shall pass the special resolution containing such item of

[11] 'Net worth', according to Section 2 (57) of the Act 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'.

business by means of voting through **postal ballot**. *[refer Rule 16 (i) of the Companies (Management and Administration) Rules, 2014.]*

Note 4: A One Person Company and other companies having members up to two hundred are not required to transact any business through postal ballot. *[refer Proviso to Rule 16 of the Companies (Management and Administration) Rules, 2014.]*

(b) To **invest otherwise in trust securities** the amount of compensation received by it as a result of any merger or amalgamation. It implies that if the investment of the compensation amount is made in trust securities[12], there is no need to obtain consent of the members through a special resolution.

(c) To **borrow money**, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves[13] and securities premium apart from temporary loans obtained from the company's bankers in the ordinary course of business.

In simple words, **'borrowings' (**including loans raised for meeting financial expenditure of a capital nature) are not to include temporary loans which are obtained by the company from its bankers in the ordinary course of business.

Limit on 'borrowings' need to be specified: Section 180 (2) requires that every special resolution passed by the company in general meeting in relation to the 'borrowings' shall specify the **total amount** up to which monies may be borrowed by the Board of Directors. Thus, the Board cannot be given blanket powers to borrow monies up to any extent of its choice but the special resolution must specify the total amount that can be borrowed. In other words, a rational thinking in the form of specifying a 'particular amount' must be exercised by the shareholders so that borrowings are restricted. The specifying of total amount that can be borrowed is a step in this direction. Excessive borrowings at the whims and caprices of the Board are dangerous to the company as a whole including its shareholders.

Debt raised in excess of the specified limit [Section 180 (5)]: If a company incurs debt in excess of the limit imposed i.e. more than the 'total amount' specified in the special resolution, it shall not be valid or effectual from the point of view of lender

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[12] 'Trust securities' are mentioned in Section 20 of the Indian Trust Act, 1882.

[13] 'Free reserves' according to Section 2 (43) of the Act means 'such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

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 recognised 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'.

unless such lender proves that he advanced the loan in good faith and without knowledge that the limit imposed had been exceeded. Thus, lender has to be fully cautious before extending any loan to a company. The loaned amount must not be in excess of the limit imposed otherwise it shall not be legally enforceable against the company. In other words, the lender must be aware in no uncertain terms the implications of Section 180 (5) and must carefully check the financial statements as well as the special resolution, if any, passed by the company before extending any loan facility to it.

Meaning of "Temporary Loans": It is clarified by way of *Explanation* that the term '**temporary loans'** means loans repayable on **demand or within six months** from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

Exemption to a banking company: The acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall **not** be deemed to be a **borrowing of monies** by the banking company.

(d) To **remit, or give time for the repayment of, any debt due from a director**. Thus, if any debt is repayable by a director, then it cannot be remitted or its repayment time cannot be extended unless consent by passing a special resolution is given by the company.

(ii) Contribution to *bona-fide* and charitable funds, etc.: This type of contributions by a company beyond certain limit requires passing of an ordinary resolution as required by Section 181, the provisions of which are discussed later in the Chapter.

Example: The Board of Directors of Stepping Stones Publications Ltd. resolved to borrow a sum of ₹ 15 crores from a nationalized bank at a Board meeting held on 15.1.2019. One of the directors, who opposed the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the borrowing powers of the Board. The Company seeks your advice and the following data is given for your information:

(i) Share Capital ₹ 5 crores

(ii) Reserves and Surplus ₹ 5 crores

(iii) Secured Loans ₹ 15 crores

(iv) Unsecured Loans ₹ 5 crores

Advise the management of the company.

Answer: According to the provisions of Section 180(1)(c) of the Companies Act, 2013, the powers of the Board are not uncontrolled and there are restrictions on the borrowing powers to be exercised

by the Board of Directors. According to the said section, the borrowings should not exceed the aggregate of the paid-up share capital, free reserves and securities premium. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of business will be excluded. However, from the figures available in the present case, the proposed borrowing of ₹ 15 crore will exceed the limit calculated as per the given information. Thus, the proposed borrowings are beyond the powers of the Board of directors.

In view of the above position, the management of Stepping Stone Publications Ltd., should take steps to pass a special resolution authorising to borrow the proposed amount of ₹ 15.00 crores, so that the requirement of Section 180(1)(c) is satisfied. Only thereafter, the proposed borrowing can be availed of.

Exemption

*As notified by the MCA, Section 180 of the Act (i.e. restrictions on the powers of the Board) shall not apply to a **private company** which has not committed a default in filing is financial statements under Section 137 or Annual Return under Section 92 with the Registrar. [Notification No. 464 (E), dated 5th June, 2015 as amended by Notification No. 583 (E), dated 13th June, 2017.]*

9. COMPANY TO CONTRIBUTE TO BONA FIDE AND CHARITABLE FUNDS, ETC. [SECTION 181]

Section 181 of the Act, applicable to both public and private companies, empowers the Board of Directors to contribute to *bona fide* charitable and other funds up to a particular limit which if exceeded needs to be permitted by company through passing an ordinary resolution.

Limit on contribution by the Board of Directors: The Board is empowered to contribute any amount in any financial year if the aggregate amount of such contribution does not exceed five per cent of the average net profits of the company for the three immediately preceding financial years.

Where the above limit is exceeded: In case the aggregate contribution amount in any financial year is beyond the limit specified for the Board, prior permission of the company in general meeting shall be required for such contribution.

The expression "other funds" is wide enough to enable contributions of the kind, specified in the special resolution to be made by the company. [*Straw Products Ltd. vs. Registrar of Companies [1969].*

Example: The Board of Directors of Very Well Ltd., is contributing every year to a charitable organization a sum of ₹ 60, 000. In a particular year, the company suffered losses and the directors are contemplating to contribute the said amount in spite of the losses. In this connection, state whether the directors can do so?

Answer: Under section 181 of the Companies Act, 2013, the Board of Directors of a company is authorized to contribute to *bona fide* charitable and other funds. However, in case the aggregate

amount of such contribution in any financial year exceeds five per cent. of its average net profits for the three immediately preceding financial years, prior permission of the company in general meeting shall be required.

The section does not make it mandatory for the company to have a profit for making a charitable contribution in any financial year. As the amount of donation is restricted to the average of immediately previous 3 years' profits, it is possible for a company suffering a loss to make contribution provided it is made to a *bona fide* charitable fund and the average of the three immediately preceding financial years' profits (including current losses) is positive.

In the present case, even though the company has incurred a loss it can contribute to the charitable fund only if it is a *bona fide* charitable fund and the amount is up to 5% of the average of the immediately preceding three years' profits (including current losses). In case the contribution exceeds the limit, the prior approval of the members must be taken at a general meeting of the company.

10. PROHIBITIONS AND RESTRICTIONS REGARDING POLITICAL CONTRIBUTIONS [SECTION 182]

Section 182 of the Act, deals with the provisions relating to prohibitions and restrictions regarding political contributions. These provisions are stated as under:

(i) **Contribution by a company to political parties**: A company is permitted to contribute any amount (without any limit) directly or indirectly to any political party, notwithstanding anything contained in any other provision of the Companies Act, 2013. It is to be noted that Section 182 (1) has overriding effect.

Meaning of Political Party[14]*:* The term "political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

(ii) **Companies not allowed to contribute to political parties:** The following companies are not allowed to contribute to any political party:

(a) a Government company; and

(b) a company which has been in existence for less than three financial years.

(iii) **Procedure for making contribution:** A company shall make the contribution to a political party only after a resolution authorising the making of such contribution is passed at a meeting of the Board of Directors. In effect, such resolution shall be deemed to be justification in law for the making of the contribution authorised by it. [Proviso to Section 182(1)]

[14] As per Explanation to Section 182.

(iv) **Deemed political contributions [Section 182(2)]:** In addition to making any direct contribution to a political party, following contributions are also deemed as political contributions:

(a) a donation or subscription or payment given by a company to a person who, to its knowledge, is carrying on any activity which, at the time at which such donation or subscription or payment was given, can reasonably be regarded as likely to affect public support for a political party;

(b) the amount of expenditure incurred, directly or indirectly, by a company on an advertisement in any publication being in the nature of a souvenir, brochure, tract, pamphlet or the like:

(1) where such publication is by or on behalf of a political party; and

(2) where such publication is not by or on behalf of, but for the advantage of a political party.

(v) **Disclosure of contributed amount [Section 182(3)]:** Every company shall disclose in its profit and loss account the total amount contributed by it under Section 182 during the financial year to which the account relates.

(vi) **Modes of contribution [Section 182 (3A)]**: The contribution to a political party under Section 182 shall be made according to following modes:

- by an account payee cheque drawn on a bank; or
- by an account payee bank draft; or
- by using electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme[15] notified under any law for the time being in force, for contribution to the political parties. [Section 182(3A)]

(vii) **Punishment for contravention:** If a company makes any contribution in contravention of the provisions of Section 182, the punishment shall be as under:

- *Company:* punishable with fine up to **five times** the amount of contribution so made.
- *Every defaulting officer:* punishable with imprisonment up to **six months** and with fine up to **five times** the amount of contribution so made.

The MCA vide General Circular 19/ 2013 dated 10th December 2013, issued a clarification on disclosures to be made under Section 182 (3) while making contributions to 'Electoral Trust'. According to the Circular:

[15] A scheme relating to 'Electoral Trust Companies' has come into force in terms of Section 2 (22AA) of the Income-tax Act, 1961 read with Ministry of Finance Notification No. S.O. 309 (E), dated 31-01-2013.

With the coming into force of the scheme relating to 'Electoral Trust Companies' under Section 2 (22AA) the Income Tax Act, 1961 read with Ministry of Finance Notification No. S.O. 309(E) dated 31st January, 2013, it will be expedient to explain the requirements of disclosure on part of a company of any amount or amounts contributed by it to any political parties under Section 182(3) of the Companies Act, 2013.

The Ministry hereby clarifies that:

(i) Companies contributing any amount or amounts to an 'Electoral Trust Company' for contributing to a political party or parties are not required to make disclosures required under Section 182(3) of Companies Act 2013. It will suffice if the Accounts of the company disclose the amount released to an Electoral Trust Company.

(ii) Companies contributing any amount or amounts directly to a political party or parties will be required to make the disclosures laid down in Section 182(3) of the Companies Act, 2013.

(iii) Electoral trust companies will be required to disclose all amounts received by them from other companies/sources in their Books of Accounts and also disclose the amount or amounts contributed by them to a political party or parties as required by Section 182(3) of Companies Act, 2013.

Example: The Board of Directors of LM Ltd., incorporated in April, 2017, proposes to donate ₹ 50,000 to a political party for the F.Y. 2019-20. The average net profits determined in accordance with the provisions of the Companies Act, 2013 during the two immediately preceding financial years are ₹ 20,00,000. Advise, whether the proposed donation is within the powers of Board of Directors of the company?

Answer: As per section 182(1) of the Companies Act, 2013 any company may contribute any amount directly or indirectly to any political party except a government company and a company which has been in existence for less than three financial years.

In the given case, LM Ltd. happens to be a company which has been in existence for less than three financial years. Hence, it is not permitted to donate any amount to the concerned political party for the F.Y. 2019-20.

Example: Sea Hawk Cycles Limited is a company incorporated four years ago. It has earned profits amounting to ₹ 5 lakhs, ₹ 8 lakhs and ₹ 11 lakhs respectively during the last three financial years. The Board of Directors of the company proposes to donate a sum of ₹ 50,000 to a political party. Whether the proposed donation is within the powers of Board of Directors of the company.

Answer: According to section 182(1) of the Companies Act, 2013, a company except a Government Company and a company which has been in existence for not less than three financial years, can make political contributions, directly or indirectly, to any political party.

Further, the contribution shall be made by a company only after passing a resolution at a meeting of the Board of Directors authorizing such contribution.

In view of the above provisions, Sea Hawk Cycles Limited can contribute the said amount of ₹ 50,000 to the concerned political party. However, it needs to pass a board resolution authorising making of such contribution at a meeting of the Board of Directors.

11. POWER OF BOARD AND OTHER PERSONS TO MAKE CONTRIBUTIONS TO NATIONAL DEFENCE FUND, ETC. [SECTION 183]

Section 183 of the Act, empowers the Board and other authorised persons to make contributions to the National Defence Fund, etc. as described below:

(i) **Contribution of amount to National Defence Fund/other fund as approved by the Central Government:**

(a) ***No limit:*** Contribution to the National Defence Fund or any other Fund approved by the Central Government for the purpose of national defence can be made without any limit.

(b) ***Exercise of power:*** The power to make such contribution shall be exercised by:

- The Board of Directors of the company; or
- Any person or authority exercising the powers of the Board of Directors or of the company in general meeting.

(c) ***Overriding effect:*** Section 183 has overriding effect *i.e.* the contribution may be made notwithstanding anything contained in Sections 180, 181 and 182 or any other provision of the Companies Act, 2013 or in the memorandum, articles or any other instrument relating to the company.

(ii) **Disclosure in profits and loss account:** Every company shall disclose in its profits and loss account the total amount or amounts contributed by it to the National Defence Fund or any other approved fund, during the financial year to which the amount relates.

12. DISCLOSURE OF INTEREST BY DIRECTOR [SECTION 184]

The office of director in a company is that of 'trust'. A person holds the directorship in a fiduciary capacity. As trustee of the assets of the company, the director is duty bound to pass on the benefits accruing from all such transactions which belong to the company. At any stage if he becomes interested in a transaction the benefits of which rightfully accrue to the company, he must disclose his interest so that the Board and if required, the company, may take a rational decision whether to continue with that transaction or not. The disclosure of interest to be made by a director includes

both 'general disclosure of interest' and 'specific disclosure of interest'. Section 184 of the Act, which contains provisions in respect of 'disclosure of interest' by the directors, is applicable to all the companies and their directors. These provisions are discussed as under:

(i) **General disclosure of interest [Section 184(1)]:** Every director shall disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in the manner prescribed in Rule 9 of the *Companies (Meetings of Board and its Powers) Rules, 2014*. The intention of law behind such disclosure is to make known the other directors of the company about the interest of concerned director in other companies, firms, etc.

When to make general disclosure of interest: Every director shall disclose his interest:

(a) at the first meeting of the Board in which he participates as a director, and

(b) thereafter, at the first meeting of the Board in every financial year, or

(c) whenever there is any change in the disclosures already made, then at the first Board meeting held after such change.

Provisions of Rule 9: As regards manner of disclosure and certain other matters, the provisions of Rule 9 are given as under:

(a) Every director shall disclose his concern or interest by giving a written notice in Form MBP-1.

(b) The director giving notice of interest shall be duty bound to cause it to be disclosed at the meeting held immediately after the date of the notice.

(c) All notices shall be kept at the registered office of the company.

(d) They shall be preserved for a period of eight years from the end of the financial year to which they relate.

(e) They shall be kept in the custody of the Company Secretary or any other person authorised by the Board for the purpose.

(ii) **Specific disclosure of interest:** According to Section 184 (2), a director of a company shall make a specific disclosure of interest whenever he, in any way, whether directly or indirectly, is concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into:

(a) with a body corporate in which such director or such director in association with any other director holds **more than two per cent shareholding** of that body corporate; or

(b) with a body corporate in which such director is a promoter, manager, Chief Executive Officer; or

(b) with a firm or other entity in which, such director is a partner, owner or member.

When to make specific disclosure of interest: The disclosure shall be made as under:

- The interested director shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed for the first time; and
- He shall not participate in such meeting. 'Non-participation' implies that he shall not discuss the matter relating to such contract and also shall not vote if there happens to be a voting in this connection.
- It may happen that any director is not so concerned or interested at the time of entering into such contract or arrangement. However, if he becomes interested after the contract or arrangement is entered into, he shall disclose his concern or interest forthwith when he becomes so or at the first meeting of the Board held after his becoming concerned or interested.

Exception/Modification

*1. In case of 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, the provisions of Section 184 (2) shall apply with the exception that the interested director may participate in such meeting after disclosure of his interest. [Notification No. G.S.R. 464 (E), dated 5th June, 2015 as amended by Notification No. G.S.R. 583 (E), dated 13th June, 2017.]*

*2. In respect of a **Section 8 company** which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, the provisions of Section 184(2) shall apply only if the transaction with reference to Section 188 on the basis of terms and conditions of the contract or arrangement **exceeds one lakh rupees**. [Notification No. G.S.R. 466(E), dated 5th June 2015 as amended by Notification No. G.S.R. 584 (E), dated 13th June, 2017.]*

(iii) **Contract voidable at the option of company if there is non-disclosure [Section 184(3)]:** A contract or arrangement entered into by the company shall be voidable at its option if the interested director who has a direct or indirect concern or interest in such contract or arrangement does not disclose his interest as required by Section 184 (2) or if such director participates in the meeting where such contract or arrangement is discussed.

It may be noted that the contract is voidable and not void and the option of rescinding the contract lies with the company and not with the interested director. Thus, if the company decides to honour the contract, the interested director cannot rescind it because of irregularity.

(iv) **Punishment for contravention [Section 184(4)]:** If a director of the company contravenes the provisions of Section 184 (1) and (2) *i.e.* does not disclose his interest or furnishes wrong information in this respect, he shall be punishable as under:

- with imprisonment up to one year; or
- with fine up to ₹ one lakh; or
- with both.

(v) **No restriction on directors:** Nothing in Section 184 shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement with the company.

(vi) **Exemption from disclosure if the holding is up to two per cent**: According to Section 184 (5) (b), the provisions of Section 184 regarding disclosure by interested director shall not apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the either company or two or more of them together holds or hold **not more than 2%** of the paid-up share capital in the other company.

Example: Y Ltd. entered into a contract with Z Ltd. which has a paid-up capital of ₹ 50 lakhs. One of the directors of Y Ltd. is holding equity shares of the nominal value of ₹ 50,000 in Z Ltd. but he did not disclose his interest at the appropriate Board meeting. Is the concerned director liable for punishment for such non-disclosure?

Answer: As per section 184 (2) of the Companies Act, 2013 the disclosure of interest by directors is not required in any contract or arrangement between two companies where any of the directors of one company or two or more of them together holds or hold not more than 2% of the paid-up share capital in the other company. In the present case, the holding of the director of Y Ltd. in Z Ltd. is only 1% [*i.e.* (50,000/50,00,000)*100 = 1%] which is much less than 2%. Therefore, he is not liable for any punishment if he does not disclose his interest regarding holding of equity shares in Z Ltd.

13. DEFECTS IN APPOINTMENT OF DIRECTORS NOT TO INVALIDATE ACTIONS TAKEN [SECTION 176]

Section 176 of the Act contains protective provisions by which actions taken by a director shall not get invalidated if subsequently it is noticed that there happened to be defects in his appointment. The validation of actions provides a kind of protection to the company as well as the third parties. The provisions of Section 176 are stated as under:

(i) **No act done by a person as a director shall be deemed to be invalid**, if it was subsequently noticed that his appointment was invalid by reason of:

- any defect; or
- disqualification; or
- had been terminated by virtue of any provision contained in the Companies Act, 2013 or in the articles of the company.

(ii) **Acts not valid if done after noticing his appointment to be invalid or to have terminated:** It is provided that Section 176 shall not be deemed to give validity to any act done by the director after his appointment has been noticed by the company to be invalid or to have terminated.

In other words, any subsequent act done by a director shall not get validated under the following circumstances:

- where it comes to the notice of the company that his appointment is invalid or illegal or there is no appointment.
- where it is in the notice of the company that his appointment has been terminated.
- where it is noticed by the company that his acts are illegal *i.e. ultra vires* the company or the Companies Act.
- where it was well within the knowledge of the third party that the appointment of director was not valid or there existed any irregularity or there was any disqualification attached to the director and still such party dealt with him.
- where the director knows it fully that his term of office has expired but he continues to occupy his office despite such knowledge.
- where a person exercises his powers as director though he apparently knows that he has no authority to exercise such powers because his appointment was invalid or he has since been terminated.

(iii) Protection to the acts of MD or WTD or Manager: In terms of Section 196 (5), any act done by a managing director or whole-time director or manager before his appointment was disapproved by the company at a general meeting shall be deemed to be valid.

Example: Mr. Mohan was appointed as director at the Annual General Meeting of a company held on 30th September, 2018 and he functioned in the capacity as director from then onwards. Subsequently, during the mid of August, 2019, it was noticed that there were certain irregularities in his appointment and therefore, on 31st August, 2019, his appointment was declared invalid. However, Mr. Mohan continued to act as director even after 31st August, 2019. Whether the subsequent acts done by him as director are valid and binding on the company?

Answer: According to Section 176 of the Companies Act, 2013, any act done by a person as a director shall be deemed to be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles of the company.

The Proviso to Section 176, however, states that nothing in this section shall be deemed to give validity to acts done by a director after his appointment has been noticed by the company to be invalid or to have terminated.

In view of the above provisions of Section 176, the acts done by Mr. Mohan till the date of noticing irregularity in his appointment shall be deemed as valid and binding on the company.

Any act done by him after the date on which irregularity in his appointment was noticed by the company shall be invalid. Accordingly, acts done by Mr. Mohan after 31st August, 2019 shall be invalid and not binding upon the company.

14. LOAN TO DIRECTORS, ETC. [SECTION 185]

Section 185[16] of the Act contains provisions which impose restrictions on the loans, etc. being given to directors, etc. These provisions are stated below:

(i) **Imposition of restrictions [Section 185 (1)]:** A company (subject to exemptions stated in the *Box* given later) is not permitted, directly or indirectly, to advance any loan, including any loan represented by a book debt to, or to give any guarantee or provide any security in connection with any loan taken by,—

(a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

(b) any firm in which any such director or relative is a partner.

(ii) **Relaxation from restrictions [Section 185 (2)]:** Subject to the specified conditions, a company is permitted to:

- advance any loan including any loan represented by a book debt, or
- give any guarantee or provide any security in connection with any loan taken,

by any person in whom any of the director of the company is interested.

The specified conditions to be followed are:

(a) a **special resolution** is passed by the company in general meeting.

However, the explanatory statement to the notice for the relevant general meeting shall disclose;

- the *full particulars* of the loans given or guarantee given or security provided; and
- the *purpose* for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security and
- any other relevant fact;

[16] As substituted by the Companies (Amendment) Act, 2017 w.e.f. 07-05-2018.

(b) the loans are utilised by the **borrowing company** for its **principal business activities**.

Explanation: The expression "any person in whom any of the director of the company is interested" means—

(a) any **private company** of which any such director is a director or member;

(b) any **body corporate** at a general meeting of which **not less than twenty-five per cent** of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(c) any **body corporate**, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

(iii) **Non-applicability of restrictions [Section 185 (3)]:** In the following cases, restrictions stated in Section 185 (1) or specified conditions for relaxation of restrictions stated in Section 185 (2) shall not apply:

(a) where any loan is given to a **managing or whole-time director**—

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any such **scheme** which is approved by the members by a **special resolution**.

(b) where a company in the ordinary course of its business:

- provides loans or gives guarantees or securities for the due repayment of any loan; and
- in respect of such loans an **interest is charged at a rate not less than the rate of prevailing yield** of one year, three years, five years or ten years Government security closest to the tenor of the loan.

(c) (i) where any loan is made by a holding company to its wholly owned subsidiary company; or

(ii) where any guarantee is given or security is provided by a holding company in respect of any loan made to its wholly owned subsidiary company.

(d) where any guarantee is given or security is provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company.

As a pre-condition, it must be ensured that the loans made under clauses (c) and (d) are utilised by the subsidiary company for its principal business activities.

(iv) **Penalty for contravention:** Penalty for contravention of the provisions of Section 185 (*i.e.* if any loan is advanced or a guarantee or security is given or utilised contravening the provisions of Section 185) shall be as under:

(a) **Company**: punishable with minimum fine of ₹ 5,00,000 and maximum fine of ₹ 25,00,000.

(b) **Every defaulting officer:** punishable with imprisonment up to six months or with minimum fine of ₹ 5,00,000 and maximum fine of ₹ 25,00,000.

(c) the director or the other person to whom any loan is advanced or guarantee or security is given in connection with any loan taken by him or the other person: punishable with imprisonment up to six months or with minimum fine of ₹ 5,00,000 and maximum fine of ₹ 25,00,000, or with both.

Exemptions

*1. Section 185 shall not apply to **Government company** in case such company obtains approval of 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 before making any loan or giving any guarantee or providing any security under the section.*

***Note:** The above exemption is applicable to a Government company if it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

[Notification No. G.S.R. 463 (E), dated 5th June 2015 as amended by Notification No. G.S.R. 582 (E), dated 13th June 2017.]

*2. Section 185 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 of its paid-up share capital or fifty crore rupees, whichever is lower, and

(c) Such company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.

***Note:** The above exemption is applicable to a private company if it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

[Notification No. G.S.R 464(E), dated 5th June 2015 as amended by Notification No. G.S.R 583(E), dated 13th June 2017.]

*3. Section 185 shall not apply to the **Nidhis**, provided the loan is given to a director or his relative in their capacity as members and such transaction is disclosed in the annual accounts by a note. However, while complying with such exception, the Nidhis shall ensure that the interests of their shareholders are protected.*

[Notification no. G.S.R. 465 (E), dated 5th June 2015.]

15. LOAN AND INVESTMENT BY COMPANY [SECTION 186]

Section 186 of the Act, applicable to both public and private companies, deals with the provisions relating to 'Loan and Investment' by a company. In addition, Rules 11, 12 and 13 also contain provisions governing the making of loans and investments, giving of guarantees and providing of securities by a company. These provisions are discussed as under:

(i) Investment permitted through two layers of Investment Companies [Section 186(1)]: A company, unless otherwise prescribed, is not permitted to make investment through more than two layers of investment companies. Placing of such a restriction helps in preventing diversion of funds. It is a common experience that the funds can be more flagrantly diverted if a company invests through a number of step-down subsidiaries.

Note: It is clarified by way of *clause (a) of Explanation* that the expression **"investment company"** means a company whose principal business is the acquisition of shares, debentures or other securities. Further, a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its **assets** in the form of investment in shares, debentures or other securities constitute **not less than fifty per cent** of its total assets, or if its **income** derived from investment business constitutes **not less than fifty per cent** as a proportion of its gross income.

Exception to the rule of two layers: In the following cases, the provisions of Section 186 (1) shall not apply *i.e.* rule of 'two layers' shall not be applicable:

(a) **Acquisition of a company incorporated outside India:** If a company acquires any other company incorporated in a country outside India and if such other company has investment subsidiaries beyond two layers as per the laws of such country, the rule of 'two layers' shall not prevent this kind of acquisition.

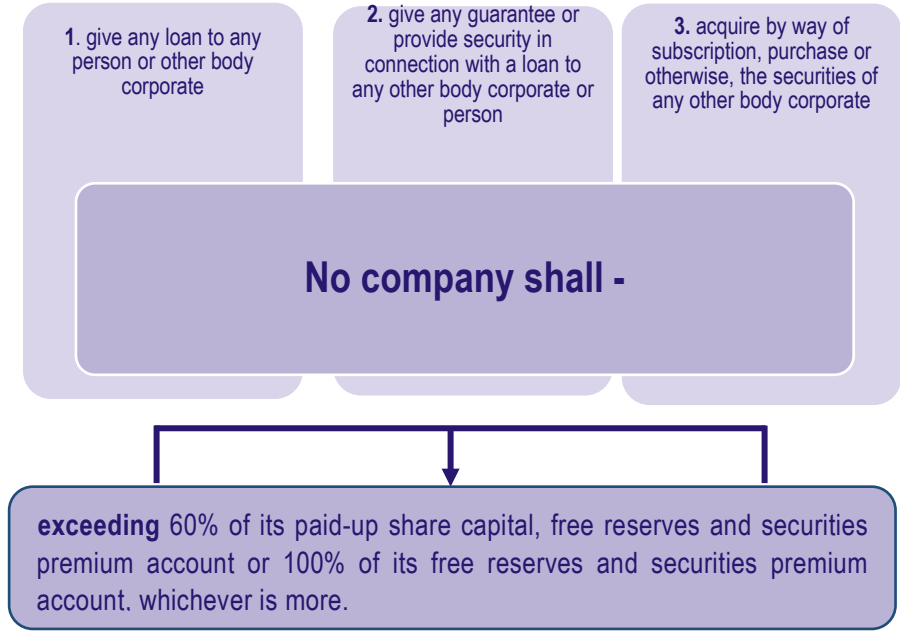
(b) **Subsidiary from having an investment subsidiary**: Again, the rule of 'two layers' shall not prevent a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

(ii) Imposition of limit on the quantum of loan and investment made by a company: According to Section 186 (2), following types of transactions (both direct and indirect) shall be subject to the specified limit as depicted in the diagram:

(a) giving of **loan** to any person or other body corporate;

(b) giving of **guarantee or** provision of **security** in connection with a loan to any other body corporate or person;

(c) acquiring by way of subscription, purchase or otherwise the securities of any other body corporate.



Explanation: For the purposes of Section 186 (2), the word "person" does not include any individual who is in the employment of the company.

Loans and Advances to Employees – Clarification on the applicability of Section 186

*The MCA has clarified that loans and/or advances made by the companies to their employees, other than the managing or whole-time directors (which is governed by Section 185) are **not** governed by the requirements of Section 186.*

This clarification will, however, be applicable if such loans/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in cases where such policy is required to be formulated.

[General Circular No. 04/2015, dated 10/3/2015.]

In other words, a company is permitted to enter into transactions of giving loan or guarantee or providing security or acquiring of securities (*i.e.* shares, debentures, etc.), in the aggregate, up to 60% of its paid-up share capital (both equity and preference), free reserves and securities premium or 100% of its free reserves and securities premium, whichever is more.

(iii) **Prior approval by a special resolution for exceeding limit [Section 186(3)]:** Where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under Section 186 (2), no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a **special resolution** passed in a general meeting.

Note 1: In case the provisions of Section 110 of the Act apply to the company which is considering giving of loans or extending guarantee or providing security in excess of the limit specified under Section 186 (3), it shall pass the special resolution containing such item of business by means of voting through **postal ballot**. *[refer Rule 16 (j) of the Companies (Management and Administration) Rules, 2014.]*

Note 2: A One Person Company and other companies having members up to two hundred are not required to transact any business through postal ballot. *[refer Proviso to Rule 16 of the Companies (Management and Administration) Rules, 2014.]*

Disclosure of total amount in resolution in respect of loan or guarantee or security or acquisition: As per the Rule 13 of the *Companies (Meetings of Board and its Powers) Rules, 2014,* a resolution passed at a general meeting in terms of Section 186 (3) to give any loan or guarantee or investment or providing any security or the acquisition under Section 186 (2) shall specify the total amount up to which the Board of Directors are authorised to give such loan or guarantee, to provide such security or make such acquisition.

Exemption from special resolution [First Proviso to Section 186 (3) and Rule 11 (1)]: However, where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of passing a special resolution as required by Section 186 (3) shall not apply.

Disclosure in financial statement [Second Proviso to Section 186 (3) and Proviso to Rule 11 (1)]: In case of exemption from special resolution, the company shall disclose the details of such loans or guarantee or security or acquisition in the financial statement as provided under Section 186 (4).

(iv) **Disclosure to members [Section 186(4) and Proviso to Rule 13]:** The company shall make full disclosure to the members as depicted in the following diagram:

Company shall disclose to the members in the financial statements the full particulars of-		
loan given,	investment made or guarantee given or security provided,	the purpose for which the loan or guarantee or security is proposed to be utilized by the recipient of the loan or guarantee or security.

(v) **Unanimous resolution of the Board [Section 186(5)]:**

- Any investment shall be made or loan or guarantee or security given by the company only after when the resolution sanctioning it is passed at a meeting of the Board **with the consent of all the directors present** at the meeting.
- The prior approval of the public financial institution concerned where any term loan is subsisting shall also be obtained.

Circumstances when no prior approval of public financial institution (PFI) is required [Proviso to Section 186 (5)]: Prior approval of a public financial institution (PFI) **shall not be required** where the aggregate of the loans and investments so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given:

- does not exceed the limit as specified in section 186 (2) (i.e. 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more), and
- there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution.

(vi) **Rate of interest on loan [Section 186 (7)]:** A loan under this section shall be given at a rate of interest which is not lower than the prevailing yield of one year, 3 year, 5 year or 10 year Government Security closest to the tenor of the loan.

1. Clarification in respect of Section 186 (7) - Rate of Interest

The MCA has clarified that in cases where effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan, there is no violation of sub-section (7) of Section 186 of the Companies Act, 2013. [General Circular No. 06/2015, dated 9th April, 2015]

2. Modification in Section 186 (7) in respect of Section 8 Companies

In respect of Section 8 Companies which have not committed a default in filing their financial statements under Section 137 or Annual Return under Section 92 with the Registrar, following proviso shall be inserted in Section 186(7):

'Provided that nothing contained in this sub-section shall apply to a company in which twenty-six per cent or more of the paid-up share capital is held by the Central Government or one or more State Governments or both, in respect of loans provided by such company for funding Industrial Research and Development projects in furtherance of its objects as stated in its memorandum of association'. [Notification No. GSR 466 (E), dated 5-6-2015 as amended by Notification No. GSR 584 (E), dated 13-6-2017.]

(vii) **No giving of loan, etc., till default in respect of deposits is subsisting [Section 186 (8)]:** A company which is in default in the repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon, shall not give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

(viii) **Maintenance of Register [Section 186 (9)]:** Every company giving loan or giving a guarantee or providing security or making an acquisition shall keep a register. It shall contain such particulars and shall be maintained in such manner as is prescribed in Rule 12 of the *Companies (Meetings of Board and its Powers) Rules, 2014.* The requirements of Rule 12 are as under:

(a) Every company shall, from the date of its incorporation, maintain a register in *Form MBP 2* and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made.

(b) The entries in the register shall be made chronologically in respect of each such transaction within **7 days** of making loan or giving guarantee or providing security or making acquisition.

(c) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

(d) The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

(e) The register can be maintained either manually or in electronic mode.

(f) The extracts from such register maintained may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ₹10 for each page.

(ix) **Provisions regarding keeping of Register of 'Loan and Investment' and its Inspection [Section 186 (10)]:**

(a) The register shall be kept at the registered office of the company. This is also prescribed by Rule 12.

(b) It shall be open to inspection and extracts may be taken therefrom by any member, and copies thereof may be furnished to any member of the company on payment of prescribed fee as per Rule 12 *i.e.* maximum ₹ 10 for each page.

(x) **Non-applicability of Section 186 except sub-section (1) to certain transactions [Section 186 (11)]:** Section 186, (except Section 186 (1), shall not apply:

(a) to any loan made, any guarantee given or any security provided or any investment:

- made by a banking company, or an insurance company, or a housing finance company in the ordinary course of its business; or
- made by a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities[17];

(b) to any investment—

(i) made by an investment company;

[18]**Note:** The expression **"investment company"** means a company whose principal business is the acquisition of shares, debentures or other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than fifty per cent. of its total assets, or if its income derived from investment business constitutes not less than fifty per cent. as a proportion of its gross income

(ii) made in shares allotted in pursuance of Section 62 (1) (a) (*i.e.* right shares) or in shares allotted in pursuance of rights issues made by a body corporate;

(iii) made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter III-B of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities.

(xi) **Restriction on the inter-corporate loans/deposits to be taken by companies registered under Section 12 of SEBI [Section 186 (6) and Rule 11 (3)]:** A company registered under Section 12 of the Securities and Exchange Board of India Act, 1992 and covered under such class or classes of companies which may be notified by the Central Government in consultation with the Securities and Exchange Board, shall not take inter-corporate loan or deposits in excess of the limits specified under the regulations applicable to this kind of

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[17] As per *Explanation (b)* to Section 186 of the Act, the expression "infrastructural facilities" means the facilities specified in Schedule VI.

[18] As per *Explanation (a)* to Section 186 of the Act.

company, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India.

Further, such company shall furnish in its financial statement the details of the loan or deposits.

Note: Section 12 of the SEBI Act, 1992 requires stock broker, sub-broker, share transfer agent, banker to an issue, registrar to an issue, merchant banker, underwriter, portfolio manager, etc. to get registered with SEBI and obtain certificate of registration. There are regulations framed by SEBI which regulate such entities.

(xii) **Punishment for contravention [Section 186 (13)]:** In case of contravention of any of the provisions of Section 186, the punishment shall be as under:

- Company: punishable with minimum fine of ₹ 25,000 and maximum of ₹ 5 lakhs.
- Every defaulting officer: punishable with imprisonment maximum up to two years and with fine minimum of ₹ 25,000 and maximum of ₹ 1,00,000.

For the purposes of section 186,

(b) the expression "infrastructure facilities" means the facilities specified in Schedule VI.

Note: The students may also refer the Companies (Restriction on Number of Layers) Rules, 2017, which have been enforced w.e.f. 20th September 2017.

Exemptions

Section 186 shall not apply to:

*(a) a **Government company** engaged in defence production;*

*(b) a **Government company, other than a listed company,** in case such company obtains approval of 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 before making any loan or giving any guarantee or providing any security or making any investment under the section.*

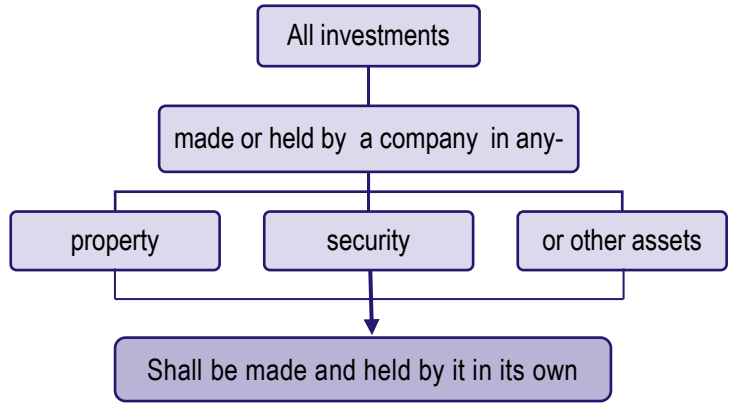
***Note:** The above exception is applicable to a Government company which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

[Notification No. G.S.R. 463 (E), dated 5th June 2015 as amended by Notification No. G.S.R. 582 (E), dated 13th June 2017.]

16. INVESTMENTS OF COMPANY TO BE HELD IN ITS OWN NAME [SECTION 187]

Section 187 of the Act contains provisions which, as a general rule, require that all investments made by a company shall be held by it in its own name. There are certain exemptions also. The provisions of Section 187 are discussed as under:

(i) **Investments by a company in its own name:** According to Section 187 (1), all investments made or held by a company in any property, security or other assets shall be made and held by it in its own name. Following diagram depicts this provision:



As an exception[19], it is provided that company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

(ii) **Exemptions:** It is not always necessary that a company must hold the investments in its own name. Certain exemptions provided by Section 187 (2) are as under:

(a) A company is permitted to deposit with its bankers any shares or securities for the collection of any dividend or interest payable thereon.

(b) A company is permitted to deposit with or transfer to or hold in the name of its bankers (*i.e.* the State Bank of India or a scheduled bank), shares or securities, in order to facilitate the transfer thereof.

However, if within a period of **6 months** from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of its bankers (*i.e.* the State Bank of India or a scheduled bank), no transfer of such shares or securities takes place, the company shall, as soon as practicable after the expiry of

[19] As per Proviso to Section 187 (1).

that period, have the shares or securities re-transferred to it from its bankers or, as the case may be, again hold the shares or securities in its own name.

(c) A company is permitted to deposit with or transfer to any person any shares or securities, by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it.

(d) A company is permitted to hold investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

(iii) **Maintenance of Register by a company in case securities are held in the name of a depository and not in its own name [Section 187 (3)]:** Section 187 (2) (d) permits a company to hold securities (*i.e.* any shares or securities) in the name of a depository, the company being the beneficial owner. In this case, though the investment in shares and securities has been made by the company but the securities are not held by it in its own name.

When the above situation arises, the company shall maintain a register which shall contain such particulars as may be prescribed (refer Rule 14 below) and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Provisions regarding maintenance of register as per Rule 14: The requirements of Rule 14 of the *Companies (Meetings of Board and its Powers) Rules, 2014* are as under:

(a) From the date of its registration, every company shall maintain a register in Form MBP-3.

(b) The company shall enter in the register, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name. It shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

(c) The company shall also record whether such investments are held in a third party's name for the time being or otherwise.

(d) The register shall be maintained at the registered office of the company.

(e) The register shall be preserved permanently

(f) The register shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

(g) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

Securities held by any person in which the company holds beneficial interest, compliance of section 89 requires declaration in respect of beneficial interest of any securities.

(iv) **Punishment for contravention [Section 187 (4)]**: If a company contravenes the provisions of Section 187, the punishment shall be as under:

- **Company:** punishable with minimum fine of ₹ 25,000 and maximum fine of ₹ 25 lakhs.
- **Every defaulting officer:** punishable with imprisonment up to 6 months or with minimum fine of ₹ 25,000 and maximum fine of ₹ 1 lakh or with both.

17. RELATED PARTY TRANSACTIONS [SECTION 188]

Section 188 of the Act along with Rule 15 of the *Companies (Meetings of Board and its Powers) Rules, 2014* contain provisions which regulate 'related party transactions'. Further, Section 2 (76) of the Act defines who is a 'related party'. These provisions are discussed in the following paragraphs:

(1) Meaning of 'Related Party':

As per Section 2(76), 'related party', with reference to a company, means:

(i) a director or his relative;

(ii) a key managerial personnel (KMP) 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 or manager is a director and holds along with his relatives, more than 2% 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:

Note: It is provided that sub-clauses (vi) and (vii) shall not apply to the advice, directions or instructions which are given in a professional capacity;

(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.

Note: It is clarified by way of *Explanation* that "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.

Exemption

In case of 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 sub-clause (viii) of clause 76 of Section 2 shall not apply with respect to Section 188. [Notification No. GSR 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June, 2017.]

(ix) such other person as may be prescribed (refer *Box* below).

In this respect, Rule 3 of the Companies (Specification of Definitions Details) Rules, 2014 provides that for the purposes of sub-clause (ix) above, 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.

Further, the persons covered under sub-clauses (vi) and (vii) above shall not be related parties if advice, directions or instructions are given by them in a professional capacity.

Meaning of 'Relative'

Section 2 (77) of the Act defines the term 'relative'. Accordingly, 'relative', with reference to any person, means any one who is related to another, if—

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

(*ii*) they are husband and wife; or

[20](iii) one person is related to the other in the prescribed manner as under:

(1) Father (including step-father).
(2) Mother (including step-mother).
(3) Son (including step-son).
(4) Son's wife.
(5) Daughter.
(6) Daughter's husband.
(7) Brother (including the step-brother).
(8) Sister (including the step-sister).

[20] As per Rule 4 of the Companies (Specification of Definitions Details) Rules, 2014.

(2) **Related party transactions to which Section 188 is applicable**: Section 188(1) specifies certain transactions (*i.e. contracts or arrangements*) which shall be termed as 'related party transactions' if a company undertakes them with a 'related party'. Such transactions are depicted in the following diagram:

Transactions referred to in sub-section (1) of Section 188:

[21]Meaning of "Office or Place of Profit"

The expression "office or place of profit" means any office or place—

(1) **where such office or place is held by a director -** if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(2) **where such office or place is held by an individual other than a director or by any firm, private company or other body corporate -** if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise.

[21] As per *Explanation (a)* to Section 188 (1) of the Act.

It is noteworthy that Section 188 does not bar a company from entering into 'related party transactions'. They can very well be undertaken, but after following the procedure prescribed as per the law like taking permission from the Board and if required, from the company in general meeting when prescribed limits are exceeded. If the provisions do not require any procedure to be followed, these transactions can also be entered without following the prescribed procedure.

(3) Related Party Transactions for which no approval is required [Fourth Proviso to Section 188 (1)]: In case any related party transaction is entered into by the company in its ordinary course of business and at an arm's length basis, Section 188 (1) is not attracted and therefore, no approval is required. However, transactions which are not on an arm's length basis shall require the appropriate approval.

Note: The expression **"arm's length transaction" means**[22] a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

(4) Related Party Transactions requiring consent of the Board[23]**:** In case, a related party transaction covered under Section 188 (1) (*i.e.* contract or arrangement between a company and related party) is not on arm's length basis and also does not require approval of the shareholders, it shall be entered into by the company after obtaining consent of the Board of Directors given by a resolution at a meeting of the Board and subject to the conditions as prescribed by Rule 15 (1) of the Companies (Meetings of Board and its Powers) Rules, 2014.

According to Rule 15 (1), if a company enters into a transaction with a related party, the agenda of the Board meeting at which the resolution is proposed to be moved shall disclose the following matters:

(a) the name of the related party and nature of relationship;

(b) the nature, duration of the contract and particulars of the contract or arrangement;

(c) the material terms of the contract or arrangement including the value, if any;

(d) any advance paid or received for the contract or arrangement, if any;

(e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;

(f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and

(g) any other information relevant or important for the Board to take a decision on the proposed transaction.

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[22] As per *Explanation (b)* to Section 188 (1) of the Act.
[23] As per Section 188 (1) of the Act.

Note: According to Rule 15 (2), in case any director is interested in any contract or arrangement with a related party, he shall not be present at the meeting during discussions on the resolution relating to such contract or arrangement-

(5) (i) Related Party Transactions requiring approval by ordinary resolution[24]: In case a company enters into a contract or arrangement with a related party and the value of transaction exceeds the prescribed value as per Rule 15 (3), it shall be entered into with the prior approval of the company by passing an ordinary resolution.

The provisions of Rule 15(3) are explained as under:

(A) Approval by an ordinary resolution is required where the transaction or transactions to be entered into as contracts or arrangements with respect to clauses (a) to (e) of Section 188 (1) are as per the following criteria:

Details of transactions to be entered into as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of Section 188	Prescribed limits for seeking approval by a resolution relating to the specified transactions mentioned on the left side of Table
(i) Sale, purchase or supply of any goods or materials, directly or through appointment of agent, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of Section 188.	If the value of such transaction or transactions amounts to 10% or more of the turnover of the company or ₹ 100 crores, whichever is lower. **Note:** Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
(ii) Selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of Section 188.	If the value of such transaction or transactions amounts to 10% or more of net worth of the company or ₹ 100 crores, whichever is lower. **Note:** Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
(iii) Leasing of property of any kind, as mentioned in clause (c) of sub-	If the value of such transaction or transactions amounts to 10% or more

[24] As per First Proviso to Section 188 (1) and Rule 15 (3) of the Companies (Meetings of Board and its Powers) Rules, 2014.

section (1) of Section 188.	of the net worth of the company or 10% or more of turnover of the company or ₹ 100 crores, whichever is lower. **Note:** Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.
(iv) Availing or rendering of any services, directly or through appointment of agent, as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188.	If the value of such transaction or transactions amounts to 10% or more of the turnover of the company or ₹ 50 crores, whichever is lower. **Note:** Above limit shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

(B) Where the transaction or transactions to be entered into as contract or arrangement is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration **exceeding ₹ 2.5 lakh rupees as mentioned in clause (f) of sub-section (1) of Section 188,** approval by an ordinary resolution is required.

(C) Where the transaction or transactions to be entered into as contract or arrangement is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company **exceeding 1% of the net worth as mentioned in clause (g) of sub-section (1) of Section 188,** approval by an ordinary resolution is required.

[25]**Note 1: Turnover or Net Worth:** The turnover or net worth shall be computed on the basis of the audited financial statement of the preceding financial year.

[26]**Note 2: The explanatory statement to be annexed to the notice** of a general meeting convened pursuant to Section 101 shall contain the following particulars, namely:

(a) name of the related party;

(b) name of the director or key managerial personnel who is related, if any;

(c) nature of relationship;

[25] As per Explanation (1) to Rule 15 (3).

[26] As per Explanation (3) to Rule 15 (3).

(d) nature, material terms, monetary value and particulars of the contract or arrangement;

(e) any other information relevant or important for the members to take a decision on the proposed resolution."

(ii) No voting by a related member [Second Proviso to Section 188(1)]: A member of the company who is a related party shall not vote on the resolution meant for approving any contract or arrangement which may be entered into by the company.

[27]**Note:** However, nothing contained in the second proviso shall apply to a company in which ninety per cent or more members, in number, are relatives of promoters or are related parties.

Exemptions

1. *First and Second Proviso to Section 188(1) shall not apply to:*

(a) a government company in respect of contracts or arrangements entered into by it with any other government company;

(b) a government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of 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 before entering into such contract or arrangement.

***Note:** The above exemption is 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 No. G.S.R. 463(E), dated 5th June 2015 as amended by Notification No. G.S.R. 582(E), dated 13th June 2017.]

2. *Second Proviso to Section 188(1) shall not apply to a private company provided it has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar.*

***Note:** This exemption implies that a member of a private company is permitted to vote on the resolution irrespective of the fact that such member is a related party.*

[Notification No. G.S.R. 464(E), dated 5th June 2015 as amended by Notification No. G.S.R. 583(E), dated 13th June 2017.]

[27] As per Third Proviso to Section 188 (1).

Scope of Second Proviso to Section 188(1) - Clarification

The second proviso to sub-section (1) of Section 188 requires that no member of the company shall vote on a resolution to approve the contract or arrangement (referred to in the first proviso), if such a member is a related party.

The MCA has clarified that 'related party' referred to in the Second Proviso has to be construed with reference only to the contract or arrangement for which the said resolution is being passed.

Thus, the term 'related party' in the above context refers only to such related party as may be a related party in the context of the contract or arrangement for which the said resolution is being passed. [General Circular No. 30/2014, dated 17th July, 2014]

(6) Transactions between a holding company and its wholly owned subsidiary [Fifth Proviso to Section 188 (1)]: In case transactions are entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting, there is no need for seeking approval of the company by passing an ordinary resolution by the members.

Explanation (2) to Rule 15 (3) states that in case of a wholly owned subsidiary, the resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between the wholly owned subsidiary and the holding company.

(7) Related party transactions voidable at the option of the Board/shareholders [Section 188 (3)]: A contract or arrangement shall be voidable at the option of the Board or, as the case may be, of the shareholders:

(a) **Contract/arrangement entered without obtaining the consent of the Board or approval by a resolution:** Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting as required under Section 188 (1), and

No ratification by Board/shareholders: if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into.

Further, if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

(b) **Company may proceed to recover loss in contravention of the provisions of this section:** Section 188 (4) provides that it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of Section 188 for recovery of any loss sustained by it as a result of such contract or arrangement.

(8) Punishment for contravention [Section 188 (5)]: Any director or any other employee of a company who had entered into the contract or arrangement, or authorised it, in violation of the provisions of Section 188 shall be punishable as under:

In the case of	Punishment
Listed company	The defaulting director or employee shall be punishable with imprisonment up to 1 year or with minimum fine of ₹ 25,000 and maximum fine of ₹ 5 lakhs, or with both.
Any other company	The defaulting director or employee shall be punishable with minimum fine of ₹ 25,000 and maximum fine of ₹ 5 lakhs.

(9) Disclosures of 'related party transactions' in Board's report [Section 188 (2)]: Every contract or arrangement entered into under Section 188 (1) (*i.e.* the related party transactions) shall be mentioned in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.

Applicability of Section 188 to Corporate Restructuring, Amalgamations etc.

The MCA has clarified that transactions arising out of Compromises, Arrangements and Amalgamations dealt with under specific provisions of the Companies Act, 2013, will not attract the requirements of Section 188 of the Companies Act, 2013. [General Circular No. 30/2014, dated 17th July, 2014]

18. REGISTER OF CONTRACTS OR ARRANGEMENTS IN WHICH DIRECTORS ARE INTERESTED [SECTION 189]

Section 189 of the Act, contains provisions for maintenance of Register of contracts or arrangements in which directors are interested. According to this section:

(i) **Maintenance of register of contracts or arrangements [Section 189(1)]:** It is mandatory for all companies to keep one or more registers giving separately the particulars of all contracts or arrangements as required under:

(a) Section 184(2) [Disclosure of Interest by Directors]; or

(b) Section 188 [Related Party Transactions].

(ii) **Manner of preparation of register:** Such register shall be prepared in the prescribed manner and shall contain prescribed particulars. [Section 189(1)]

As regards prescribed manner and particulars, we may refer Rule 16 of the *Companies (Meetings of Board and its Powers) Rules, 2014* which states that the Register of contracts or arrangements shall be maintained in Form No. MBP 4. The company concerned shall enter therein:

- the particulars of company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest, as mentioned under Section 184 (1).

  As an exception, the particulars of the company or companies or bodies corporate in which a director himself together with any other director **holds two percent or less of the paid-up share capital** would not be required to be entered in the register.

- the particulars of contracts or arrangements with a body corporate or firm or other entity as mentioned under Section 184 (2), in which any director is, directly or indirectly, concerned or interested; and

- the particulars of contracts or arrangements with a related party with respect to transactions to which Section 188 applies.

(iii) **When to make entries in the Register:** As per Rule 16, the entries in the Register shall be made at once and in the chronological order. They shall be authenticated by the Company secretary or any other person authorised by the Board.

(iv) **Register to be signed [Section 189(1)]:** The register, after being duly filled and updated, shall be placed before the next meeting of the Board and signed by all the directors present at the meeting.

(v) **Disclosure to be made by a director or KMP [Section 189(2)]:** Every director or key managerial personnel (KMP) shall, within a period of 30 days of his appointment, or relinquishment of his office, as the case may be, disclose the particulars specified in Section 184(1) relating to his concern or interest in the other associations which are required to be included in the register or such other information relating to himself as may be prescribed.

(vi) **Register to be kept at registered office [Section 189(3)]:** The register shall be kept at the registered office of the company and it shall remain open for inspection at such office during business hours.

(vii) **Preservation and custody:** According to Rule 16 (3), the register shall be preserved permanently and shall be kept in the custody of the Company Secretary or any other person authorised by the Board for the purpose.

(viii) **Extracts from register [Section 189(3) and Rule 16 (4)]:** The company shall provide extracts from such register to a member of the company on his request, within seven days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company, subject to a maximum of ₹ 10 per page.

(ix) **Register to be produced at AGM [Section 189(4)]:** The register shall be produced at the commencement of every annual general meeting (AGM). It shall remain open and accessible during the continuance of the meeting to any person having the right to attend the meeting. Thus, even a proxy has a right to inspect the Register.

(x) **Exceptions [Section 189(5)]:** Section 189(1) shall not apply to any contract or arrangement *i.e.* the particulars of a contract or arrangement shall not be entered in the Register-

(a) if it is for the sale, purchase or supply of any goods, materials or services and the value of such goods and materials or the cost of such services does not exceed ₹ 5,00,000 in the aggregate in any year; or

(b) if it is entered into by a banking company for the collection of bills in the ordinary course of its business.

(xi) **Penalty for contravention [Section 189(6)]:** Every director who fails to comply with the provisions of Section 189 regarding maintenance of 'Register of contracts or arrangements in which directors are interested' and the Rules made thereunder shall be liable to a penalty of ₹ 25,000.

In respect of a Section 8 company which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, the provisions of Section 189 shall apply only if the transaction with reference to Section 188 on the basis of terms and conditions of the contract or arrangement ***exceeds one lakh rupees****. [Notification No. G.S.R. 466 (E), dated 5th June 2015 as amended by Notification No. G.S.R. 584 (E), dated 13th June, 2015.]*

19. CONTRACT OF EMPLOYMENT WITH MANAGING OR WHOLE- TIME DIRECTORS [SECTION 190]

A Company may enter into a contract of employment with managing or whole-time directors. Section 190 of the Act contains provisions relating to keeping of such contract of employment. These provisions are stated as under:

(i) **Maintenance of copy of contract of employment:** Every company shall keep at its registered office,—

(a) **where a contract of service with a managing or whole-time director is in writing,** a copy of the contract; or

(b) **where such a contract is not in writing**, a written memorandum setting out its terms.

(ii) **Inspection:** The copies of the contract or the memorandum shall be open to inspection by any member of the company without payment of fee.

(iii) **Penalty for non-compliance [Section 190 (3)]:** If any default is made in complying with Section 190, the penalty shall be as under:

- **Company:** liable to a penalty of ₹ 25,000 for each default
- **Every defaulting officer:** liable to a penalty of ₹ 5,000 for each default.

(iv) **Exception [Section 190 (4)]:** The provisions of Section 190 shall not apply to a **private company.**

20. PAYMENT TO DIRECTOR FOR LOSS OF OFFICE, ETC., IN CONNECTION WITH TRANSFER OF UNDERTAKING, PROPERTY OR SHARES [SECTION 191]

Section 191 of Act, applicable to all companies, contains provisions which regulate payment to the directors for loss of office, etc., in connection with transfer of undertaking, property or shares by a company. These provisions are discussed as under:

(i) **No compensation except after specific disclosures and after approval of payment proposal by members:** Section 191 (1) enumerates happening of certain specific events in relation to a company and also states, *inter-alia*, whether or not any director of that company shall receive compensation, etc. on happening of such events. These events are given as under:

(a) the transfer of the whole or any part of any undertaking or property of the company; or

(b) the transfer to any person of all or any of the shares in a company being a transfer resulting from—

(i) an offer made to the general body of shareholders.

(ii) an offer made by or on behalf of some other body corporate with a view to a company becoming a subsidiary company of such body corporate or a subsidiary company of its holding company;

(iii) an offer made by or on behalf of an individual with a view to his obtaining the right to exercise, or control the exercise of, not less than 1/3rd of the total voting power at any general meeting of the company; or

(iv) any other offer which is conditional on acceptance to a given extent,

Disclosure of particulars and approval in general meeting: In connection with above events, a director of a company shall not receive any payment **unless** particulars as may be prescribed (*refer Rule 17 below*) with respect to the payment proposed to be made by the transferee or person, including the amount thereof, have been disclosed to the members of the company and the proposal has been approved by the company in general meeting.

Subject to the conditions of disclosure and approval as mentioned above, a director of a company may receive payment:

- by way of compensation for loss of office, or
- as consideration for retirement from office, or

- in connection with such loss or retirement from such company, or
- from the transferee of such undertaking or property, or
- from the transferees of shares or
- from any other person, not being such company.

According to **Rule 17 (1)** of the *Companies (Meetings of Board and its Powers) Rules, 2014,* the specified particulars which need to be disclosed to the members of the company for approving the proposal by passing a resolution at a general meeting are as under:

(a) name of the director;

(b) amount proposed to be paid;

(c) event due to which compensation becomes payable;

(d) date of Board meeting recommending such payment;

(e) basis for the amount determined;

(f) reason or justification for the payment;

(g) manner of payment - whether payable in cash or otherwise and how;

(h) sources of payment; and

(i) any other relevant particulars as the Board may think fit.

(ii) **Payment lawful if within prescribed limits [Section 191 (2)]:** Any payment made by a company to a MD or WTD or manager of the company by way of compensation for loss of office or as consideration for retirement from office or in connection with such loss or retirement shall be considered as lawful if it is subject to limits or priorities as prescribed in Rule 17 (2) *of the Companies (Meetings of Board and its Powers) Rules, 2014.*

According to Rule 17 (2), such payment, to be lawful, shall not exceed the limit as set out under Section 202.

(iii) **No compensation payable under specific circumstances:** According to Rule 17 (3), no compensation shall be paid to the MD or WTD or manager of the company for the loss of office or as consideration for retirement from office (except 'notice pay' and 'statutory payments' according to the terms of their appointment) or in connection with such loss or retirement if:

(a) the company is in default in repayment of public deposits or payment of interest thereon;

(b) the company is in default in redemption of debentures or payment of interest thereon;

(c) the company is in default in repayment of any liability, secured or unsecured, payable to any bank, public financial institution or any other financial institution;

(d) the company is in default in payment of any dues towards income tax, VAT, excise duty, service tax or any other tax or duty, by whatever name called, payable to the Central Government or any State Government, statutory authority or local authority (other than in cases where the company has disputed the liability to pay such dues);

(e) there are outstanding statutory dues to the employees or workmen of the company which have not been paid by the company (other than in cases where the company has disputed the liability to pay such dues); and

(f) the company has not paid dividend on preference shares or not redeemed preference shares on due date.

(iv) **Payment proposal cannot be taken as approved if no quorum present [Section 191 (3)]:** If the payment is not approved for want of quorum either in a meeting or an adjourned meeting, the proposal shall not be deemed to have been approved.

(v) **Receipt of payment in contravention of Section 191 (1) [Section 191 (3)]:** In case a director of a company receives payment of any amount in contravention of Section 191 (1) or the proposed payment is made before it is approved in the meeting, the amount so received by the director shall be deemed to have been received by him in trust for the company.

In other words, the director shall not own such amount but keep it as trustee of the company.

[28](vi) **Penalty for non-compliance [Section 191 (5)]:** If a director of the company makes any default in complying with the provisions of Section 191, he shall be liable to a penalty of **one lakh rupees.**

(vii) **No effect on disclosures [Section 191 (6)]:** Section 191 shall not be taken to prejudice the operation of any law requiring disclosure to be made with respect to any payment received under Section 191 or such other like payments made to a director. In other words, if required by any law, the disclosures regarding any payment of compensation shall be made.

Note: Due to the notifying of Section 247 (1) *w.e.f.* 18-10-2017, the valuation of stocks, shares, debentures, securities, etc. will be conducted by a Registered Valuer as appointed by the Audit Committee or in its absence by the Board of Directors. Before this, it was being conducted by an independent merchant banker registered with SEBI or an independent chartered accountant in practice having a minimum experience of ten years.

21. RESTRICTION ON NON-CASH TRANSACTIONS INVOLVING DIRECTORS [SECTION 192]

Section 192 of the Act places restrictions on the non-cash transactions involving directors and the company or *vice-versa*. The provisions of Section 192 also operate if non-cash transactions involve

[28] Substituted by the Companies (Amendment) Act, 2019, w.r.e.f. **2-11-2018**.

a person who is a director of the company's holding, subsidiary or [29]associate company. A person connected with any such director is also included. These provisions are discussed as under:

(i) **Restriction on acquiring assets for consideration other than cash:** According to Section 192 (1), no company shall enter into an arrangement by which—

(a) **a director of the company or its holding, subsidiary or associate company or a person connected with him acquires** or is to acquire assets for consideration other than cash, from the company; or

(b) **the company acquires** or is to acquire assets for consideration other than cash, from such director or person so connected.

(ii) **Relaxation of restriction:** The above restriction shall be relaxed *i.e.* the company may enter into an arrangement involving non-cash transactions as stated in clause (i) above, if prior approval for such arrangement is accorded by a resolution of the company in general meeting.

Where the director or connected person is a director of its holding company, approval shall also be required to be obtained by passing a resolution in general meeting of the holding company.

(iii) **Contents of notice issued for approval of resolution:** The notice for approval of the resolution in general meeting issued by the company or holding company shall include the particulars of the arrangement. It shall also include the value of the assets involved in such arrangement duly calculated by a registered valuer.

(iv) **What happens if Section 192 is contravened:** Any arrangement entered into by a company or its holding company in contravention of the provisions of Section 192 shall be voidable at the instance of the company. The arrangement shall not be voidable;

(a) if the restitution of any money or other consideration which is the subject-matter of the arrangement is no longer possible and the company has been indemnified by any other person for any loss or damage caused to it; or

(b) if any rights are acquired *bona fide* for value and without notice of the contravention of the provisions of this section (*i.e.* Section 192) by any other person.

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[29] An associate company is defined by Section 2 (6) of the Act. Accordingly, an '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 20% 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.

22. CONTRACTS BY ONE PERSON COMPANY (OPC) [SECTION 193]

Section 193 of Act contains provisions in respect of contracts entered into by a One Person Company (OPC) which is limited by shares or by guarantee. This section becomes applicable when such OPC enters into a contract with its sole member who is also its director. Section 193 operates in the following manner:

(i) Preferably, such contract should be in writing.

(ii) If not in writing, the OPC shall ensure that the terms of the contract or offer are contained in a memorandum or are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract.

(iii) ***Exception:*** If the contracts are entered into by the company in the ordinary course of its business then provisions of Section 193 are not applicable.

(iv) ***Submission of information to the registrar:*** The company shall inform the Registrar about every such contract entered into by the company and recorded in the minutes of the meeting of its Board of Directors. This shall be done within a period of 15 days of the date of approval by the Board.

TEST YOUR KNOWLEDGE

Multiple Choice Questions (MCQs)

1. The provision regarding conducting of four Board meetings every year is not applicable to:
   (a) One Person Company (OPC), small company and dormant company
   (b) One Person Company (OPC), dormant company and associate company
   (c) Small company and dormant company
   (d) One Person Company (OPC) and small company
2. One of the matters which cannot be dealt with in a board meeting conducted through electronic mode is:
   (a) Making political contributions
   (b) Approval of the Board's report
   (c) Appointing a Key Managerial Personnel
   (d) None of the above
3. A Board resolution cannot be passed by circulation when at least ---------- of the total members require it to be decided at a meeting of the Board.
   (a) 1/2
   (b) 1/3
   (c) 1/4
   (d) 1/5
4. A Board meeting needs to be called by at least ---------- days' notice in writing sent to all the directors at their addresses registered with the company.
   (a) 7
   (b) 5
   (c) 3
   (d) None of the above
5. CK Limited was incorporated on 25th June, 2018. When can it make political contributions?
   (a) After one year from the date of its incorporation.
   (b) After two years from the date of its incorporation.

(c) After three years from the date of its incorporation.

(d) After five years from the date of its incorporation.

6. A company having minimum turnover of ₹ ---------- crores is required to constitute a Nomination and Remuneration Committee.

(a) 25

(b) 50

(c) 100

(d) 200

7. Where at any time the number of interested directors exceeds or is equal to --------- of the total strength of the Board of Directors, the quorum shall be the number of non-interested directors who are present at the meeting and not less than two.

(a) 1/2

(b) 2/3

(c) 1/3

(d) None of the above

8. In case of a company where minimum ---------- per cent members (in number) are relatives of promoters or are related parties, they are not precluded from voting on a resolution for approving any related party transaction.

(a) 80

(b) 85

(c) 90

(d) 95

9. Under normal circumstances, a company is not permitted to make investment through more than ---------- layer(s) of investment companies.

(a) One

(b) Two

(c) Three

(d) Four

10. The Board of Directors can exercise its powers by means of resolution, passed at a meeting only and by no other means, to transact which of the following businesses:

(a) Authorising buy back of securities

(b) Taking note of the disclosures of director's interest and shareholding

(c) Reviewing or changing the terms and conditions of public deposits

(d) None of the above

11. Out of the total strength of six directors of SQ Ltd, five are attending a Board meeting to consider the investment of funds of the company. The resolution relating to investment shall be taken as passed in which of the following cases:

(a) When all the five directors attending the meeting consent to it

(b) When any four directors out of five consent to it

(c) When any three directors out of five consent to it

(d) Investment proposal must be consented to by the total strength of directors (six directors in this case)

12. In case of a Board meeting which is conducted through the means of video conferencing, the draft minutes shall be circulated among all the directors within ----------days of the meeting either in writing or in electronic mode as may be decided by the Board.

(a) 5

(b) 10

(c) 15

(d) 20

13. Audit Committee may make omnibus approval for:

(a) Making of investment in other companies

(b) Related party transactions proposed to be entered into by the company

(c) Transferring of non-functional undertaking

(d) All of the above

14. In case a company enters into a transaction with a related party in the ordinary course of business on an arm's length basis, which authority specifically needs to approve such transaction:

(a) Board of Directors

(b) Company by passing an ordinary resolution

(c) Company by passing a special resolution

(d) None of the above

15. Which of the following points is not related to omnibus approval to be made by an Audit Committee:

(a) Audit Committee shall consider repetitiveness of the transactions (in past or in future);

(b) The indicative base price or current contracted price and the formula for variation in the price,

(c) Omnibus approval shall be valid for a period not exceeding two financial years and shall require fresh approval after the expiry of such financial year.

(d) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

16. In case of transfer of whole of its undertaking by a company, no compensation is payable to the directors for loss of office if:

(a) the company has failed to appoint additional director

(b) the company has failed to pay dividend on preference shares

(c) the company has failed to appoint all the directors as prescribed by its articles

(d) None of the above

Descriptive Questions

Question 1

(i) What is the procedure to be followed, when a board meeting is adjourned for want of quorum?

(ii) How is a resolution by circulation passed by the Board or its Committee.

Question 2

Mr. P and Mr. Q who are the directors of C-Tech Limited informed the company about their inability to attend the Board meeting because the notice thereof was not served on them. Discuss whether there is any default on the part of C-Tech Limited and the consequences thereof.

Question 3

A director goes abroad for a period of more than 3 months and an alternate director has been appointed in his place under Section 161(2). During the period of absence of the original director, a board meeting was called. In this connection, with reference to the provisions of the Companies Act, 2013, advise who should be given the notice of Board meeting i.e. the "original director" or the "alternate director"?

Question 4

Examine with reference to the provisions of the Companies Act, 2013 whether notice of a Board Meeting is required to be sent to the following persons:

(i) *An interested Director;*

(ii) *A Director who has expressed his inability to attend a particular Board Meeting;*

(iii) *A Director who has gone abroad (for less than 3 months).*

Question 5

Out of the powers exercisable by the Board under Section 179 of the Companies Act, 2013, the Board of MN Limited wants to delegate the power to borrow monies otherwise than on debentures to the Managing Director. Advise whether such a delegation is possible? Would your answer be different, if the delegation is made to the manager or any other principal officer including a branch officer of the company?

Question 6

Advise the Board of Director of Spectra Papers Ltd. regarding validity and extent of its powers, under the provisions of the Companies Act, 2013 in relation to the following matters:

(i) *Buy-back, for the first time, the shares of the Company up to 10% of the paid-up equity share capital without passing a special resolution.*

(ii) *Delegation of power to the Managing Director so that he can invest surplus funds of the company in the shares of some other companies.*

Question 7

An Audit Committee of a listed company constituted under Section 177 of the Companies Act, 2013, submitted its report containing the recommendations in respect of certain matters to the Board. The Board, however, did not accept the recommendations. In the light of the situation, analyze whether:

(a) *The Board is empowered not to accept the recommendations of the Audit Committee.*

(b) *If so, what alternative course of action, would the Board resort to?*

Question 8

MNC Ltd., a company, whose paid up capital was ₹ 8.00 Crores, has issued right shares in the ratio of 1:1. The said company is listed with Mumbai Stock Exchange. Whether the company is required to appoint any Audit Committee and if yes, draft a suitable Board Resolution to appoint an Audit committee covering the aspects as provided in the Companies Act, 2013.

Question 9

The Balance Sheets of last three years of PTL Ltd., contain the following information and figures:

	As at 31.03.2017 ₹	As at 31.03.2018 ₹	As at 31.03.2019 ₹
Paid up capital	50,00,000	50,00,000	75,00,000
General Reserve	40,00,000	42,50,000	50,00,000

Credit Balance in Profit & Loss Account	*5,00,000*	*7,50,000*	*10,00,000*
Debenture Redemption Reserve	*15,00,000*	*20,00,000*	*25,00,000*
Securities Premium	*2,00,000*	*2,00,000*	*2,00,000*
Secured Loans	*10,00,000*	*15,00,000*	*30,00,000*

On going through other records of the Company, the following is also determined:

Net Profit for the year (as calculated in accordance with the provisions of the Companies Act, 2013)	*12,50,000*	*19,00,000*	*34,50,000*

In the ensuing Board Meeting scheduled to be held on 5th September, 2019, among other items of agenda, following items are also appearing:

(i) To decide about borrowing from Financial institutions on long-term basis.

(ii) To decide about contributions to be made to Charitable funds.

Based on above information, you are required to find out as per the provisions of the Companies Act, 2013, the amount up to which the Board can borrow from Financial institution and the amount up to which the Board of Directors can contribute to Charitable funds during the financial year 2019-20 without seeking the approval in general meeting.

Question 10

Following data relates to Prince Company Limited:

Authorised Capital (Equity Shares)	*₹ 100 crores*
Paid – up Share Capital	*₹ 40 crores*
General Reserves	*₹ 20 crores*
Debenture Redemption Reserve	*₹ 10 crores*
Provision for Taxation	*₹ 5 crores*
Securities premium	*₹ 2 crores*
Loan (Long Term)	*₹ 10 crores*
Short Term Creditors	*₹ 3 crores*

Board of Directors of the company by a resolution passed at its meeting decided to borrow an additional sum of ₹ 90 crores from the company's Bankers. Being the company's financial advisor, you are required to advise the Board of Directors regarding the procedure to be followed in this respect under the Companies Act, 2013.

Question 11

One of the Objects Clauses of the Memorandum of Association of Info Company Limited conferred upon the company power to sell its undertaking to another company with identical objects. Company's Articles also conferred upon the directors whereby power was conferred upon them to sell or otherwise deal with the property of the company. At an Extraordinary General Meeting of the company, members passed an ordinary resolution for the sale of its assets on certain terms and authorized the directors to carry out the sale. Directors refused to comply with the wishes of the members whereupon it was contended on behalf of the members that they were the principals and directors being their agents, were bound to give effect to their (members') decisions.

Examining the provisions of the Companies Act, 2013, answer the following:

Whether the contention of members against the non-compliance of members' decision by the directors is tenable?

Whether it is possible for the members to usurp the powers which by the Articles are vested in the directors by passing a resolution in the general meeting?

Question 12

(i) R Ltd. wants to constitute an Audit Committee. Draft a board resolution covering the following matters [compliance with Companies Act, 2013 to be ensured].

(1) Members of the Audit Committee

(2) Chairman of the Audit Committee

(3) Any 2 functions of the said Committee

(ii) What would be the minimum likely turnover or capital of this company?

(iii) What is the role of the Audit Committee vis-a-vis *the statutory auditor when the company wishes to engage them to perform certain engagements which are not restricted under Section 144?*

ANSWER/SOLUTION

Answer to MCQs

1. (a) **Hint:** Section 173(5) of the Companies Act, 2013

2. (b) **Hint:** Section 173(2) of the Companies Act, 2013 along with Rule 3 of the Companies (Meetings of Board and its powers) Rules, 2014

3. (b) **Hint:** Proviso to section 175(1) of the Companies Act, 2013

4. (a) **Hint:** Section 173(3) of the Companies Act, 2013

5. (c) **Hint:** Section 182 of the Companies Act, 2013

6. **(c)** **Hint:** Section 178(1) of the Companies Act, 2013

7. **(b)** **Hint:** Section 174(3) of the Companies Act, 2013

8. **(c)** **Hint**: Section 188 of the Companies Act, 2013

9. **(b)** **Hint:** Section 186 of the Companies Act, 2013

10. **(a)** **Hint**: Section 179(3) of the Companies Act, 2013

11. **(a)** **Hint**: Section 186(5) of the Companies Act, 2013

12. **(c)** **Hint**: Rule 3 of the Companies (Meetings of Board and its powers) Rules, 2014

13. **(b)** **Hint**: Section 177(4) of the Companies Act, 2013

14. **(d)** **Hint:** Fourth proviso to section 188(1) of the Companies Act, 2013

15. **(c)** **Hint:** Rule 6A of the Companies (Meetings of Board and its powers) Rules, 2014

16. **(b)** **Hint:** Rule 17 of the Companies (Meetings of Board and its powers) Rules, 2014

Answer to Descriptive Questions

1. **(i)** Section 174(4) of the Companies Act, 2013 provides that, if a Board meeting could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned to the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a national holiday, at the same time and place.

(ii) (a) The Companies Act, 2013 permits a decision of the Board of Directors to be taken by means of a resolution by circulation. Board's approvals can be taken in two ways - one, by a resolution passed at a Board Meeting and the other, by means of a resolution passed by circulation.

In terms of Section 175(1) of the Companies Act, 2013 no resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation, unless the following provisions have been complied with:

(1) the resolution has been circulated in draft, together with the necessary papers, if any,

(2) the draft resolution has been circulated to all the directors, or members of the committee, as the case may be;

(3) the Draft resolution has been sent at their addresses registered with the company in India;

(4) such delivery has been made by hand or by post or by courier, or through prescribed electronic means;

Rule 5 of the *Companies (Meetings of Board and its Powers) Rules, 2014* provides that a resolution in draft form may be circulated to the directors together with the necessary papers for seeking their approval, by electronic means which may include E-mail or fax.

(5) such resolution has been approved by a majority of the directors or members, who are entitled to vote on the resolution;

(b) However, if at least 1/3rd of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the Chairperson shall put the resolution to be decided at a meeting of the Board (instead of being decided by circulation).

(c) A resolution that has been passed by circulation shall have to be necessarily noted in the next meeting of Board or the Committee, as the case may be, and made part of the minutes of such meeting.

2. Under section 173(3) of the Companies Act, 2013 a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Section 173(4) further provides that every officer of the company whose duty is to give notice under this section and who fails to do so shall be liable to a penalty of ₹ 25,000.

In the given case, as no notice was served on Mr. P and Mr. Q who are the directors of C-Tech Limited, every officer responsible for such default in serving notice shall be punishable with fine of ₹ 25,000 as required by Section 173 (4).

Neither the Companies Act, 2013 nor *the Companies (Meetings of the Board and its Powers) Rules, 2014* lay down any specific provision regarding the validity of a resolution passed by the Board of Directors in case notice was not served to all the directors. We shall have to go by the provisions of the Companies Act, 2013 which clearly provide for the notice to be sent to every director. The Supreme Court, in case of *Parmeshwari Prasad vs. Union of India (1974)* has held that the resolutions passed in the board meeting shall not be valid, since notice to all the Directors was not given in writing. Hence, even though the directors concerned knew about the Board meeting, the meeting shall not be valid and resolutions passed thereat also shall not be valid.

3. According to Section 161(2) of the Companies Act, 2013, the Board of Directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company, to act as an alternate director for a director during his absence for a period of not less than three months from India.

According to Section 173(3), a meeting of the Board may be called by giving at least 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

There is no legal precedence whether the notice of the meeting is to be sent to the original director or the alternate director. But as a matter of prudence such notice may be served to both the alternate director as well as the original director who is for the time being outside India.

4. Notice of Board meeting

(i) **Interested director:** Section 173(3) of the Companies Act, 2013 makes it mandatory that every director needs to be given proper notice of every board meeting. It is immaterial whether a director is interested or not. In case of an interested director, notice must be given to him even though in terms of Section 184 (2) he is precluded from participation *i.e.* engaging himself in discussion or voting at the meeting on the business in which he is interested.

(ii) **A Director who has expressed his inability to attend a particular Board Meeting:** In terms of section 173(3) even if a director states that he will not be able to attend the next Board meeting, notice must be given to that director also.

(iii) **A director who has gone abroad**: A director who has gone abroad is still a director. Therefore, he is entitled to receive notice of board meetings during his stay abroad. The Companies Act, 2013, allows delivery of notice of meeting by electronic means also i.e. through e-mail. This factor carries weight because the Companies Act, 2013 permits a director to participate in a meeting by video conferencing or any other audio-visual means also, in addition to physical presence.

5. Under section 179(3) of the Companies Act, 2013, the Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board:

(a) To make calls on shareholders in respect of money unpaid on their shares;

(b) To authorise buy-back of securities under section 68;

(c) To issue securities, including debentures, whether in or outside India;

(d) To borrow monies;

(e) To invest the funds of the company;

(f) To grant loans or give guarantee or provide security in respect of loans;

(g) To approve financial statement and the Board's report;

(h) To diversify the business of the company;

(i) To approve amalgamation, merger or reconstruction;

(j) To take over a company or acquire a controlling or substantial stake in another company;

(k) Any other matter which may be prescribed.

Provided that the Board may, by a resolution passed at a meeting, delegate to any Committee of Directors, the Managing Director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in clauses (d) to (f) on such conditions as it may specify.

In respect of a company covered under Section 8 of the Companies Act, 2013, which has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar, the matters referred to in clauses (d), (e), and (f) of Section 179 (3) may be decided by the Board by circulation instead of at a meeting. This modification is permitted by Notification No. GSR 466 (E), dated 5thJune, 2015 as amended by Notification No. GSR 584 (E), dated 13thJune, 2017.

From the foregoing provisions, it is clear that the Board of MN Limited shall be perfectly in order if it delegates the power to borrow monies under clause (d) of Section 173 (3) to the Managing Director or to the manager or any other principal officer.

6. **(i)** According to clause (b) of Section 179(3), The Board of Directors of a company shall exercise the power to authorise buy-back of securities under section 68, on behalf of the company by means of resolutions passed at meetings of the Board.

According to Section 68(2), no company shall purchase its own shares or other specified securities, unless—

(a) the buy-back is authorised by its articles;

(b) a special resolution has been passed at a general meeting of the company authorising the buy-back:

However, nothing contained in this clause shall apply to a case where—

(1) the buy-back is, 10% or less of the total paid-up equity capital and free reserves of the company; and

(2) such buy-back has been authorised by the Board by means of a resolution passed at its meeting,

From the foregoing provisions, it is clear that in case a company, for the first time, resorts to buy-back of its own shares, when the buy-back is limited to 10% of its paid-up share capital, a special resolution will not be required if such buy-back has been authorised by the Board by means of a resolution passed at its meeting. Thus, the Board of Director of Spectra Papers Ltd. is empowered to buy-back the shares

because the buy-back is limited to 10% of the paid-up share capital, by means of a resolution passed at the Board meeting.

(ii) According to clause (e) of Section 179(3), the Board of Directors of a company shall exercise the power to invest the funds of the company, on behalf of the company by means of resolutions passed at the meetings of the Board.

The Board may, under the Proviso to Section 179(3), delegate the power to invest the funds of the company through a board resolution passed at a duly convened Board Meeting. However, the investment in shares of other companies will also be governed by a specific provision contained in Section 186(5), according which no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

Thus, a unanimous resolution of the Board is required. Further, Section 186 does not provide for delegation. Hence, the proposed delegation of power to the Managing Director to invest surplus funds of the company in the shares of some other companies, is not in order.

7. **(a)** According to Section 177(8) of the Companies Act, 2013, the Board's Report shall, under the provisions of Section 134 (3) which is laid before the general meeting where the financial statements of the company are placed before the members, disclose the composition of the Audit Committee and where the Board has not accepted any recommendations of the Audit Committee, the same shall also be disclosed along with the reasons therefor. Hence, the Board is empowered not to accept the recommendations of the Audit Committee but only under genuine circumstances and supported by legitimate reasons for non-acceptance.

(b) If the Board does not accept the recommendations of the Audit Committee, it shall disclose the same in its report under section 134 (3) which is placed before the general meeting of the company.

8. Under section 177(1) of the Companies Act, 2013 the Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee. Therefore, MNC Ltd being a listed company will be bound to constitute an audit committee under the Act.

Further under section 177(2) the Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.

Further, majority of the members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.

The draft Board Resolution for the constitution of an Audit Committee may be as follows:

"Resolved that pursuant to the provision contained in section 177 of the Companies Act 2013 and the applicable clause of Listing Agreement with the Mumbai Stock Exchange, an Audit Committee of the Company be and is hereby constituted with effect from the conclusion of this meeting, with members as under:

1. Mr. A -- An Independent Director.
2. Mr. B -- An Independent Director
3. Mr. C – An Independent Director
4. Mr. D -- An Independent Director
5. Mr. FE -- Financial Executive
6. Mr. MD -- Managing Director

Further resolved that the Chairman of the Committee, who shall be an Independent Director, be elected by the committee members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit Committee shall be the chairman of the Audit Committee and 2 other members (other than the Managing Director),.

Further resolved that the terms of reference of the Audit Committee shall be in accordance with the provisions of section 177(4) of the Companies Act, 2013.

Further resolved that the Audit committee shall conduct discussions with the auditors periodically about internal control system, the scope of audit including the observations of the auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations, if any.

Further resolved that the recommendations made by the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board. However, where such recommendations are not accepted by the Board, the reasons for the same shall be recorded in the minutes of the Board meeting and communicated to the shareholders.

Further resolved that the Company Secretary of the Company shall be the Secretary to the Audit Committee.

Further resolved that the Chairman of the Audit Committee shall attend the annual general meeting of the Company to provide any clarifications on matters relating to audit as may be required by the members of the company.

Further resolved that the Board's Report/Annual Report to the members of the Company shall include the particulars of the constitution of the Audit Committee and the details of the non-acceptance of any recommendations of the Audit Committee with reasons therefor."

9. (i) **Borrowing from Financial Institutions:** As per Section 180(1)(c) of the Companies Act, 2013, the Board of Directors of a company, without obtaining the approval of shareholders in a general meeting, can borrow money including moneys already borrowed up to an amount which does not exceed the aggregate of paid up capital of the company, free reserves and securities premium. Such borrowing shall not include temporary loans obtained from the company's bankers in the ordinary course of business. Here, free reserves do not include the reserves set apart for specific purpose.

Since the decision to borrow is to be taken in a meeting to be held on 5th September, 2019, the figures relevant for this purpose are the figures as per the Balance Sheet as at 31.03.2019. According to the above provisions, the Board of Directors of PTL Ltd. can borrow, without obtaining approval of the shareholders in a general meeting, up to an amount calculated as follows:

Particulars	₹
Paid up Capital	75,00,000
General Reserve (being free reserve)	50,00,000
Credit Balance in Profit & Loss Account (to be treated as free reserve)	10,00,000
Debenture Redemption Reserve (This reserve is not to be considered since it is kept apart for specific purpose of debenture redemption)	----
Securities Premium	2,00,000
Aggregate of paid-up capital, free reserves and securities premium	137,00,000
Total borrowing power of the Board of Directors of the company, i.e, 100% of the aggregate of paid-up capital, free reserves and securities premium	137,00,000
Less: Amount already borrowed as secured loans	30,00,000
Amount up to which the Board of Directors can further borrow without the approval of shareholders in a general meeting.	107,00,000

(ii) **Contribution to Charitable Funds:** As per Section 181 of the Companies Act, 2013, the Board of Directors of a company without obtaining the approval of shareholders in a general meeting, can make contributions to genuine charitable and other funds up to an amount which, in a financial year, does not exceed five per cent of its average net profits during the three financial years immediately preceding, the financial year.

According to the above provisions, the Board of Directors of the PTL Ltd. can make contributions to charitable funds, without obtaining approval of the shareholders in a general meeting, up to an amount calculated as follows:

Net Profit for the year (as calculated in accordance with the provisions of the Companies Act, 2013):

Particulars	₹
For the financial year ended 31.3.2017	12,50,000
For the financial year ended 31.3.2018	19,00,000
For the financial year ended 31.3.2019	34,50,000
TOTAL	66,00,000
Average of net profits during three preceding financial years	22,00,000
Five per cent thereof	1,10,000

Hence, the maximum amount that can be donated by the Board of Directors of PTL Ltd to a genuine charitable fund during the financial year 2019 -20 will be limited to ₹ 1,10,000; and the said donation shall not require seeking of approval from the shareholders at a general meeting.

10. **Borrowing by the Company (Section 180 of the Companies Act, 2013):** As per Section 180(1)(c) of the Companies Act, 2013, the Board of Directors of a company, without obtaining the approval of shareholders in a general meeting through a special resolution, can borrow the funds including funds already borrowed up to an amount which does not exceed the aggregate of the paid-up share capital, free reserves and securities premium. Such borrowing shall not include temporary loans obtained from the company's bankers in ordinary course of business.

Free reserves do not include the reserves set apart for specific purpose.

According to the above provisions, the Board of Directors of Prince Company Limited can borrow, without obtaining approval of the shareholders in a general meeting, up to an amount calculated as follows:

Particulars	₹
Paid up Share Capital	40 Crores
General Reserve (being free reserve)	20 Crores
Debenture Redemption Reserve (This reserve is not to be considered since it is kept apart for specific purpose of debenture redemption)	----
Securities Premium	2 Crores
Aggregate of paid-up share capital, free reserve and securities premium	62 Crores
Total borrowing power of the Board of Directors of the company, *i.e,* 100% of the aggregate of paid-up share capital, free reserves and securities premium	62 Crores

(Less: Amount already borrowed as Long term loan)	(10 Crores)
Amount up to which the Board of Directors can further borrow without the approval of shareholders in a general meeting.	52 Crores

In the present case, the directors of Prince Company Limited by a resolution passed at its meeting have decided to borrow an additional sum of ₹ 90 Crores from the company's bankers. Apparently, the proposed borrowing will be beyond the powers of the Board of Directors.

The management of Prince Company Limited, therefore, should take steps to convene the general meeting and pass a special resolution by the members in the meeting as stated in Section 180(1)(c) of the Companies Act, 2013. Then only, the proposed borrowing of ₹ 90 crores will be valid and binding on the company and its members.

[**Note:** In case of private companies which have not committed a default in filing their financial statements under Section 137 or Annual Return under Section 92 with the Registrar, Section 180 shall not apply vide Notification No. G.S.R. 464(E), dated 5th June 2015]

11. **Powers of Board:** In accordance with the provisions of the Companies Act, 2013, as contained under Section 179(1), the Board of Directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorized to exercise and do:

Provided that in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder including regulations made by the company in general meeting.

Provided further that the Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the members or articles of the company or otherwise to be exercised or done by the company in general meeting.

Section 180 (1) of the Companies Act, 2013, specifies the powers which the Board of Directors of a company shall exercise only with the consent of the company by a special resolution. Clause (a) of Section 180 (1) defines one such power as the power to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking of the whole or substantially the whole or any of such undertakings.

Therefore, the sale of the undertaking of a company can be made by the Board of Directors only with the consent of members of the company accorded by passing a special resolution.

Even if the power is given to the Board by the memorandum and articles of the company, the sale of the undertaking must be approved by the shareholders in general meeting by passing a special resolution.

Therefore, the correct procedure to be followed is for the Board to approve the sale of the undertaking clearly specifying the terms of such sale and then convene a general meeting of members to have the proposal approved by a special resolution.

In the given case, the procedure followed is completely incorrect and violative of the provisions of the Companies Act, 2013. The shareholders cannot on their own make out a proposal of sale and pass an ordinary resolution to implement it through the directors.

The contention of the shareholders is incorrect in the first place as it is not within their authority to approve a proposal independent of the Board of Directors. It is for the Board to approve a proposal of sale of the undertaking and then let the members to approve it by a special resolution. Accordingly, the contention of the members that they were the principals and the directors as their agents were bound to give effect to the decisions of the members is not correct.

Further, in exercising their powers the directors do not act as agent for the majority of members or even for all the members. The members therefore, cannot by resolution passed by a majority or even unanimously supersede the powers of directors or instruct them how they shall exercise their powers. The shareholders have, however, the power to alter the Articles of Association of the company in the manner they like subject to the provisions of the Companies Act, 2013.

12. (i) Audit Committee – Board's Resolution:

"Resolved that pursuant to Section 177 of the Companies Act, 2013, an Audit Committee consisting of the following Directors be and is hereby constituted.

1. Mr. ---- Independent Director
2. Mr. ---- Independent Director
3. Mr. ----Independent Director
4. Mr. ---- Independent Director
5. Mr. ---- Managing Director.
6. Mr. ---- Chief Financial Officer"

"Further resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves and shall be an independent director".

"Further resolved that the quorum for a meeting of the Audit committee shall be three directors (other than the Managing Director), out of which at least two must be independent directors".

"Resolved further that the Audit Committee shall perform all the functions as laid down in section 177(4) of the Companies Act, 2013 including but not limited to:

a. make the recommendation for appointment, remuneration and terms of appointment of the auditors of the company;

b. review and monitor the independence and performance of auditors of the company and the effectiveness of the audit process".

"Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations if any".

(ii) Rule 6 of the *Companies (Meetings of Board and its Powers) Rules*, 2014 states that every listed public company and a company covered under Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014 shall constitute an Audit Committee. Rule 4 has prescribed the following classes of companies to constitute an Audit Committee:

(a) public companies having a paid-up share capital of 10 crore rupees or more;

(b) public companies having turnover of 100 crore rupees or more;

(c) public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

Hence, in the given case, the likely turnover of R Ltd. shall be ₹ 100 crore or more or capital shall be ₹ 10 crore or more.

(iii) According to section 177(5), the Audit Committee is empowered to:

(1) call for the comments of the auditors about:

(A) internal control systems,

(B) the scope of audit, including the observations of the auditors,

(C) review of financial statement before their submission to the Board,

(2) discuss any related issues with the internal and statutory auditors and the management of the company.

CHAPTER 4

INSPECTION, INQUIRY AND INVESTIGATION

LEARNING OUTCOMES

At the end of this Chapter, you will be able to understand provisions relating to:

- Inspection, Inquiry and Investigation
- Powers of registrars, inspectors and Central Government
- Establishment of Serious Frauds Investigation Office and its objectives
- Duties of directors and other employees during inspection, inquiry and investigation
- Inspection Report and action to be taken on it.
- Punishment for contravention or non-compliance based on Inspection Report.

1. INTRODUCTION

It became imperative for the Central Government to assume certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Chapter XIV contains Sections 206 to 229 of the Companies Act, 2013; deals with the provisions relating to Inspection, Inquiry and Investigation into the affairs of company.

POWERS GIVEN UNDER COMPANIES ACT, 2013

Authorities	Powers
Registrar under sections 206, 207, 208 & 209	Call for information, inspection of books of account, books, papers and explanations and order for inquiry in section 206, submission of inspection report in 208, Search and seizure in 209, Shall have all the powers as are vested in a civil court in section 207.
Inspector under sections 206, 207, 208, 209 & 216	call for the books of account and other books and papers under section 206, make an inspection or inquiry under section 206, Shall have all the powers as are vested in a civil court in section 207, submit inspection report in section 208, Search and seizure of documents in 209, To investigate on matters relating to company and its membership for determining ownership of company in section 216.
Central Government under sections 206, 210, 211, 212, 216 & 224	May authorize any statutory authority to carry out the Inspection of books of accounts of company in 206, Investigate into affairs of company in 210, Appointment of inspectors to investigate into affairs of the company and to report there on in section 210, Establishment of SFIO in 211, Assignment the investigation into the affairs of company by SFIO in section 212, Appointment of inspector to investigate on matters relating to company and its membership for determining ownership of company in section 216, Actions may be taken in pursuance of inspector's report in section 224
Regional director in section 206	Appoint inspector for inspection of books and papers of company in section 206
Tribunal under section 213, 221, 222	Pass an order for investigation into company's affairs in other cases under section 213, for freezing of assets of company on inquiry and investigation in section 221, for imposing restrictions upon securities in section 222.

2. POWER TO CALL FOR INFORMATION, INSPECT BOOKS AND CONDUCT INQUIRIES (SECTION 206 OF THE COMPANIES ACT, 2013)

Section 206 of the Companies Act, 2013 provides for the power to call for information, inspect books and conduct inquiries.

Concerned authorities	In the given circumstances	Have following Powers
Registrar under section 206 (1)	On a scrutiny of any document filed by a company or on any information received by him, the Registrar is of the opinion that any further information or explanation or any further documents relating to the company is necessary	may by a written notice require the company— (a) to furnish in writing such information or explanation; or (b) to produce such documents,
Registrar under section 206 (3)	(a) If no information or explanation is furnished, or (b) If on an examination of the documents furnished, he is of the opinion that the information or explanation furnished is inadequate; or (c) If he is satisfied on a scrutiny of the documents furnished that an unsatisfactory state of affairs exists in the company and the information or documents do not disclose a full and fair statement of the information required.	may by another written notice call on the company to produce for his inspection such further books of account, books, papers and explanations as he may required.
Registrar under section 206(4)	(1) on the basis of information available with or furnished to him; or (2) on a representation made to him by any person that the business of a company is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of this Act; or (3) the grievances of investors are not being addressed,	may call on the company to furnish in writing any information or explanation on matters specified in the order and carry out such inquiry

Central Government [Section 206 (6)]	if is satisfied that the circumstances so warrant [Section 206 (5)]	direct inspection of books and papers of a company by an inspector appointed by it for the purpose
Central Government [Section 206 (6)]	having regard to the circumstances	by general or special order, authorise any statutory authority to carry out the inspection of books of account of a company or class of companies [Section 206 (6)].

According to this section:

(i) **Power of the Registrar to call for information, explanation or documents:** According to section 206(1) of the Companies Act, 2013, where on a scrutiny of any document filed by a company or on any information received by him, the Registrar is of the opinion that any further information or explanation or any further documents relating to the company is necessary, he may by a written notice require the company—

(a) to furnish in writing such information or explanation; or

(b) to produce such documents,

within such reasonable time, as may be specified in the notice.

(ii) **Duty of the company and its officers:** On the receipt of a notice under sub-section (1) of section 206, it shall be the duty of the company and of its officers concerned to furnish such information or explanation to the best of their knowledge and power and to produce the documents to the Registrar within the time specified or extended by the Registrar [Section 206 (2)].

Duty of past officers of the company: According to the proviso to sub-section (2) of section 206, where such information or explanation relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on them in writing, shall also furnish such information or explanation to the best of their knowledge.

(iii) **Additional written notice by the Registrar [Section 206 (3)]:** The Registrar may by another written notice call on the company to produce for his inspection such further books of account, books, papers and explanations as he may require at such place and at such time as he may specify in the notice:

(a) If no information or explanation is furnished to the Registrar within the time specified under Section 206 (1); or

(b) If the Registrar on an examination of the documents furnished is of the opinion that the information or explanation furnished is inadequate; or

(c) If the Registrar is satisfied on a scrutiny of the documents furnished that an unsatisfactory state of affairs exists in the company and the information or documents do not disclose a full and fair statement of the information required.

Provided that, before any notice is served under this sub-section, the Registrar shall record his reasons in writing for issuing such notice.

(iv) Inquiry by the Registrar [Section 206 (4)]:

(a) The Registrar may call on the company to furnish in writing any information or explanation on matters specified in the order within such time as he may specify therein and carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard, if the Registrar is satisfied:

(1) on the basis of information available with or furnished to him; or

(2) on a representation made to him by any person that the business of a company is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of this Act; or

(3) the grievances of investors are not being addressed,

(b) Before calling the company to furnish in writing any information or explanations and carrying out inquiry, the Registrar has to inform the company of the allegations made against it by a written order.

(c) The Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar or an inspector appointed by it for the purpose to carry out the inquiry under this sub-section.

(d) It is further provided that where business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud in the manner as provided in section 447.

(v) Inspection by Central Government: Without prejudice to the foregoing provisions of this section, the Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an inspector appointed by it for the purpose [Section 206 (5)].

(vi) The Central Government may, having regard to the circumstances by general or special order, authorise any statutory authority to carry out the inspection of books of account of a company or class of companies [Section 206 (6)].

(vii) Failure to furnish information: If a company fails to furnish any information or explanation or produce any document required under this section, the company and every officer of the

company, who is in default shall be punishable with a fine which may extend to 1 lakh rupees and in the case of a continuing failure, with an additional fine which may extend to 500 rupees for every day after the first during which the failure continues [Section 206 (7)].

3. CONDUCT OF INSPECTION AND INQUIRY (SECTION 207 OF THE COMPANIES ACT, 2013)

Section 207 of the Companies Act, 2013 provides for the conduct of inspection and inquiry as follows:

(i) Duty of director, officer or employee [Sub-Section (1)]: Where a Registrar or inspector calls for the books of account and other books and papers under section 206, it shall be the duty of every director, officer or other employee of the company:

(a) to produce all such documents to the Registrar or inspector; and

(b) to furnish him with such statements, information or explanations in such form as the Registrar or inspector may require; and

(c) to render all assistance to the Registrar or inspector in connection with such inspection.

(ii) Powers of the Registrar or inspector [Sub-section (2) and (3)]**:**

(a) The Registrar of inspector making an inspection or inquiry under section 206 may, during the course of such inspection or inquiry, as the case may be,—

(1) make or cause to be made copies of books of account and other books and papers; or

(2) place or cause to be placed any marks of identification in such books in token of the inspection having been made.

(b) The Registrar or inspector making an inspection or inquiry shall have all the 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:—

(1) the discovery and production of books of account and other documents, at such place and time as may be specified by such Registrar or inspector making the inspection or inquiry;

(2) summoning and enforcing the attendance of persons and examining them on oath; and

(3) inspection of any books, registers and other documents of the company at any place.

(iii) Penalty for Contravention [sub-section (4)]: If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director

or the officer shall be punishable with imprisonment which may extend to 1 year and with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees.

If a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company.

4. REPORT ON INSPECTION MADE (SECTION 208 OF THE COMPANIES ACT, 2013)

Section 208 of the Companies Act, 2013 provides for the submission of the report on inspection made. According to this section:

The Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

5. SEARCH AND SEIZURE (SECTION 209 OF THE COMPANIES ACT, 2013)

Section 209 of the Companies Act, 2013 provides for search and seizure. According to this section:

(i) Circumstances for seizure [Sub-section (1)]: Where, upon information in his possession or otherwise, the Registrar or inspector has reasonable ground to believe that the books and papers of

(a) a company, or relating to

(b) the key managerial personnel or

(c) any director or

(d) auditor or

(e) company secretary in practice if the company has not appointed a company secretary, are likely to be destroyed, mutilated, altered, falsified or secreted,

(f) he may, after obtaining an order from the Special Court for the seizure of such books and papers,—

(1) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept; and

(2) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

(ii) Period of seizure [Sub-section (2)]:

Original period of seizure: The Registrar or inspector shall return the books and papers seized under sub-section (1), as soon as may be, and in any case not later than 180th day after such seizure, to the company from whose custody or power such books or papers were seized.

Further period of seizure: The books and papers may be called for by the Registrar or inspector for a further period of 180 days by an order in writing if they are needed again.

(iii) Taking of copies, placing identification marks [second proviso to sub-section (2)]: The Registrar or inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

(iv) Applicability of the provisions of the Code of Criminal Procedure, 1973 [Sub-section (3)]: The provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures shall apply, mutatis mutandis, to every search and seizure made under this section.

Example: A group of creditors of Mac Trading Limited makes a complaint to the Registrar of Companies, Hyderabad alleging that the management of the company is indulging in destruction and falsification of the accounting records of the company. The complainants request the Registrar to take immediate steps to seize the records of the company so that the management may not be allowed to tamper with the records. The complaint was received at 10 A.M. on 1st July 2018 and the ROC entered the premises at 10.30 A.M. for the search. Examine the powers of the Registrar to seize the books of the company.

Answer: According to the provisions, Registrar may enter and search the place where such books or papers are kept and seize them only after obtaining an order from the Special Court.

Since in the given question, Registrar entered the premises for the search and seizure of books of the company without obtaining an order from the Special Court, he is not authorised to seize the books of the Mac Trading Limited.

6. INVESTIGATION INTO AFFAIRS OF COMPANY (SECTION 210 OF THE COMPANIES ACT, 2013)

Section 210 of the Companies Act, 2013 provides for Investigation into affairs of company. According to this section:

(i) Investigation in the opinion of Central Government: Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company,—

(a) on the receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

(c) in public interest,

it may order an investigation into the affairs of the company. [Sub-section (1)]

(ii) Investigation on the order by a court or the Tribunal: Where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company [Sub-section (2)].

(iii) Appointment of inspectors: For the purposes of this section, the Central Government may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct [Sub-section (3)].

According to the *Companies (Inspection, investigation and inquiry) Rules, 2014*:

(i) The Central Government may before appointing an inspector under sub-section (3) of Section 210, require the applicant to give a security not exceeding 25,000 rupees for payment of the costs and expenses of investigation as per the criteria given in the said rule.

(ii) Further, the above referred security shall be refunded to the applicant if the investigation results in prosecution.

Example: Shareholders of Hide and Seek Ltd. are not satisfied about performance of the company. It is suspected that some activities being run in the name of the company are not in the interest of the company or its members. 101 out of total 500 share holders of the company have made an application to the Central Government to appoint an inspector to carry out investigation and find out the true picture.

With reference to the provisions of the Companies Act, 2013, mention whether the shareholders' application will be accepted? Elaborate.

Answer: The shareholders' application will not be accepted as under 210 of the Companies Act, 2013, Central Government may order an investigation into affairs of the company on the intimation of a special resolution passed by a company that the affairs of the company ought to be investigated and then may appoint the inspectors. Here, 101 out of total 500 shareholders of the company have made an application to the Central Government to appoint an inspector to carry out investigation but it is not sufficient as the company has not passed the special resolution.

7. ESTABLISHMENT OF SERIOUS FRAUD INVESTIGATION OFFICE (SECTION 211 OF THE COMPANIES ACT, 2013)

Section 211 of the Companies Act, 2013 provides for the establishment of Serious Fraud Investigation Office as under:

(i) **Setting up of Serious Fraud Investigation Office (SFIO) [Section 211 (1)]:** The Central Government shall, by notification, establish an office to be called the Serious Fraud Investigation Office to investigate frauds relating to a company.

(ii) **Continuation of earlier SFIO:** Until the SFIO as mentioned above is established, the Serious Fraud Investigation Office set-up by the Central Government in terms of the Government of India Resolution No. 45011/16/2003-Adm-I, dated 2nd July, 2003 shall be deemed to be the Serious Fraud Investigation Office for the purpose of this section.

(iii) **Composition of SFIO [Section 211 (2)]:** The SFIO shall be:

(a) Headed by a Director, and

(b) Consist of such number of experts from the following fields to be appointed by the Central Government from amongst persons of ability, integrity and experience in,—

(iv) **Appointment of Director:** The Central Government shall, by notification, appoint a Director in the SFIO, who shall be an officer not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with matters relating to corporate affairs [Section 211 (3)].

(v) **Appointment of Experts Officers & Employees:** The Central Government may appoint such experts and other officers and employees in the SFIO as it considers necessary for the efficient discharge of its functions under this Act [Section 211 (4)].

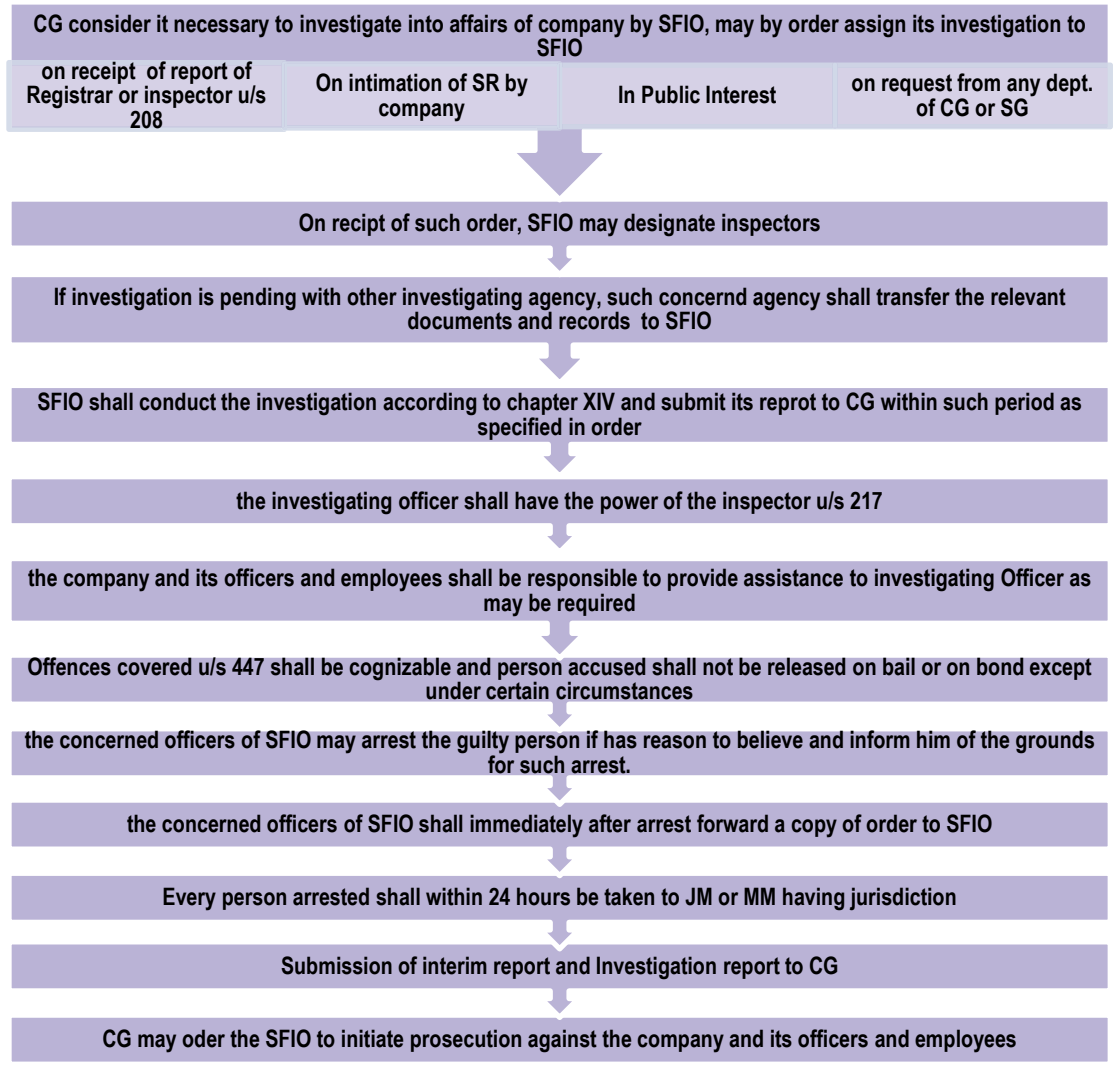
According to Rule 3 of the *Companies (Inspection, Investigation and Inquiry) Rules, 2014,* the Central Government may appoint persons having expertise in the fields of investigations, cyber forensics, financial accounting, management accounting, cost accounting and any other fields as may be necessary for the efficient discharge of Serious Fraud Investigation Office (SFIO) functions under the Act.

(vi) **Terms and conditions of service**: The terms and conditions of service of Director, experts, and other officers and employees of the SFIO shall be such as may be prescribed [Section 211 (5)].

The terms and conditions of service of the above mentioned officers have been laid down in the Rule 4 of the *Companies (Inspections, Investigations and Inquiry) Rules, 2014.*

8. INVESTIGATION INTO AFFAIRS OF COMPANY BY SERIOUS FRAUD INVESTIGATION OFFICE (SECTION 212 OF THE COMPANIES ACT, 2013)

Section 212 of the Companies Act, 2013 provides for Investigation into affairs of Company by the Serious Fraud Investigation Office (SFIO). According to this section:



(i) According to section 212(1), without prejudice to the provisions of section 210, where the Central Government -

(a) on receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that its affairs are required to be investigated;

(c) in the public interest; or

(d) on request from any Department of the Central Government or a State Government,

is of the opinion that it is necessary to investigate into the affairs of a company by the SFIO, the Central Government may, by order, assign the investigation into the affairs of the said company to the SFIO.

On receipt of such order, the Director, SFIO may designate such number of inspectors, as he may consider necessary for the purpose of such investigation.

(ii) Where any case has been assigned by the Central Government to the SFIO for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act. In case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to SFIO [Sub section (2)].

(iii) Where the investigation into the affairs of a company have been assigned by the Central Government to SIFO, it shall conduct the investigation in the manner and follow the procedure provided in this Chapter (Chapter XIV- Inspection, Inquiry and Investigation) and submit its report to the Central Government within such period as may be specified in the order [Sub section (3)]

(iv) The Director, SFIO shall cause the affairs of the company to be investigated by an Investigating Officer who shall have the power of the inspector under section 217 [Sub section (4)]

(v) The company and its officers and employees, who are or have been in employment of the company shall be responsible to provide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation [Sub section (5)]

(vi) As per sub-section (6), offences covered under section 447 of this Act shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless—

(a) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

(b) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

However, a person, who, is under the age of sixteen years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs.

Provided further that the Special Court shall not take cognizance of any offence referred in point (vi) except upon a complaint in writing made by—

(a) the Director, SFIO; or

(b) any officer of the Central Government authorised, by a general or special order in writing in this behalf by that Government.

(vii) The limitation on granting of bail specified in sub section (6) above is in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force on granting of bail [Sub section (7)].

(viii) If the Director, Additional Director or Assistant Director of SFIO authorised in this behalf by the Central Government by general or special order, has on the basis of material in his possession reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of any offence punishable under sections referred to in sub-section (6), he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest. [Sub section (8)]

(ix) The Director, Additional Director or Assistant Director of SFIO shall, immediately after arrest of such person under sub-section (8), forward a copy of the order, along with the material in his possession, referred to in that sub-section, to the SFIO in a sealed envelope, in such manner as may be prescribed and the SFIO shall keep such order and material for such period as may be prescribed. [Sub section (9)]

(x) Every person arrested under sub-section (8) shall within twenty-four hours, be taken to a Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction. The period of twenty-four hours shall exclude the time necessary for the journey from the place of arrest to the Magistrate's court. [Sub section (10)]

(xi) The SFIO shall submit an interim report to the Central Government, if the Central Government so directs [Sub section (11)].

(xii) The SFIO shall submit the investigation report to the Central Government on completion of the investigation [sub section (12)].

(xiii) Notwithstanding anything contained in this Act or in any other law for the time being in force, a copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court [Sub section (13)].

(xiv) On receipt of the investigation report, the Central Government may, after examination of the report (and after taking such legal advice, as it may think fit), direct the SFIO to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company [Sub section (14)].

(xv) Notwithstanding anything contained in this Act or in any other law for the time being in force, the investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973 [Sub section (15)].

(xvi) Notwithstanding anything contained in this Act, any investigation or other action taken or initiated by SFIO under the provisions of the Companies Act, 1956 shall continue to be proceeded with under that Act as if this Act had not been passed [Sub section (16)].

(xvii) In case SFIO has been investigating any offence under this Act, any other investigating agency, State Government, police authority, income-tax authorities having any information or documents in respect of such offence shall provide all such information or documents available with it to the SFIO [Sub section (17) (a)].

(xviii) The SFIO shall share any information or documents available with it, with any investigating agency, State Government, police authority or income tax authorities, which may be relevant or useful for such investigating agency, State Government, police authority or income-tax authorities in respect of any offence or matter being investigated or examined by it under any other law [Sub section (17) (b)].

Note: According to the *Companies (Arrests in Connection with Investigation by Serious Fraud Investigation Office) Rules, 2017* vide Notification G.S.R. 1062(E) dated 24th of August 2017, where any person has been guilty of any offence punishable under section 212 of the Act, he may be arrested as per the respective rules.

9. INVESTIGATION INTO COMPANY'S AFFAIRS IN OTHER CASES (SECTION 213 OF THE COMPANIES ACT, 2013)

Section 213 deals with the Investigation into Company's Affairs in other cases. According to this section:

Cognizance of offence by Tribunal: The Tribunal may,—

(a) on an application made by—

(i) not less than one hundred members or members holding not less than one-tenth of the total voting power, in the case of a company having a share capital; or

(ii) not less than one-fifth of the persons on the company's register of members, in the case of a company having no share capital, and supported by such evidence as may

be necessary for the purpose of showing that the applicants have good reasons for seeking an order for conducting an investigation into the affairs of the company; or

(b) **Order by tribunal:** On an application made to it by any other person or otherwise, if it is satisfied that there are circumstances suggesting that—

(i) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose;

(ii) persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or

(iii) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, or the manager, of the company,

order, after giving a reasonable opportunity of being heard to the parties concerned, that the affairs of the company ought to be investigated by an inspector or inspectors appointed by the Central Government and where such an order is passed, the Central Government shall appoint one or more competent persons as inspectors to investigate into the affairs of the company in respect of such matters and to report thereupon to it in such manner as the Central Government may direct:

(c) **Punishment in case of guilty:** If after investigation, it is proved that—

(i) the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or

(ii) any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud,

then, every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable for fraud in the manner as provided in section 447.

10. SECURITY FOR PAYMENT OF COSTS AND EXPENSES OF INVESTIGATION (SECTION 214 OF THE COMPANIES ACT, 2013)

Section 214 of the Companies Act, 2013 provides for security for payment of costs and expenses of investigation as under:

Where an investigation is ordered by the Central Government in pursuance of clause (b) of sub-section (1) of section 210, or in pursuance of an order made by the Tribunal under section 213, the

Central Government may before appointing an inspector under sub-section (3) of section 210 or clause (b) of section 213, require the applicant to give such security not exceeding 25,000 rupees as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation. Such security shall be refunded to the applicant if the investigation results in prosecution.

11. FIRM, BODY CORPORATE OR ASSOCIATION NOT TO BE APPOINTED AS INSPECTOR (SECTION 215 OF THE COMPANIES ACT, 2013)

Section 215 of the Companies Act, 2013 provides that no firm, body corporate or other association shall be appointed as an inspector.

12. INVESTIGATION OF OWNERSHIP OF COMPANY (SECTION 216 OF THE COMPANIES ACT, 2013)

Section 216 of the Companies Act, 2013 provides for Investigation of ownership of company as under:

(i) As per sub section (1), where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons—

  (a) who are or have been financially interested in the success or failure, whether real or apparent, of the company; or

  (b) who are or have been able to control or to materially influence the policy of the company, or

  (c) who have or had beneficial interest in shares of a company or who are or have been beneficial owners or significant beneficial owner of a company.

(ii) Without prejudice to its powers under sub-section (1), the Central Government shall appoint one or more inspectors under that sub-section, if the Tribunal, in the course of any proceeding before it, directs by an order that the affairs of the company ought to be investigated as regards the membership of the company and other matters relating to the company, for the purposes specified in sub-section (1). [Sub-section (2)]

(iii) While appointing an inspector under sub-section (1), the Central Government may define the scope of the investigation, whether as respects the matters or the period to which it is to extend or otherwise, and in particular, may limit the investigation to matters connected with particular shares or debentures [Sub-section (3)]

(iv) Subject to the terms of appointment of an inspector, his powers shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purposes of his investigation [Sub-section (4)]

13. PROCEDURE, POWERS, ETC., OF INSPECTORS (SECTION 217 OF THE COMPANIES ACT, 2013)

Section 217 of the Companies Act, 2013 provides for procedure, powers, etc., of inspectors as under:

(i) As per sub- section (1), it shall be the duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation in accordance with the provisions contained in this Chapter, and where the affairs of any other body corporate or a person are investigated under section 219, of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person —

(a) to preserve and to produce to an inspector or any person authorised by him in this behalf all books and papers of, or relating to, the company or, as the case may be, relating to the other body corporate or the person, which are in their custody or power; and

(b) otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.

(ii) The inspector may require any body corporate, other than a body corporate referred in point (i) to furnish such information to, or produce such books and papers before him or any person authorised by him in this behalf as he may consider necessary, if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation [Sub section (2)].

(iii) The inspector shall not keep in his custody any books and papers produced under point (i) or point (ii) for more than 180 days and return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced [Sub section (3)].

However, the books and papers may be called for by the inspector if they are needed again for a further period of 180 days by an order in writing.

(iv) As per sub-section (4), an inspector may examine on oath—

(a) any of the persons referred to in point (i); and

(b) any other person with the prior approval of the Central Government,

in relation to the affairs of the company, or other body corporate or person, as the case may be, and for that purpose may require any of those persons to appear before him personally.

However, in case of an investigation under section 212, the prior approval of Director, SFIO shall be sufficient under point (b) above (instead of the Central Government).

(v) As per sub-section (5), notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the inspector, being an officer of the Central Government making an investigation under this chapter, shall have all the 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:—

(a) the discovery and production of books of account and other documents, at such place and time as may be specified by such person;

(b) summoning and enforcing the attendance of persons and examining them on oath; and

(c) inspection of any books, registers and other documents of the company at any place.

(vi) If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees [Sub section (6) (i)].

If a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company [Sub section (6) (ii)].

(vii) The notes of any examination under sub section (4) above, shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him [Sub section (7)].

(viii) As per sub-section (8), if any person fails without reasonable cause or refuses—

(a) to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty under point (i) or point (ii) to produce;

(b) to furnish any information which is his duty under point (ii) to furnish;

(c) to appear before the inspector personally when required to do so under point (iv) or to answer any question which is put to him by the inspector in pursuance of that point; or

(d) to sign the notes of any examination referred to in sub section (7) above,

he shall be punishable with imprisonment for a term which may extend to 6 months and with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees, and

also with a further fine which may extend to 2,000 rupees for every day after the first during which the failure or refusal continues.

(ix) The officers of the Central Government, State Government, police or statutory authority shall provide assistance to the inspector for the purpose of inspection, inquiry or investigation, which the inspector may, with the prior approval of the Central Government, require [Sub section (9)].

(x) The Central Government may enter into an agreement with the Government of a foreign State for reciprocal arrangements to assist in any inspection, inquiry or investigation under this Act or under the corresponding law in force in that State and may, by notification, render the application of this Chapter in relation to a foreign State with which reciprocal arrangements have been made subject to such modifications, exceptions, conditions and qualifications as may be deemed expedient for implementing the agreement with that State [Sub section (10)].

(xi) Notwithstanding anything contained in this Act or in the Code of Criminal Procedure, 1973 if, in the course of an investigation into the affairs of the company, an application is made to the competent court in India by the inspector stating that evidence is, or may be, available in a country or place outside India, such court may issue a letter of request to a court or an authority in such country or place, competent to deal with such request, to examine orally, or otherwise, any person, supposed to be acquainted with the facts and circumstances of the case, to record his statement made in the course of such examination and also to require such person or any other person to produce any document or thing, which may be in his possession pertaining to the case, and to forward all the evidence so taken or collected or the authenticated copies thereof or the things so collected to the court in India which had issued such letter of request [Sub section (11)].

Provided that, the letter of request shall be transmitted in such manner as the Central Government may specify in this behalf.

Provided further that every statement recorded or document or thing received under this sub-section shall be deemed to be the evidence collected during the course of investigation.

According to Rule 6 of the *Companies (Inspection, investigation and inquiry) Rules, 2014*, the 'letter of request', in terms of section 217, shall be transmitted in such manner as specified by the Ministry of Corporate Affairs.

(xii) Upon receipt of a letter of request from a court or an authority in a country or place outside India, competent to issue such letter in that country or place for the examination of any person or production of any document or thing in relation to affairs of a company under investigation in that country or place, the Central Government may, if it thinks fit, forward such letter of request to the court concerned, which shall thereupon summon the person before it and record his statement or cause any document or thing to be produced, or send the letter to any inspector for investigation, who shall thereupon investigate into the affairs

of company in the same manner as the affairs of a company are investigated under this Act and the inspector shall submit the report to such court within 30 days or such extended time as the court may allow for further action [Sub section (12)].

Provided that the evidence taken or collected as above or authenticated copies thereof or the things so collected shall be forwarded by the court, to the Central Government for transmission, in such manner as the Central Government may deem fit, to the court or the authority in country or place outside India which had issued the letter of request.

14. PROTECTION OF EMPLOYEES DURING INVESTIGATION (SECTION 218 OF THE COMPANIES ACT, 2013)

Section 218 of the Act deals with the protection of Employees during Investigation.

(1) **Approval of tribunal to take action against the employee:** Notwithstanding anything contained in any other law for the time being in force, if—

(a) **during the course of any investigation of the affairs** and other matters of or relating to a company, other body corporate or person under section 210, section 212, section 213 or section 219 or of the membership and other matters of or relating to a company, or the ownership of shares in or debentures of a company or body corporate, or the affairs and other matters of or relating to a company, other body corporate or person, under section 216; or

(b) **during the pendency of any proceeding** against any person concerned in the conduct and management of the affairs of a company under Chapter XVI, such company, other body corporate or person proposes—

(i) to discharge or suspend any employee; or

(ii) to punish him, whether by dismissal, removal, reduction in rank or otherwise; or

(iii) to change the terms of employment to his disadvantage,

the company, other body corporate or person, as the case may be, shall obtain approval of the Tribunal of the action proposed against the employee and if the Tribunal has any objection to the action proposed, it shall send by post notice thereof in writing to the company, other body corporate or person concerned.

(2) **Action against employee:** If the company, other body corporate or person concerned does not receive within thirty days of making of application under sub-section (1), the approval of the Tribunal, then and only then, the company, other body corporate or person concerned may proceed to take against the employee, the action proposed.

(3) **Appeal:** If the company, other body corporate or person concerned is dissatisfied with the objection raised by the Tribunal, it may, within a period of thirty days of the receipt of the notice of the objection, prefer an appeal to the Appellate Tribunal in such manner and on payment of such fees as may be prescribed.

(4) **Final and Binding order:** The decision of the Appellate Tribunal on such appeal shall be final and binding on the Tribunal and on the company, other body corporate or person concerned.

(5) **Over-riding effect:** For the removal of doubts, it is hereby declared that the provisions of this section shall have effect without prejudice to the provisions of any other law for the time being in force.

Tribunal's Objection On the action Proposed by Company/ Body Corporate/ Person	Objection not Received	Company can terminate / punish the employee	
	Objection Received	Company / Employee can apply to the Appeallte Tribunal	The decision of Appellate Tribunal shall be Final.

15. POWERS OF INSPECTOR

1. To conduct investigation into affairs of related companies, etc. (Section 219 of the Companies Act, 2013)

Section 219 of the Companies Act, 2013 provides for power of inspector to conduct investigation into affairs of related companies, etc. as under:

(i) Investigation into affairs of related companies: If an inspector appointed under section 210 or section 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, can also investigate the affairs of—

(a) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;

(b) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;

(c) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or

(d) any person who is or has at any relevant time been the company's managing director or manager or employee.

(ii) Report of inspector: The inspector shall, subject to the prior approval of the Central Government, investigate into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.

2. Seizure of documents by inspector (Section 220 of the Companies Act, 2013)

Section 220 of the Companies Act, 2013 provides for seizure of documents by inspector as under:

(i) Seizure of books and papers [Sub section (1)]: Where in the course of an investigation under this Chapter, the inspector has reasonable grounds to believe that the books and papers of, or relating to, any company or other body corporate or managing director or manager of such company are likely to be destroyed, mutilated, altered, falsified or secreted, the inspector may —

(a) enter, with such assistance as may be required, the place or places where such books and papers are kept in such manner as may be required; and

(b) seize books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books and papers at its cost for the purposes of his investigation.

(ii) Time period for keeping books and papers [Sub section (2)]: The inspector shall keep in his custody the books and papers seized under this section for such a period not later than the conclusion of the investigation as he considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person from whose custody or power they were seized.

(iii) Extracts of books and papers: The inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such manner as he considers necessary.

(iv) Application of provisions of Cr. PC.: The provisions of the Code of Criminal Procedure, 1973, relating to searches or seizures shall apply *mutatis mutandis* to every search or seizure made under this section.

3. Freezing of Assets of Company on Inquiry and Investigation (Section 221 of the Companies Act, 2013)

Section 221 of the Act deals with the Freezing of Assets of Company on Inquiry and Investigation. According to this section:

(i) **Order of the tribunal:** Where it appears to the Tribunal, on a reference made to it by the Central Government or in connection with any inquiry or investigation into the affairs of a

company under this Chapter or on any complaint made by such number of members as specified under sub-section (1) of section 244 or a creditor having one lakh amount outstanding against the company or any other person having a reasonable ground to believe that the removal, transfer or disposal of funds, assets, properties of the company is likely to take place in a manner that is prejudicial to the interests of the company or its shareholders or creditors or in public interest, it may by order direct that such transfer, removal or disposal shall not take place during such period not exceeding three years as may be specified in the order or may take place subject to such conditions and restrictions as the Tribunal may deem fit.

(ii) **Punishment in case of contravention of order of tribunal:** In case of any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1), the company 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 or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

4. Imposition of Restrictions upon Securities (Section 222 of the Companies Act, 2013)

Section 222 of the Act deals with the Imposition of Restrictions upon Securities. According to this section:

(i) **Tribunal may by order put restrictions upon securities:** Where it appears to the Tribunal, in connection with any investigation under section 216 or on a complaint made by any person in this behalf, that there is good reason to find out the relevant facts about any securities issued or to be issued by a company and the Tribunal is of the opinion that such facts cannot be found out unless certain restrictions, as it may deem fit, are imposed, the Tribunal may, by order, direct that the securities shall be subject to such restrictions as it may deem fit for such period not exceeding three years as may be specified in the order.

(ii) **Punishment in case of contravention to an order:** Where securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1), the company 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 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.

16. INSPECTOR'S REPORT (SECTION 223 OF THE COMPANIES ACT, 2013)

Section 223 of the Companies Act, 2013 lays down the following provisions in respect of the Inspector's report on investigation conducted under this chapter:

(i) **Submission of interim report and final report [Sub section (1)]:** An inspector appointed under this Chapter (Chapter XIV- Inspection, Inquiry and Investigation) may, and if so directed by the Central Government shall, submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government.

(ii) **Report to be writing or printed [Sub section (2)]:** Every report made under sub section (1) above, shall be in writing or printed as the Central Government may direct.

(iii) **Obtaining copy or report [Sub section (3)]:** A copy of the above report may be obtained by members, creditors or any other person whose interest is likely to be affected by making an application in this regard to the Central Government.

(iv) **Authentication of report [Sub section (4)]:** The report of any inspector appointed under this Chapter shall be authenticated either—

(a) by the seal, if any, of the company whose affairs have been investigated; or

(b) by a certificate of a public officer having the custody of the report, as provided under section 76 of the Indian Evidence Act, 1872,

and such report shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

(v) **Exceptions [Sub section (5)]:** Nothing in this section shall apply to the report referred to in section 212 of the Companies Act, 2013.

17. ACTIONS TO BE TAKEN IN PURSUANCE OF INSPECTOR'S REPORT (SECTION 224 OF THE COMPANIES ACT, 2013)

Section 224 of the Companies Act, 2013 provides the following provisions in respect of the actions to be taken in pursuance of inspector's report:

(i) If, from an inspector's report, made under section 223, it appears to the Central Government that any person has, in relation to the company or in relation to any other body corporate or other person whose affairs have been investigated under this Chapter been guilty of any offence for which he is criminally liable, the Central Government may prosecute such person for the offence and it shall be the duty of all officers and other employees of the company or body corporate to give the Central Government the necessary assistance in connection with the prosecution [Sub section (1)].

(ii) As per sub-section (2), if any company or other body corporate is liable to be wound up under this Act or under the Insolvency and Bankruptcy Code, 2016 and it appears to the Central Government from any such report made under section 223 that it is expedient so to do by reason of any such circumstances as are referred to in section 213, the Central Government may, unless the company or body corporate is already being wound up by the

Tribunal, cause to be presented to the Tribunal by any person authorised by the Central Government in this behalf—

(a) a petition for the winding up of the company or body corporate on the ground that it is just and equitable that it should be wound up;

(b) an application under section 241; or

(c) both.

(iii) As per sub-section (3), if from any such report as aforesaid, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or any body corporate whose affairs have been investigated under this Chapter—

(a) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation, or the management of the affairs, of such company or body corporate; or

(b) for the recovery of any property of such company or body corporate which has been misapplied or wrongfully retained,

the Central Government may itself bring proceedings for winding up in the name of such company or body corporate.

(iv) The Central Government, shall be indemnified by such company or body corporate against any costs or expenses incurred by it in, or in connection with, any proceedings brought by virtue of sub-section (3) [Sub section (4)].

(v) Where the report made by an inspector states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property, or cash, as the case may be, and also for holding such director, key managerial personnel, officer or other person liable personally without any limitation of liability.

18. EXPENSES OF INVESTIGATION (SECTION 225 OF THE COMPANIES ACT, 2013)

Section 225 of the Companies Act, 2013 lays down the following provisions in respect of expenses of investigation:

(i) As per sub-section (1), the expenses of, and incidental to, an investigation by an inspector appointed by the Central Government under this Chapter (Chapter XIV- Inspection, Inquiry and Investigation) other than expenses of inspection under section 214 (Security for payment of costs and expenses of investigation) shall be defrayed in the first instance by the Central Government, but shall be reimbursed by the following persons to the extent mentioned below, namely:—

(a) any person who is convicted on a prosecution instituted, or who is ordered to pay damages or restore any property in proceedings brought, under section 224, to the extent that he may in the same proceedings be ordered to pay the said expenses as may be specified by the court convicting such person, or ordering him to pay such damages or restore such property, as the case may be;

(b) any company or body corporate in whose name proceedings are brought as aforesaid, to the extent of the amount or value of any sums or property recovered by it as a result of such proceedings;

(c) unless, as a result of the investigation, a prosecution is instituted under section 224,—

(1) any company, body corporate, managing director or manager dealt with by the report of the inspector; and

(2) the applicants for the investigation, where the inspector was appointed under section 213,

to such extent as the Central Government may direct.

(ii) Any amount for which a company or body corporate is liable under clause (b) above shall be a first charge on the sums or property mentioned in that clause [Sub section (2)].

19. VOLUNTARY WINDING UP OF COMPANY, ETC., NOT TO STOP INVESTIGATION PROCEEDINGS (SECTION 226 OF THE COMPANIES ACT, 2013)

Section 226 of the Companies Act, 2013 provides the following provisions:

An investigation under this Chapter may be initiated notwithstanding, and no such investigation shall be stopped or suspended by reason only of, the fact that—

(a) an application has been made under section 241;

(b) the company has passed a special resolution for voluntary winding up; or

(c) any other proceeding for the winding up of the company is pending before the Tribunal.

Where a winding up order is passed by the Tribunal in a proceeding referred to in clause (c), the inspector shall inform the Tribunal about the pendency of the investigation proceedings before him and the Tribunal shall pass such order as it may deem fit.

Nothing in the winding up order shall absolve any director or other employee of the company from participating in the proceedings before the inspector or any liability as a result of the finding by the inspector.

20. LEGAL ADVISERS AND BANKERS NOT TO DISCLOSE CERTAIN INFORMATION (SECTION 227 OF THE COMPANIES ACT, 2013)

Section 227 of the Companies Act, 2013 provides for non-disclosure of certain information by certain persons.

Nothing in this Chapter shall require the disclosure to the Tribunal or to the Central Government or to the Registrar or to an inspector appointed by the Central Government—

(a) **by a legal adviser**, of any privileged communication made to him in that capacity, except as respects the name and address of his client; or

(b) **by the bankers** of any company, body corporate, or other person, of any information as to the affairs of any of their customers, other than such company, body corporate, or person.

21. INVESTIGATION ETC. OF FOREIGN COMPANIES (SECTION 228 OF THE COMPANIES ACT, 2013)

Section 228 of the Companies Act, 2013 provides for Investigation etc. of foreign companies. According to this section:

The provisions of this Chapter (Chapter XIV- Inspection, Inquiry and Investigation) shall apply *mutatis mutandis* to inspection, inquiry or investigation in relation to foreign companies.

22. PENALTY FOR FURNISHING FALSE STATEMENT, MUTILATION, DESTRUCTION OF DOCUMENTS (SECTION 229 OF THE COMPANIES ACT, 2013)

Section 229 of the Companies Act, 2013 lays down the following penalty for furnishing false statement, mutilation, destruction of documents:

Where a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation,—

(a) destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate;

(b) makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or

(c) provides an explanation which is false or which he knows to be false,

(d) he shall be punishable for fraud in the manner as provided in section 447.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Mr. Sharma who was a Key Managerial Personal (Manager) of XYZ Ltd. retired on 12th May 2018. An examination of the final accounts of the company for the year ended on 31st March 2018, the Registrar of Companies found some serious irregularities in writing off of the huge amounts of bad debts and no satisfactory explanation was provided for the same from the company. In such a situation the Registrar of Companies wants some explanation from the company and Mr. Sharma. Can the ROC seek explanation from Mr. Sharma? Advice –

   (a) No, Mr. Sharma can't be called upon, as he does not hold the position in the company any more.

   (b) Mr. Sharma can be called upon within a period of one year from the date of completion of his service.

   (c) Mr. Sharma can be called upon for necessary explanation within a period of 180 days from the date of leaving his office through a written notice served upon him.

   (d) Mr. Sharma can be called upon by the Registrar through a written notice served on him without any time period limit.

2. A group of creditors of X Limited makes a complaint to the Registrar of Companies. They asserted that the management of the company is indulged in destruction and falsification of the accounting records of the company. The complainants request the Registrar to take an immediate steps to stop the management to tamper with the records. The complaint was received in the morning on 1st January 2019 and the ROC entered the premises within half an hour for the search. The course of action that can be taken by Registrar are:

   (a) Registrar may enter and search the place where such books or papers are kept and seize them.

   (b) Registrar may enter and search the place where such books or papers are kept and can seize only after obtaining an order from the special court.

   (c) Registrar may enter and search the place where such books or papers are kept only on the order of the NCLT.

   (d) Registrar may enter and search the place where such books or papers are kept and give an opportunity to the company to represent why such documents may not be seized.

Descriptive Questions

Question 1

Provide various grounds on which the investigation is assigned to Serious Fraud Investigation Office?

Question 2

Discuss the powers of Inspectors regarding investigation into affairs of related companies.

Question 3

A group of creditors of XYZ Limited makes a complaint to the Registrar of Companies, Gujarat alleging that the management of the company is indulging in destruction and falsification of the accounting records of the company. The complainants request the Registrar to take immediate steps to seize the records of the company so that the management may not be allowed to tamper with the records. The complaint was received at 11 A.M. on 06th June, 2018 and the registrar has attempted to enter the premise of company but has been denied by the company, due to not having order from special court.

Is the contention of company being valid in terms of Companies Act, 2013?

Question 4

Mr. Atul is an employee of the company ABC Limited and investigation is going on him under the provisions of Companies Act, 2013. The company wants to terminate the employee on the ground of investigation is going against him. They have filed the application to tribunal for approval of termination. Company has not received any reply from the tribunal within 30 days of filling an application. The company consider it as a deemed approval and terminated Mr. Atul.

- *Is the contention of company being valid in law?*
- *What is remedy available to Mr. Atul?*
- *What is remedy available to Mr. Atul, if reply of Tribunal has been received within 30 days of application?*

ANSWER/SOLUTION

Answer to MCQ

1. (d) **Hint:** As per the provisions of Section 206(2) of the Companies Act, 2013, the Registrar can call for any information or explanation or any other further documents related to the company from the company or any officer if the company, which he thinks, is necessary for deciding any matter of the company. Proviso to Section 206(2) provides that, where such information or explanation relates to any past period, the officers who had been in the employment of the company for such period,

if so called upon by the Registrar through a notice served on him, in writing, shall also furnish such information or explanation to the best of their knowledge. So, in the given case Mr. Sharma, the ex-manager of the company can be called upon for such information/explanation which was related to their period of service.

2. **(b)** **Hint:** According to section 209 of the Companies Act, 2013, Registrar may enter and search the place where such books or papers are kept and seize them only after obtaining an order from the Special Court.

Answer to Descriptive Questions

1. As per section 212 of the Companies Act, 2013, the Central Government may assign the investigation into affairs of a company to the Serious Frauds Investigation Office on the basis of an opinion formed from the following:

(a) After the inspection of books of account or papers or inquiry the Registrar shall submit a written report to the Central Government. The report may recommend the need for further investigation along with reasons in support. The Central Government on receipt of such report can order an investigation under Serious Frauds Investigation Office.

(b) The company may pass a special resolution and can request Central Government to investigate into the affairs of the company.

(c) The Central Government can order investigation under Serious Frauds Investigation Office, in public interest.

(d) The departments Central Government and State Governments can request for investigation under Serious Frauds Investigation Office.

2. **Section 219 states that**, if the inspector appointed under Sections 210, 212 or 213 to investigate into the affairs company considers it necessary for the purposes of the investigation to investigate, he can do the investigation of the affairs of other related companies or body corporate with the prior approval of the Central Government.

- **Holding or Subsidiary Company:** which is or has been at the relevant time been the company's subsidiary or holding or subsidiary of its holding company;
- **Related Party:** which is or has been at the relevant time been managed by any person as a managing director or manager who is or was at the relevant time the managing director or the manager of the company;
- **Deemed Control:** whose Board of Directors' comprises nominees of the company or is accustomed to act in accordance with the directions of the company or any of its directors; or

- **In Employment of Company:** in case any person is or has at any relevant time been the company's managing director or manager or employee.

The results of the investigation are relevant to the investigation of the affairs of the company for which he is appointed.

3. Section 209, of the Companies Act, 2013 states that, if the Registrar has **reasonable ground to believe** that the books and papers of

- A company or
- relating to the key managerial personnel or
- any director or
- auditor or
- company secretary in practice if the company has not appointed a company secretary

are likely to be destroyed, mutilated, altered, falsified or secreted he may, after obtaining an order from the special court for the seizure of such books and papers,

(a) enter with such assistance as may be required and search the place where such books or papers are kept; and

(b) seize such books and papers as he considers necessary after allowing the company to take copies or extracts there from.

According the above provisions the registrar may enter, search and seize the books only after obtaining an order from the Special Court.

In the given scenario, the registrar has failed to obtain permission from the special court so, he is not authorized to enter the premises of the company and seize the books of accounts of XYZ Limited. Hence, the contention of the XYZ Limited is valid in law.

4. The provision of Section 218 states that, the company shall require to take approval of the tribunal before taking action against the employee if there is any pendency of any proceedings against any person concerned in the conduct and management of the affairs company.

The company shall require approval in the following circumstances:

- discharge or suspension of an employee; or
- punishment to an employee by dismissal, removal, reduction in rank or otherwise; or
- change in the terms of employment to the disadvantage of employee(s);

The Tribunal shall notify its objection to the action proposed in writing.

In case, the company, other body corporate or person concerned does not receive the approval of the Tribunal within 30 days of making the application, it may proceed to take the action proposed against the employee. That means it can be consider as a deemed approval by the tribunal.

Appeal to the Appellate Tribunal

If the company, other body corporate or person concerned is dissatisfied with the objection raised by the Tribunal, it may, within a period of 30 days of the receipt of the notice of the objection, refer an appeal to the Appellate Tribunal in such manner and on payment of fees of INR 1,000 as per the schedule of Fees.

The decision of the Appellate Tribunal on such appeal shall be final and binding on the Tribunal and on the company, other body corporate or person concerned.

- Yes, the termination of Mr. Atul made by the company is totally valid in law and company can do so by considering deemed approval of tribunal.
- In this scenario, Mr. Atul has not any remedy available. As per the provision of the law appeal to the appellate tribunal can be made only if the person is dissatisfied with the objection raised by the tribunal. Hence, in this case the tribunal has not replied Mr. Atul cannot refer an appeal to Appellate Tribunal.
- In this case, Mr. Atul can refer and appeal to appellate tribunal within 30 days of the receiving letter of objection raised by the tribunal and with payment of Fees on ₹ 1,000 as per schedule of Fees.

CHAPTER 5

COMPROMISES, ARRANGEMENTS AND AMALGAMATIONS

LEARNING OUTCOMES

At the end of this Chapter, you will be able to understand the

- Concepts of Compromise, Arrangement, Merger and Amalgamation
- Power to Company, Members, Central Government or Tribunal to Compromise or make arrangements with members or creditors
- Fast Track Mergers
- Cross Border Mergers
- Power of Central Government to order Mergers and Amalgamation in the public interest
- Power to acquire shares of shareholders dissenting from scheme or contract approved by majority
- Purchase of minority shareholding

1. INTRODUCTION

Mergers and acquisitions have always been a topic of corporate interest in the modern times. The complexity of the laws governing these modes of corporate restructuring makes them even more intriguing and mystifying.

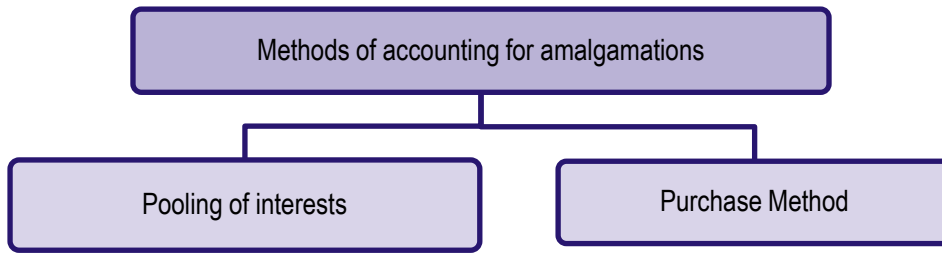
Amalgamation

- Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.

- Transferor company means the company which is amalgamated into another company.
- Transferee company means the company into which a transferor company is amalgamated.

Types of Amalgamations

Amalgamations fall into two broad categories. In the first category are those amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies. These are known as Amalgamation in nature of merger. In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.



Amalgamation in the Nature of Merger

Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions.

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Amalgamation in the Nature of Purchase

Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified above.

Methods of Accounting for Amalgamations

There are two main methods of accounting for amalgamations.

- the pooling of interests method and
- the purchase method.

Chapter XV (Section 230 to 240) of Companies Act, 2013 contains provisions on 'Compromises, Arrangements and Amalgamations', that covers compromise or arrangements, mergers and amalgamations, Corporate Debt Restructuring, demergers, fast track mergers for small companies/ holding subsidiary companies, cross border mergers, takeovers, amalgamation of companies in public interest etc. This chapter is a complete code in itself which contains provisions regarding all forms of compromises with creditors and arrangements with members. The procedural aspects involved such as format of application to be made to National Company Law Tribunal, form of notice and the procedural aspects involved with respect to the substantive law are covered under the Rules made under Chapter XV of the Act.

Important aspects of this chapter are as follows:

(i) This chapter provides the provisions which specifies the detailed disclosures to be made during the process of corporate restructuring. This requirement of extensive disclosures is to ensure transparency and allows stakeholders to take decisions.

(ii) Introduction of voting by way of postal ballot, will ensure larger public participation.

(iii) Introduction of concept of dispensation by providing a threshold for the dispensation of creditors meetings.

(iv) This chapter also requires serving of notices to the various statutory authorities with regard to the scheme, arrangement or restructuring, so that participation of various regulators may assist the tribunal to take a informed decision.

(v) Provision related to takeover of listed companies through the scheme of compromise or arrangement, emphasis on the pricing guidelines which the SEBI would prescribe ensuring uniformity in law.

(vi) This chapter also provides of a provision which prohibits the maintenance of treasury stock. The practice of indirectly holding investments through intermediaries is now prohibited and cannot be structured by companies.

(vii) Exit options to shareholders through pre-determined formula or valuation can be given on merger of listed company with an unlisted company.

(viii) Statement certifying implementation of the scheme shall be given by Chartered Accountant or Company Secretary.

(ix) The provision in this chapter are in compliance with the SEBI regulations and guidelines issued by RBI.

(x) This chapter provides for Fast Track amalgamations between-

- 2/more small companies, or
- Holding company and its wholly owned subsidiaries.

(xi) Enables cross border amalgamations between Indian Companies and Foreign companies.

(xii) Lays the mechanism under which the transferee company under a scheme or contract can acquire shares of dissenting shareholders.

(xiii) Provides of exit method for minority shareholders, and promoters to have 100% promoter entity. So that balance between the interests of the promoters and minority shareholders may be maintained.

(xiv) This chapter also provides the process of amalgamation of companies for public interest.

(xv) Books and Papers of the amalgamating company/ the company in which shares have been acquired by another company shall not be disposed of on prior permission of the Central Government.

(xvi) Liability of the officers of the transferor company on any offence committed under this Act shall be retrospective even after the merger, amalgamation or acquisition.

2. POWER TO COMPROMISE OR MAKE ARRANGEMENTS WITH CREDITORS AND MEMBERS [SECTION 230]

Section 230 of the Companies Act, 2013 contains the powers of the Tribunal on the filing of application for the compromise or arrangement. According to this section:

(1) **Power of Tribunal on an application filed for a compromise/arrangement [Sub-section 1)]:** Where a compromise or arrangement is proposed between—

(a) a company and its creditors or any class of them; or

(b) a company and its members or any class of them,

the Tribunal may, on the application of the-

Company, or | **Creditor, or** | **Member of the company, or**

Liquidator in case of company is into voluntary liquidation

order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

Explanation—For the purposes of this sub-section, arrangement includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods.

(2) **Disclosures by applicant [Sub-section (2)]:** The company or any other person, by whom an application is made, shall disclose to the Tribunal by affidavit—

(a) **all material facts** relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;

(b) **reduction of share capital** of the company, if any, included in the compromise or arrangement;

(c) **any scheme of corporate debt restructuring** consented to by not less than seventy-five per cent. of the secured creditors in value, including—

(i) a creditor's responsibility statement in the prescribed form;

(ii) safeguards for the protection of other secured and unsecured creditors;

(iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

(iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

(v) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

(3) **Notice of meeting conducted on order of Tribunal [Sub-section (3)]:** Where a meeting is proposed to be called in pursuance of an order of the Tribunal, a notice of such meeting shall be sent to-

- all the creditors or class of creditors, and
- to all the members or class of members,
- and the debenture-holders of the company,
- Sectoral regulators u/s 230(5)

individually at the address registered with the company.

Annexure with Notice: Notice of meeting shall be accompanied by a statement disclosing the

Annexure with Notice	
	details of the compromise or arrangement,
	a copy of the valuation report, if any, and
	explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders and
	the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and
	such other matters as may be as prescribed under *Rule 6 of the Companies (Compromises, arrangements and amalgamations) Rules, 2016*.

Advertisement of notice: Such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as prescribed under Rule 7 of the *Companies (Compromises, arrangements and amalgamations) Rules, 2016.*

Time period for the receipt of the copies of the compromise or arrangement: Where the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

(4) **Notices to sectoral regulators to make representation, if likely to be affected by the compromise or arrangement [Sub-section (5)]:** A notice along with all the documents in such form as may be prescribed shall also be sent to-

- the Central Government,
- the income-tax authorities,

- the Reserve Bank of India,
- the Securities and Exchange Board,
- the Registrar,
- the respective stock exchanges,
- the Official Liquidator,
- the Competition Commission of India established under the Competition Act, 2002, if necessary,
- and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and

shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

(5) **The Tribunal may dispense with calling of a meeting** of creditor or class of creditors where such creditors or class of creditors, having at least ninety per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement. [Sub-section (9)]

(6) **Vote to the adoption of the compromise or arrangement [Sub-section (4)]:** A notice shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice:

Provided that any objection to the compromise or arrangement shall be made only by persons holding not less than ten per cent of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement.

(7) **Binding order of Tribunal [Sub-section (6)]:** Where, at a meeting held, majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by

postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator, "appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be," and the contributories of the company.

(8) **Particulars to be stated in the order [Sub-section (7)]:** An order made by the Tribunal, shall provide for all or any of the following matters, namely:—

(a) **where the compromise or arrangement provides for conversion of preference shares into equity shares**, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;

(b) the **protection of any class** of creditors;

(c) if the compromise or arrangement results in the **variation of the shareholders' rights**, it shall be given effect to under the provisions of section 48;

(d) if **the compromise or arrangement is agreed to by the creditors** under sub-section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction (BIFR) established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;

(e) **such other matters** including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement:

Provided that no compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

(9) **Filing of order of tribunal with registrar [Sub-section (8)]:** The order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.

(10) **Exemption in relation to buy-back of securities [sub-section (10)]:** No compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

[1][(11) **Inclusion of takeover offer [Sub-section (11)]:** Any compromise or arrangement may include takeover offer made in such manner as may be prescribed.

Provided that in case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

[1]Sub-sections (11) and (12) are yet to be notified.

(12) **Application to tribunal by aggrieved party [Sub-section (12)]:** An aggrieved party may make an application to the Tribunal in the event of any grievances with respect to the takeover offer of companies other than listed companies in such manner as may be prescribed and the Tribunal may, on application, pass such order as it may deem fit.]

Explanation—For the removal of doubts, it is hereby declared that the provisions of section 66 shall not apply to the reduction of share capital effected in pursuance of the order of the Tribunal under this section.

Since reduction of share capital requires an application to Tribunal by company after passing Special Resolution and on confirmation by Tribunal, reduction of share capital gets effected. However, in the case of compromise under section 230 if that results into reduction of capital, compliance of section 66 is not required to be made separately in such cases.

3. POWER OF TRIBUNAL TO ENFORCE COMPROMISE OR ARRANGEMENT [SECTION 231]

(1) **Power of tribunal to enforce the order:** Where the Tribunal makes an order under section 230 sanctioning a compromise or an arrangement in respect of a company, it—

(a) shall have power **to supervise the implementation** of the compromise or arrangement; and

(b) may, at the time of making such order or at any time thereafter, **give such directions** in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

(2) **Winding up order by tribunal:** If the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding up the company and such an order shall be deemed to be an order made under section 273.

(3) **Retrospective effect of order:** The provisions of this section shall, so far as may be, also apply to a company in respect of which an order has been made before the commencement of this Act sanctioning a compromise or an arrangement.

4. MERGER AND AMALGAMATION OF COMPANIES [SECTION 232]

(1) **Filing of an application for purpose of reconstruction or companies involving merger/ amalgamation or transfer of undertaking, property etc.:** Where an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement

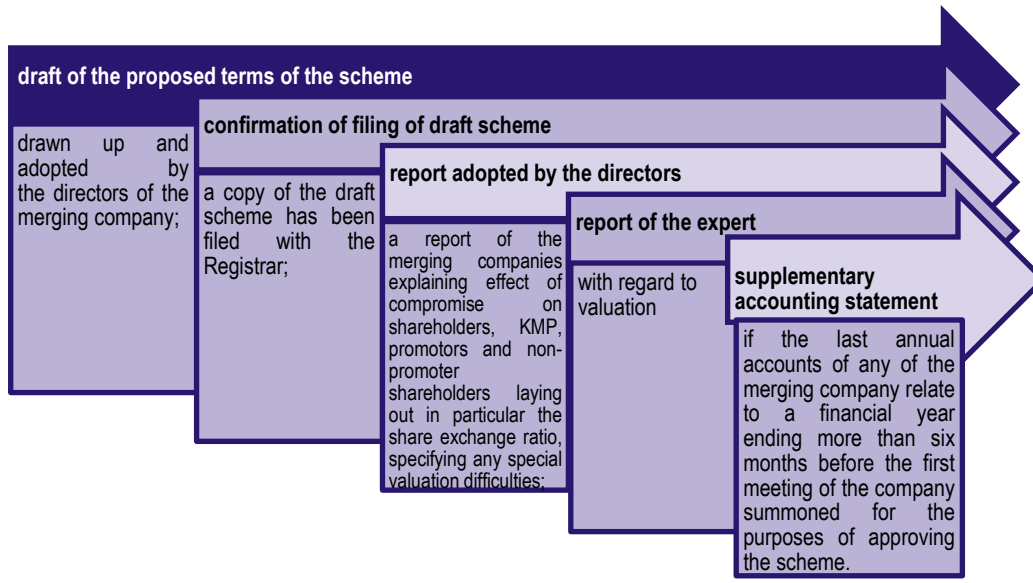
proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal—

(a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and

(b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies,

the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply *mutatis mutandis*.

(2) **Circulation of information for the meeting by the merging companies / the companies in respect of which a division is proposed:** Where an order has been made by the Tribunal as above, merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following for the meeting so ordered by the Tribunal, namely:—



(a) the **draft of the proposed terms of the scheme** drawn up and adopted by the directors of the merging company;

(b) confirmation that a copy of the draft scheme has been filed with the Registrar;

(c) a **report adopted by the directors of the merging companies** explaining effect of compromise on each class of shareholders, key managerial personnel, promotors and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;

(d) **the report of the expert** with regard to valuation, if any;

(e) a **supplementary accounting statement** if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme.

(3) **Order of tribunal on the agreement of compromise or arrangement:** The Tribunal, after satisfying itself that the procedure specified in sub-sections (1) and (2) has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make provision for the following matters, namely:—

(a) **the transfer to the transferee company** of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise;

(b) **the allotment or appropriation by the transferee company** of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person:

Provided that a transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the name of any trust whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished;

(c) **the continuation by or against the transferee company of any legal proceedings** pending by or against any transferor company on the date of transfer;

(d) **dissolution, without winding-up**, of any transferor company;

(e) **the provision to be made for any persons who**, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement;

(f) **where share capital is held by any non-resident shareholder** under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order;

(g) **the transfer of the employees of the transferor company** to the transferee company;

(h) **where the transferor company is a listed company and the transferee company is an unlisted company,—**

(A) the transferee company shall remain an unlisted company until it becomes a listed company;

(B) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal:

Provided that the amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it;

(i) **where the transferor company is dissolved**, the fee, if any, paid by the transferor company on its authorised capital shall be set-off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and

(j) such **incidental, consequential and supplemental matters** as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out:

Provided that no compromise or arrangement shall be sanctioned by the Tribunal unless **a certificate by the company's auditor has been filed with the Tribunal** to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

(4) **Effect of an order of tribunal:** Where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have effect.

(5) **Filing of certified copy of order with registrar:** Every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order.

(6) **Effective date specified in scheme:** The scheme under this section shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

(7) **Filing of duly certified statement of compliance of scheme with registrar:** Every company in relation to which the order is made shall, until the completion of the scheme, file a statement in such form and within such time as may be prescribed with the Registrar every year duly certified by a chartered accountant or a cost accountant or a company secretary in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

(8) **In case of contravention:** If a transferor company or a transferee company contravenes the provisions of this section, the transferor company or the transferee company, as the case may be, 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 such transferor or transferee 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.

Explanation— For the purposes of this section,—

(i) **in a scheme involving a merger**, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect

of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company;

(ii) **references to merging companies** are in relation to a merger by absorption, to the transferor and transferee companies, and, in relation to a merger by formation of a new company, to the transferor companies;

(iii) **a scheme involves a division**, where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company; and

(iv) **property includes** assets, rights and interests of every description and liabilities include debts and obligations of every description.

5. POWER TO ACQUIRE SHARES OF SHAREHOLDERS DISSENTING FROM SCHEME OR CONTRACT APPROVED BY MAJORITY [SECTION 235]

(1) **Basic requirements as to acquisition of shares:**

- The scheme or contract involving the transfer of shares or any class of shares in a company (the transferor company) to another company (the transferee company) has been approved by the holders of not less than 9/10th in value of the shares whose transfer is involved.
- The approval from 9/10th shareholders in value shall be received within four months after making of an offer in that behalf by the transferee company.
- The shares already held at the date of the offer by Transferee Company, or by a nominee of the transferee company or its subsidiary companies shall not be counted for this purpose.
- The transferee company shall express his desire to acquire the remaining shares of dissenting shareholders within two months after the expiry of the said four months and shall give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares.

(2) **Order of Tribunal to acquire shares of dissenting shareholders:** Where a notice under sub-section (1) is given, the transferee company shall, unless on an application made by the dissenting shareholder to the Tribunal, within one month from the date on which the

notice was given and the Tribunal thinks fit to order otherwise, be entitled to and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee company.

(3) **Application by dissenting shareholders:**

(i) Where a notice has been given by the transferee company **on an application made by the dissenting shareholder** and the Tribunal has not, made an order to the contrary i.e. order made in favour of the company- the transferee company shall, on the expiry of one month from the date on which the notice has been given, or,

(ii) if an application to the Tribunal by the dissenting shareholder is then pending, - Nothing is required to be done.

(iii) after that **application has been disposed of**-

shall send a copy of the notice to the transferor company together with an instrument of transfer, to be executed on behalf of the shareholder by any person appointed by the transferor company and on its own behalf by the transferee company, and pay or transfer to the transferor company- the amount or other consideration representing the price payable by the transferee company for the shares which that company is entitled to acquire,

(iv) The **transferor company shall—**

(a) thereupon register the transferee company as the holder of those shares; and

(b) within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration and of the receipt of the amount or other consideration representing the price payable to them by the transferee company.

(4) **Separate Bank account for disbursement to entitled shareholders:** Any sum received by the transferor company under this section shall be paid into a separate bank account, and any such sum and any other consideration so received shall be held by that company in trust for the several persons entitled to the shares in respect of which the said sum or other consideration were respectively received and shall be disbursed to the entitled shareholders within sixty days.

(5) **Scheme/contract made before the commencement of Act:** In relation to an offer made by a transferee company to shareholders of a transferor company before the commencement of this Act, this section shall have effect with the following modifications, namely:—

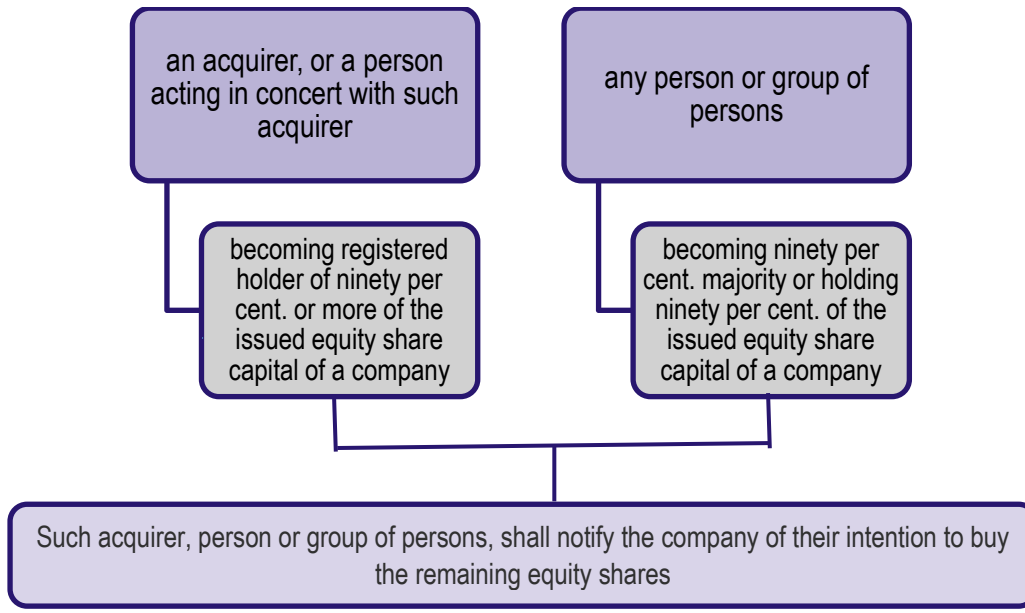
(a) in sub-section (1), for the words “the shares whose transfer is involved other than shares already held at the date of the offer by, or by a nominee of, the transferee

company or its subsidiaries,", the words "the shares affected" shall be substituted; and

(b) in sub-section (3), the words "together with an instrument of transfer, to be executed on behalf of the shareholder by any person appointed by the transferee company and on its own behalf by the transferor company" shall be omitted.

Explanation—For the purposes of this section, **"dissenting shareholder"** includes a shareholder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares to the transferee company in accordance with the scheme or contract.

6. PURCHASE OF MINORITY SHAREHOLDING [SECTION 236]



(1) **Notify to company for purchase of minority shareholding:**

- In the event of an acquirer, or a person acting in concert with such acquirer - becoming registered holder of ninety per cent. or more of the issued equity share capital of a company, or
- in the event of any person or group of persons- becoming ninety per cent. majority or holding ninety per cent. of the issued equity share capital of a company,

by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, such acquirer, person or group of persons, as the case may be, shall notify the company of their intention to buy the remaining equity shares.

(2) **Offer of equity shares to minority shareholders by acquirer, person or group of persons:** The acquirer, person or group of persons shall offer to the minority shareholders of the company for buying the equity shares held by such shareholders at a price determined on the basis of valuation by a registered valuer in accordance with Rule 27.

(3) **Offer to majority shareholder to purchase the minority equity shareholding:** The minority shareholders of the company may offer to the majority shareholders to purchase the minority equity shareholding of the company at the price determined in accordance with Rule 27.

(4) **Deposit of amount in separate bank account:** The majority shareholders shall deposit an amount equal to the value of shares to be acquired by them under sub-section (2) or sub-section (3), as the case may be, in a separate bank account to be operated by the company whose shares are being transferred for at least one year for payment to the minority shareholders and such amount shall be disbursed to the entitled shareholders within sixty days:

Provided that such disbursement shall continue to be made to the entitled shareholders for a period of one year, who for any reason had not been made disbursement within the said period of sixty days or if the disbursement have been made within the aforesaid period of sixty days, fail to receive or claim payment arising out of such disbursement.

(5) **Role of company whose shares are being transferred to act as a transfer agent in the event of purchase:** In the event of a purchase under this section, the company whose shares are being transferred shall act as a transfer agent for receiving and paying the price to the minority shareholders and for taking delivery of the shares and delivering such shares to the majority, as the case may be.

(6) **Company whose shares are being transferred to issue shares:** In the absence of a physical delivery of shares by the shareholders within the time specified by the company,

- the share certificates shall be deemed to be cancelled, and
- the company whose shares are being transferred shall be authorised to issue shares in lieu of the cancelled shares and complete the transfer in accordance with law, and
- make payment of the price out of deposit made under sub-section (4) by the majority in advance to the minority by despatch of such payment.

(7) **Right of shareholders to make an offer for sale of minority equity shareholding:** In the event of a majority shareholder or shareholders requiring a full purchase and making payment of price by deposit with the company for-

- any shareholder or shareholders who have died or ceased to exist, or
- whose heirs, successors, administrators or assignees have not been brought on record by transmission,

the right of such shareholders to make an offer for sale of minority equity shareholding shall continue and be available for a period of three years from the date of majority acquisition or majority shareholding.

(8) **Sharing of additional compensation:** Where the shares of minority shareholders have been acquired in pursuance of this section, and as on or prior to the date of transfer following such

acquisition, the shareholders holding seventy-five per cent. or more minority equity shareholding negotiate or reach an understanding on a higher price for any transfer, proposed or agreed upon, of the shares held by them without disclosing the fact or likelihood of transfer taking place on the basis of such negotiation, understanding or agreement,-

the majority shareholders shall share the additional compensation so received by them with such minority shareholders on a pro rata basis.

Explanation—For the purposes of this section, the expressions "acquirer" and "person acting in concert" shall have the meanings respectively assigned to them in clause (b) and clause (e) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

Example: The issued equity share capital of ABC Limited is INR 50 Crores and 90% of such issued capital has been acquired by the XYZ Limited as a part of Amalgamation. In remaining minority shareholding of INR 5 crores, INR 4 crores has been held by Person "A". Hence, if he negotiate with the company with price higher then the decided under the scheme. The extra amount / compensation received by person "A" shall be allocated to all minority shareholders on pro rata basis.

(9) **Determination of price for purchase of minority shareholders:** Rule 27 prescribes that the Registered valuer shall determine the price to be paid by the acquirer, person or group of persons referred to in sub-section (1) of section 236 of the Act for purchase of equity shares of the minority shareholders of the company in accordance with the prescribed rules.

(10) **On failure of acquisition of shares:** When a shareholder or the majority equity shareholder fails to acquire full purchase of the shares of the minority equity shareholders, then, the provisions of this section shall continue to apply to the residual minority equity shareholders, even though,—

(a) the shares of the company of the residual minority equity shareholder had been delisted; and

(b) the period of one year or the period specified in the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, had elapsed.

7. POWER OF CENTRAL GOVERNMENT TO PROVIDE FOR AMALGAMATION OF COMPANIES IN PUBLIC INTEREST [SECTION 237]

(1) **Central Government may by order provide for amalgamation in the public interest:** Where the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

(2) **Continuation by or against the transferee company of any legal proceedings:** The order may also provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

(3) **Same Interest Rights or Compensation:** Every member or creditor, including a debenture holder, of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the transferee company as he had in the company of which he was originally a member or creditor, and in case the interest or rights of such member or creditor in or against the transferee company are less than his interest in or rights against the original company, he shall be entitled to compensation to that extent, which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette, and the compensation so assessed shall be paid to the member or creditor concerned by the transferee company.

(4) **Appeal by aggrieved person on assessment of compensation:** Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within a period of thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.

(5) **Requirements for passing of an order:** No order shall be made under this section unless—

(a) a copy of the proposed order has been sent in draft to each of the companies concerned;

(b) the time for preferring an appeal under sub-section (4) has expired, or where any such appeal has been preferred, the appeal has been finally disposed off; and

(c) the Central Government has considered, and made such modifications, if any, in the draft order as it may deem fit in the light of suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof.

(6) **Copies to be presented to parliament:** The copies of every order made under this section shall, as soon as may be after it has been made, be laid before each House of Parliament.

8. REGISTRATION OF OFFER OF SCHEMES INVOLVING TRANSFER OF SHARES [SECTION 238]

(1) **Registration of circular/ offer involving transfer of shares:** In relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company under section 235,—

(a) **every circular containing such offer and recommendation** to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in such manner as prescribed in Rule 28;

(b) **every such offer** shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available; and

(c) **every such circular shall be presented to the Registrar** for registration and no such circular shall be issued until it is so registered:

Provided that the Registrar may refuse, for reasons to be recorded in writing, to register any such circular which does not contain the information required to be given under clause (a) or which sets out such information in a manner likely to give a false impression, and communicate such refusal to the parties within thirty days of the application.

(2) **Appeal against the order of the registrar:** An appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular under sub-section (1).

(3) **In case of failure of registration:** The director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section (1), shall be liable to a penalty of one lakh rupees.[2]

9. PRESERVATION OF BOOKS AND PAPERS OF AMALGAMATED COMPANIES [SECTION 239]

The books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company under this Chapter shall not be disposed of without the prior permission of the Central Government and before granting such permission, that Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the transferor company or its amalgamation or the acquisition of its shares.

10. LIABILITY OF OFFICERS IN RESPECT OF OFFENCES COMMITTED PRIOR TO MERGER, AMALGAMATION, ETC. [SECTION 240]

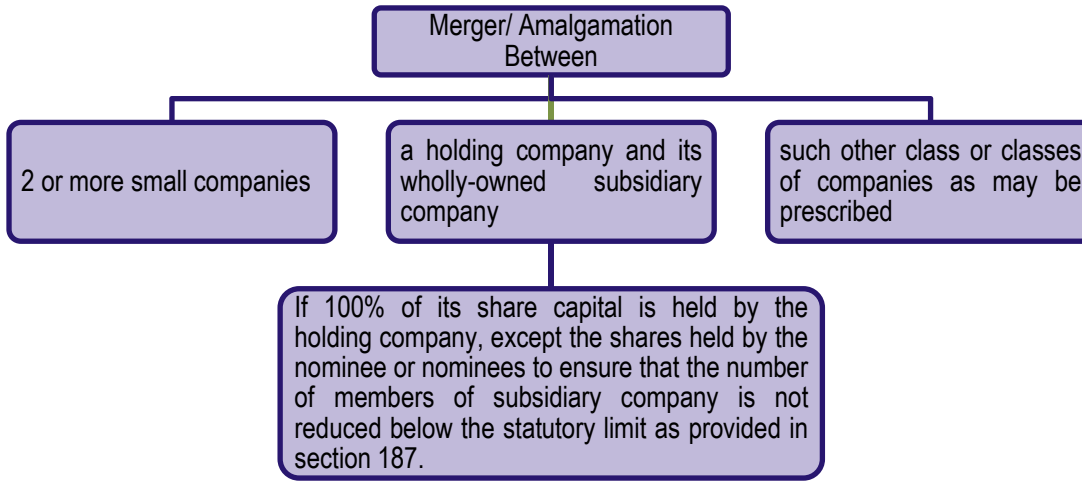
Retrospective effect of liability: Notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the

[2] Substituted for "punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees" by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. 2-11-2018.

transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

11. FAST TRACK MODE OF MERGER OR AMALGAMATION OF CERTAIN COMPANIES [SECTION 233]

- Preparation of proposed scheme
- Notice of the proposed scheme to Registrar and OL
- Consider their objections/suggestions, if any and amend the scheme accordingly
- Approval of scheme in respective General meeting of transferor company and transferree company
- Filing of declaration of solvency with Registrar by company
- convening meeting of creditors by giving 21 days notice
- Approval of scheme by majority representing 9/10th in value of creditors
- filing of the approved scheme by transferee company with a Central Govermment (power delegated to Regional Director) Registrar and OL
- RD to consider objections or suggestions of ROC and OL if any
- Passing of an application to Tribunal for approval of scheme
- Confirmation by Tribunal



(1) **Companies who may enter into scheme of merger or amalgamation:** A scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as given in *Rule 25 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016*, subject to the following, namely:—

(a) a **notice of the proposed scheme inviting objections or suggestions**, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company;

(b) the **objections and suggestions received are considered by the companies** in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent. of the total number of shares;

(c) each of the companies involved in the merger files a **declaration of solvency**, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

(d) the **scheme is approved by majority** representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

(2) **Filing of copy of scheme with the Central Government, Registrar and the Official Liquidator**: The transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

(3) **On the receipt of the scheme** if the Registrar or the Official Liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days.

If no such communication is made, it shall be presumed that he has no objection to the scheme.

(4) **Filing of application by Central government with Tribunal:** If the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal **within a period of sixty days of the receipt of the scheme,** stating its objections and requesting that the Tribunal may consider the scheme under section 232.

(5) **Passing of an order of Tribunal:** On receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit:

Provided that if the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

(6) **Communication of an order to registrar:** A copy of the order confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

(7) The registration of the scheme, shall be deemed to have the effect of dissolution of the transferor company without process of winding-up.

(8) **Effect of Registration of Scheme**: The registration of the scheme shall have the following effects, namely:—

- transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company
- the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;
- legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and
- where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

(9) **Effect of merger and amalgamation on transferee**: A transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

(10) **Filing of an application by transferee company with the Registrar:** The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital:

Provided that the fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

(11) **Applicability of the provisions:** The provisions of this section shall *mutatis mutandis* apply to-

- a company or companies specified in sub-section (1) in respect of a scheme of compromise or arrangement referred to in section 230, or
- division or transfer of a company referred to clause (b) of subsection (1) of section 232.

(12) The Central Government may provide for the merger or amalgamation of companies in such manner as may be prescribed.

(13) A company covered under this section may use the provisions of section 232 for the approval of any scheme for merger or amalgamation.

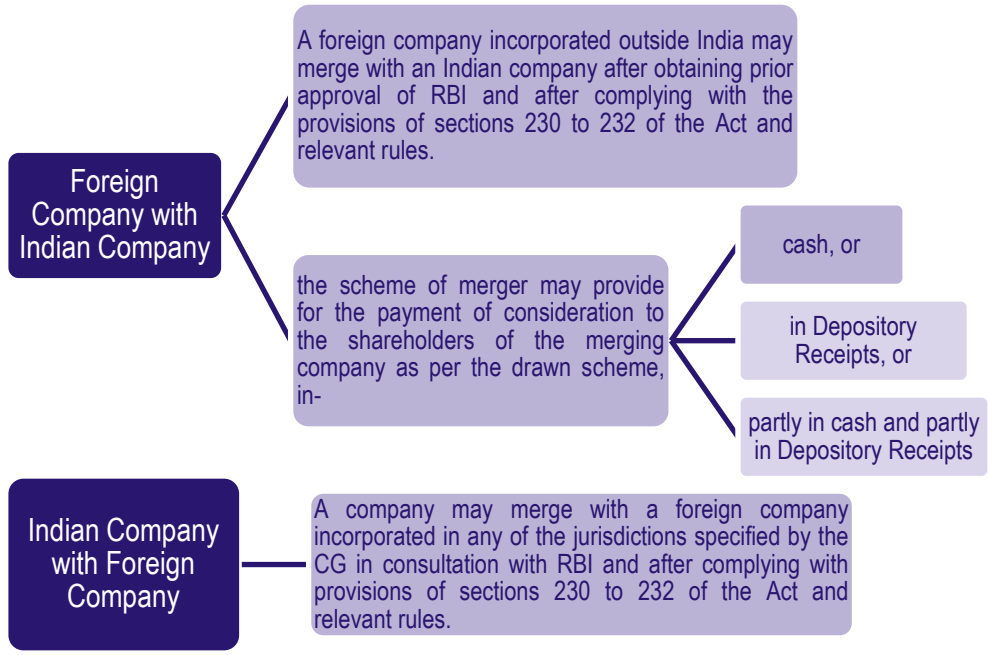
(14) According to sub-rule (8) of Rule 25, it is clarified that with respect to schemes of arrangements or compromise falling within the purview of section 233 of the Act, the

concerned companies may, at their discretion, opt to undertake such schemes under sections 230 to 232 of the Act, including where the condition prescribed in clause (d) of sub-section (1) of section 233 of the Act has not been met.

12. MERGER OR AMALGAMATION OF COMPANY WITH FOREIGN COMPANY [SECTION 234]

The provisions given in this section is also known as provision related to cross border merger.

The expression "**foreign company**" means any company or body corporate incorporated outside India whether having a place of business in India or not.



TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Under what circumstances the meeting of the creditors may be dispensed by the NCLT?

   (a) if 70% of the creditors in value agree and confirm to the scheme by way of affidavit

   (b) if 80% of the creditors in value agree and confirm to the scheme by way of affidavit

   (c) if 90% of the creditors in value agree and confirm to the scheme by way of affidavit

   (d) None of the above

2. PQR Limited and LMN Limited have proposed Scheme of Amalgamation between them under Section 232 of the Companies Act 2013. They are seeking your advice on which of the following approvals can be asked for in the petition to be filed before NCLT for the proposed scheme.

   (a) Change in Main Object Clause of Memorandum of Association;

   (b) Reduction of Share Capital;

   (c) Dissolution of the Transferor Company without winding up;

   (d) All of the above.

3. ABHI Limited is a wholly owned subsidiary company of ETERNAL Limited. ETERNAL Ltd., makes an application for merger of Holding and Subsidiary Companies under the section 232 of the Companies Act, 2013. The Company Secretary of the ETERNAL Ltd., states that company cannot apply for merger under section 232 of the said Act. He further stated that the company shall have to apply for merger as per section 233 i.e. Fast Track Merger. State the correct statement in terms of the validity of the difference in the opinion of the Company secretary-

   (a) Opinion of the Company Secretary of the ETERNAL Ltd. is valid holding that merger shall be as per section 233.

   (b) Opinion of the Company Secretary of the ETERNAL Ltd. is invalid as merger shall be possible only as per section 232.

   (c) Opinion of the Company Secretary of the ETERNAL Ltd. is invalid as the provisions given for fast track merger in the section 233 are of the optional nature.

   (d) Opinion of the Company Secretary of the ETERNAL Ltd. is invalid as the provisions given for fast track merger in the section 233 can be made between only small companies.

Descriptive Questions

Question 1

ABC Limited is a wholly owned subsidiary company of XYZ Limited. The Company wants to make application for merger of Holding and Subsidiary Companies under Section 232. The Company Secretary of the XYZ Limited is of the opinion that company cannot apply for merger as per section 232. The company shall have to apply for merger as per section 233 i.e. Fast Track Merger. Is the contention of Company Secretary being valid as per law?

Question 2

A meeting of members of ABC Limited was convened under the orders of the Court to consider a scheme of compromise and arrangement. Notice of the meeting was sent in the prescribed manner to all the 600 members holding in the aggregate 25,00,000 shares. The meeting was attended by 450 members holding 15,00,000 shares. 210 members holding 11,00,000 shares voted in favor of the scheme. 180 members holding 3,00,000 shares voted against the scheme. The remaining members abstained from voting.

Examine with reference to the relevant provisions of the Companies Act, 2013 whether the scheme is approved by the requisite majority.

Question 3

A meeting of members of DEF Limited was convened under the orders of the Court for the purpose of considering a scheme of compromise and arrangement. The meeting was attended by 300 members holding 9,00,000 shares. 120 members holding 7,00,000 shares in the aggregate voted for the scheme. 140 members holding 2,00,000 shares in aggregate voted against the scheme. 40 members holding 1,00,000 shares abstained from voting. Examine with reference to the relevant provisions of the Companies Act, 2013 whether the scheme was approved by the requisite majority?

ANSWER/SOLUTION

Answer to MCQ

1. (c) **Hint:** As per Section 230 (9) of the Companies Act, 2013, the Tribunal may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having at least ninety per cent. value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

2. (d) **Hint:** As per the provisions of Section 230, Section 232 of Section 233 of the Companies Act, 2013 and The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016; the Scheme of Amalgamation is a Complete Code for absorbing the objects of the Transferor Company, Increase in Authorized Share Capital of the Transferee Company, Reduction of Share Capital required if any and the dissolution of the Transferor Company without winding up. Hence, the petition for

approval of the proposed Scheme of Amalgamation between PQR Limited and LMN Limited can seek approval for all three options namely Change in Main Object clause of MOA, Reduction of Share Capital and Dissolution of the Transferor Company without winding up as effect of Amalgamation.

3. **(c)** **Hint:** As per section 233 (1), a scheme of merger or amalgamation may be entered between,

- 2 or more small companies, or
- a holding company and its wholly-owned subsidiary company, or
- such other class or classes of companies as may be prescribed.

The provisions given for fast track merger in the section 233 are in the optional nature and not a compulsion to the company. If a company wants to make application for merger as per section 232, it can do so.

Hence, here the Company Secretary of the XYZ Eternal limited has erred in the law and his contention is not valid as per law. The company shall have an option to choose between normal process of merger and fast track merger.

Answer to Descriptive Questions

1. **As per section 233 (1),** notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered between,

- 2 or more small companies
- a holding company and its wholly-owned subsidiary company. If 100% of its share capital is held by the holding company, except the shares held by the nominee or nominees to ensure that the number of members of subsidiary company is not reduced below the statutory limit as provided in section 187
- such other class or classes of companies as may be prescribed.

The provisions given for fast track merger in the section 233 are in the optional nature and not a compulsion to the company. If a company wants to make application for merger as per section 232, it can do so.

Hence, here the Company Secretary of the XYZ limited has erred in the law and his contention is not valid as per law. The company shall have an option to choose between normal process of merger and fast track merger.

2. **As per section 230 (6),** of the Companies Act, 2013 where majority of persons at a meeting held **representing 3/4th in value,** voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order. The majority of person representing 3/4th Value shall be counted of the following:

- the creditors, or

- class of creditors or
- members or
- class of members, as the case may be,

The majority is dual, in number and in value. A simple majority of those voting is sufficient. Whereas the 'three-fourths' requirement relates to value. The three-fourths value is to be computed with reference to paid-up capital held by members present and voting at the meeting.

In this case out of 600 members, 450 members attended the meeting, but only 390 members voted at the meeting. As 210 members voted in favor of the scheme the requirement relating to majority in number (i.e. 196) is satisfied. 390 members who participated in the meeting held 14,00,000, three-fourth of which works out to 10,50,000 while 210 members who voted for the scheme held 11,00,000 shares. As both the requirements are fulfilled, the scheme is approved by the requisite majority.

3. **As per section 230 (6),** of the Companies Act, 2013 where majority of persons at a meeting held **representing 3/4th in value,** voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order. The majority of person representing 3/4th Value shall be counted of the following:

- the creditors, or
- class of creditors or
- members or
- class of members, as the case may be,

The majority is dual, in number and in value. A simple majority of those voting is sufficient. Whereas the 'three-fourths' requirement relates to value. The three-fourths value is to be computed with reference to paid-up capital held by members present and voting at the meeting.

In this case 300 members attended the meeting, but only 260 members voted at the meeting. As 120 members voted in favor of the scheme the requirement relating to majority in number (i.e. 131) is not satisfied.

260 members who participated in the meeting held 9,00,000 shares, three-fourth of which works out to 6,75,000 while 120 members who voted for the scheme held 7,00,000 shares. The majority representing three-fourths in value is satisfied.

Thus, in the instant case, the scheme of compromise and arrangement of DEF Limited is not approved as though the value of shares voting in favor is significantly more, the number of members voting in favor do not exceed the number of members voting against.

CHAPTER 6

PREVENTION OF OPPRESSION AND MISMANAGEMENT

LEARNING OUTCOMES

After studying this chapter, the students would be able to learn

- The consequences which the NCLT might take to acknowledge the fact of oppression and mismanagement in a company.
- The list of persons who have the right to file the application.
- About remedies available to aggrieved party in case of oppression or mismanagement
- The provisions relating to Class Action Suits.

1. INTRODUCTION

To begin with, let us understand the basic concept hidden behind this chapter. Why would the company law even introduce such a thing, when all the provisions are super clear and explanatory? Because, the law evaders find a way to the loophole. Okay, let's see this more clearly – imagine a situation of a company say, Rexagon Private Limited, which has 7 shareholder – Abhishek, Archit, Ankur, Anupam, Himanshu, Manas and Rajan. Out of these, Abhishek, Archit and Ankur hold around 94% of the shares of the company. Now, at the general meeting of the company, when any resolution is required to be passed – ordinary or special, the resolution shall be passed in the favour, if these three people vote in the favour of the resolution, since they form a majority. Therefore, the voice of the minority shareholders – Anupam, Himanshu, Manas and Rajan won't be heard.

This is because the corporate law works on the principle of democracy and it becomes more vulnerable because it is reckoned with the number of shares and not with the number of individuals involved. This is known as the famous **'Rule of Majority'** or which is also called the '***Foss v. Harbottle***' Rule, which is a landmark judgment in the history of company law. It states that the ones who hold majority of shares "rule" the company (*Foss v. Harbottle (1843) 2 Hare 461).* The judgment held that if the majority shareholders have made a decision to take or not to take a certain action, it shall be respected. Also, the courts are not expected to ordinarily intervene to protect the minority interest affected by resolution.

Rule of majority

What happened in *Foss v. Harbottle*? In the said case, two shareholders commenced legal action against the promoters and directors of the company alleging that they had misapplied the company assets and had improperly mortgaged the company property. The Court rejected the two shareholders' plea and held that a breach of duty by the directors of the company was a wrong done to the company for which it (i.e. the company) alone could sue. In other words, the proper plaintiff in that case was the company and not the two individual shareholders. Thus, the *Foss v. Harbottle* derives two major rules or principles of the company law – first, a company is a legal entity separate from its shareholders; and second that the Court will not interfere with the internal management of companies acting within their powers. Therefore, where an ordinary majority of members can ratify the act, the Court will not interfere.

However, the said rule has 4 exceptions, which are as follows –

- *Ultra-vires* or illegal acts;
- Transactions requiring special majorities;
- Personal Rights; and
- The "fraud on the minority" exception.

This Chapter focuses on the last exception as mentioned above.

Oppression

Let us understand the meaning of 'oppression' as used in the Act. The meaning of the term "oppression" as explained by Lord Cooper in the Scottish case of *Elder v. Elder & Watson Ltd*. was cited with approval by Wanchoo J. of the Supreme Court of India in *Shanti Prasad Jain v. Kalinga Tubes*. He said that the conduct of complained of, should at least involve a visible departure from the standards of their dealing, and violations of conditions of fair play on which every shareholder who entrusts his money to company, is entitled to rely.

The complaining member must show that he is suffering from oppression in his capacity as a member and not in any other capacity.

To constitute oppression, persons concerned with the management of the company's affairs must, in connection thereof, be guilty of fraud, misfeasance or misconduct towards the members. It does not include mere domestic disputes between directors and members, or lack of confidence between one set of members and others.

It was observed in *Rao (V.M.) v. Rajeshwari Ramakrishnan* that the oppression complained off must affect a person in his capacity or character as a member of the company; harsh or unfair treatment in other capacity, e.g., as a director or a creditor is outside the purview of this chapter.

There must be a continuous acts constituting oppression up to the date of the petition.

The events have to be considered not in isolation but as a part of a continuous suffering.

The conduct complained of, can be said to be "oppression" only when it could be said that it is burdensome, harsh and wrongful; involves at least an element of lack of probity and fair dealing to a member in matters of his proprietary right as a shareholder.

How Act explained oppression and mismangagement: The Act defines that

(i) If affairs of a company have been or are been conducted prejudicial to public interest or in a manner prejudicial or oppressive to any member or prejudicial to the interest of company, there is a case of oppression or mismanagement.

(ii) Any material change that has taken place in management or control of a company and that by reason of such change it is likely that the affairs of a company will be conducted prejudicial to interest of its member or company, that would also be considered as oppression or mismanagement.

2. APPLICATION TO TRIBUNAL FOR RELIEF IN CASES OF OPPRESSION, ETC. [SECTION 241]

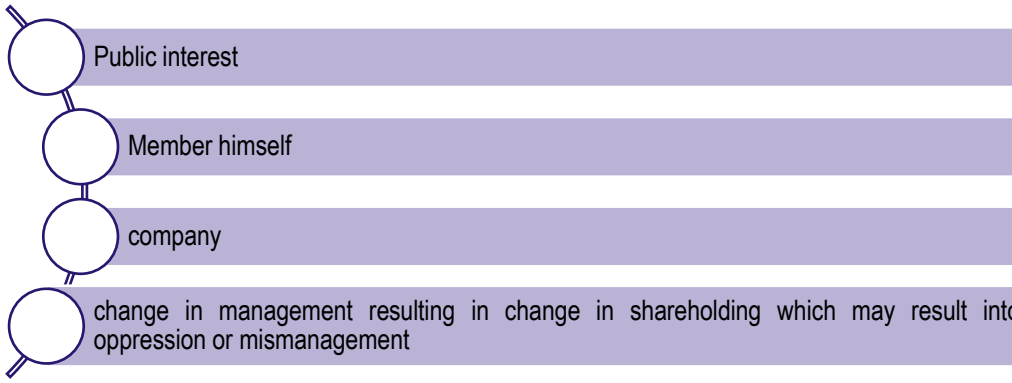
The section seeks to provide the circumstances in which an application may be made to the Tribunal by any member of a company or by the Central Government for relief in cases of oppression and mismanagement in the affairs of the company.

(1) **Right to apply by member:** Any member of a company who complains that—

(a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or

(b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other

manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members, may apply to the Tribunal, provided such member has a right to apply under section 244, for an order under this Chapter.



Section 241(1) addresses complaints on the conducts of the company's affairs, which could be a prejudicial to public interest and prejudicial or oppressive to the members or the company.

The provision gives the members, the right to move the Tribunal not only on complaints of oppression but also on complaints that the conduct of the affairs of the company have been or are 'prejudicial' to them.

Thus, section 241(1)(a) also includes past acts of oppression.

This section also corresponds to the remedy for mismanagement in the affairs of the company. It states that a member can complain "that the affairs of a company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company".

So, a company can complain in case a material change in the management is likely to be prejudicial to the interests of the members.

(2) **Central Government suo moto to apply the Tribunal:** The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order under this Chapter.

Examples

1. A shareholder was reduced to a minority status since the company had increased the capital and allotted the additional shares in a manner that resulted in a new majority. As against a petition filed by this shareholders, the majority shareholders offered to restore his status back to the existing before the increase of capital, if the management of another company was handed over to them. Such a transfer of management of another company, does not come under the purview of this section.

2. In an application filed to the Tribunal, claiming oppression, a shareholder who is also the director of the company cannot claim compensation by way of salary paid to other directors. Shareholders can share the dividend of the company, if it is declared but cannot seek directions to be compensated. The payment of salary is a question that concerns the Board of Directors and not the Tribunal.

3. Failure to declare dividend does not amount to oppression. (*Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd*).

4. A shareholder died. A petition was filed by his legal heir who was in the position of a minority shareholder. Can the application filed by the legal heir to the Tribunal, be maintainable in court?

   The legal heir of the deceased shareholder with minority status is entitled to file the petition.

5. Where a person without being so appointed, was acting as a Managing Director and was discharging his functions as such, whether with or without the knowledge of the members, a member could not claim that it was an act of oppression, by filing an application with the Tribunal.

6. While obtaining relief from Tribunal, continuous losses cannot, by itself, be regarded as oppression *(Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth).*

3. RIGHT TO APPLY UNDER SECTION 241 [SECTION 244]

The section is linked to section 241 of the Act, and provides for the eligibility of members who hold the right to file the application under section 241 for oppression and mismanagement with the Tribunal. These qualification as provided in section 244 ensure that only the persons with sufficient interest in the affairs of the company can file the petition under section 241 of the Act.

(1) **Members having right to apply**: The following members of a company shall have the right to apply under section 241, namely:—

(a) **in the case of a company having a share capital**, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

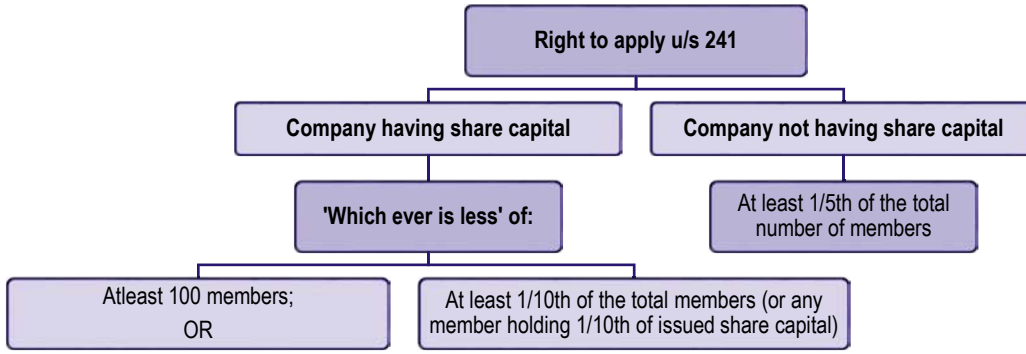
(b) **in the case of a company not having a share capital**, not less than one-fifth of the total number of its members:

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b)so as to enable the members to apply under section 241. [Thus, The section also enables the members not meeting the

membership qualification in section 244(1) to file an application with the Tribunal for waiver of these requirements for filing the petition.]

Explanation—For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

(2) Entitlement to members to make an application: Where any members of a company are entitled to make an application under subsection (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.



Examples

1. In case, where the shareholding of the petitioner-member gets reduced to below 10 per cent because of fresh issue/allotment of shares, which is challenged as oppressive, the maintainability of the petition would be reduced after determining the validity of the issue of allotment. The petition shall be maintainable and the petitioner-member shall be entitled to relief.

2. The requirement of shareholding up to the prescribed percentage is mandatory. It must be shown with the help of documentary evidence. Possession of share certificates is a prima facie proof that the petitioner is a shareholder. There is a presumption that a share certificate is a valid title to shares.

3. Shareholding and membership is reckoned not on the basis of the subscribed or paid-up share capital, but on the basis of the 'issued' share capital. For instance, a company may have issued a capital of 50 lakh rupees divided into 50,000 shares of 100 rupees each, but only 45,000 shares may have been subscribed for. The remaining shares will then be left to be disposed of in such a manner as the Board of Directors think best in the interests of the company. 'Issued' share capital would include both equity and preference share capital.

4. The consent to be given by a shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by any shareholder during the course of proceedings shall not affect the maintainability of the petition [*Rajamundhry Electric Corporation Vs. V. Nageswar Rao A.I.R. (1956) Sc. 2013.]*

4. POWERS OF TRIBUNAL [SECTION 242]

(1) **Order passed by the tribunal:** If, on any application made under section 241, the Tribunal is of the opinion—

(a) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up,

the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

(2) **Nature of orders that can be passed by the Tribunal:** Without prejudice to the generality of the powers under sub-section (1), an order under that sub-section may provide for—

(a) the regulation of conduct of affairs of the company in future;

(b) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(d) restrictions on the transfer or allotment of the shares of the company;

(e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

Provided that no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

(g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;

(h) removal of the managing director, manager or any of the directors of the company;

(i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);

(k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(l) imposition of costs as may be deemed fit by the Tribunal;

(m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

(3) **Filing of copy of order of tribunal:** A certified copy of the order of the Tribunal shall be filed by the company with the Registrar within 30 days of the order of the Tribunal.

(4) **Interim order:** The Tribunal may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable.

(5) **Alteration through order of the Tribunal:** Where an order of the Tribunal makes any alteration in the memorandum or articles of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the memorandum or in the articles.

(6) **Punishment in case of contravention:** If a company contravenes the provisions of sub-section (5) [i.e. not amending the memorandum or articles of association of the company, in a manner consistent with orders passed for alteration of these documents], the company 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 six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

(7) **Altered provision shall apply:** The alterations made by the order in the memorandum or articles of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered.

(8) **Certified copy of altered order shall be filed with the Registrar:** A certified copy of every order altering, or giving leave to alter, a company's memorandum or articles, shall within 30 days after the making thereof, be filed by the company with the Registrar who shall register the same.

Examples

1. Mere lack of confidence among members themselves resulting in certain acts of irregularities or illegalities cannot be held to be oppressive *per se*. A case of oppression as well as mismanagement has to be made out by the petitioners substantiating that the acts complained of have caused prejudice to the interest of the company and its members and shareholders to have a cause of action to attract the provisions of the Act.

2. Directorial complaints cannot be entertained in such a petition unless it is a composite complaint and is in the case of a company in the nature of *quasi* – partnership (i.e. small partnerships of a limited number of individuals which, although operating as a limited company, run as if they are partnership between those individuals at the control.

3. The matter of selection and appointment of dealers of the company's products is not within the ambit and scope of the proceedings under section 241 (erstwhile section of the Act). In a tripartite agreement with the government, a project was assigned to the company. In this case, the right to manage the affairs of the company is vested in the majority of the shareholders and not in the person who might have procured the project for the company.

4. The decisions relating to the operation of the company's bank accounts are a part of the managerial power of the directors. The mere fact that a director is not being associated with the operation of the company's bank accounts, does not constitute oppression or mismanagement. *(Sudha M. Singh v. Eagle Cones Pvt. Ltd (2000) 36 CLA 189)*

5. The decision of the Board of Directors to write-off bad debts is a commercial decision and does not require any judicial interference.

6. The members of the company, Minions Private Limited have filed an application for oppression in the company. To prove their facts, the members have requested for the inspection of documents of the company, which the company denied to provide. Discuss, whether this amount to oppression?

   The right to inspection of documents and books of account of a company is not limited to the Board of directors. In order to prove allegations made in a petition under section 241 (erstwhile section of the Act), the shareholders are entitled to be allowed inspection of the books of account and other relevant papers of the company. However, mere denial of inspection, whether during the pendency of the petition or before it, does not amount to an act of oppression as held in the case of *Lalita Rajya Lakshmi v. Indian Motor Co. (Hazaribagh) Ltd. (1962) 32 Com Cases 207.* If a petitioner cannot make out a case of

mismanagement and oppression, because he was unable to collect materials for the purpose, it is not for the court to direct the directors of the company to offer inspection of the company's books and accounts so as to enable a petitioner to collect materials for the petition under the Act.

7. In deciding an application under section 241 and 242 (erstwhile section of the Act), the Tribunal has to bear in mind that the act of oppression must be a continuing one. A single act of renting out the premises of the company without the knowledge of the members cannot be termed as oppression or mismanagement.

8. The power to issue shares should be exercised bona-fide in the interest of the company and not for benefiting the directors or any other group. The directors are in a fiduciary position with the company and must exercise their power to issue the shares for the benefit of the company. If the power is exercised solely for their personal benefit, the Tribunal may interfere and prevent the directors from doing so. The act of issue of further shares by the directors of a company for the purpose of converting a majority into minority is a grave act of oppression.

5. CONSEQUENCES OF TERMINATION OR MODIFICATION OF CERTAIN AGREEMENTS [SECTION 243]

(1) **Consequence of termination or modifications of certain agreements by an order passed by the Tribunal:** Where an order made under section 242 terminates, sets aside or modifies an agreement such as is referred to in sub-section (2) of that section,—

(a) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;

(b) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company:

Provided that the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

(2) **Penalty:** Any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (b) of sub-section (1), and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

6. CLASS ACTION [SECTION 245]

This section introduces the concept of class action by shareholders and depositors of a company with substantive remedies. Under section 245 of the act, members and depositors, or an individual member or depositor, can file a petition for reliefs, if they are of the opinion that the affairs of the company are being managed or conducted in a manner prejudicial to the interests of the company, its members or depositors.

According to section 245:

(1) **Filing of application before the Tribunal on behalf of the members or depositors:** Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:—

(a) to restrain the company from committing an act which is ultra vires the articles or memorandum of the company;

(b) to restrain the company from committing breach of any provision of the company's memorandum or articles;

(c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;

(d) to restrain the company and its directors from acting on such resolution;

(e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

(f) to restrain the company from taking action contrary to any resolution passed by the members;

(g) to claim damages or compensation or demand any other suitable action from or against—

(i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;

(ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent,

unlawful or wrongful act or conduct; or

(iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;

(h) to seek any other remedy as the Tribunal may deem fit.

(2) **Required number of members to apply:**

(i) The requisite number of members provided in sub-section (1) shall be as under:—

(a) **in the case of a company having a share capital**, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(b) **in the case of a company not having a share capital**, not less than one-fifth of the total number of its members.

(ii) **The requisite number of depositors** provided in sub-section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever less is, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

(3) **Requirement for consideration of application:** In considering an application under sub-section (1), the Tribunal shall take into account, in particular—

(a) whether the member or depositor is acting in good faith in making the application for seeking an order;

(b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of subsection (1);

(c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;

(d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;

(e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—

(i) authorised by the company before it occurs; or

(ii) ratified by the company after it occurs;

(f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

(4) **In case of admission of application:** If an application filed under sub-section (1) is admitted, then the Tribunal shall have regard to the following, namely:—

(a) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;

(b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;

(c) two class action applications for the same cause of action shall not be allowed;

(d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

(5) **Remedy:** Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

(6) **Order shall be binding:** Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

(7) **Punishment for non-compliance**: Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five 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 twenty-five thousand rupees but which may extend to one lakh rupees.

In addition to this punishment, penalties given under sections 337 to 341 (both inclusive) shall also apply.

(8) **Application filed is frivolous/vexatious:** Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost,

not exceeding one lakh rupees, as may be specified in the order.

(9) **Exemption from application of section**: Nothing contained in this section shall apply to a banking company.

(10) **Application may be filed on behalf of affected persons:** Subject to the compliance of this section, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1).

7. APPLICATION OF CERTAIN PROVISIONS TO PROCEEDINGS UNDER SECTION 241 OR SECTION 245 [SECTION 246]

The provisions of sections 337, 338, 339, 340 and 341 (both inclusive) related to winding up, shall apply *mutatis mutandis*, in relation to an application made to the Tribunal under section 241 or section 245.

Penalty for Frauds by Officers [Section 337]

Liability Where Proper Accounts not Kept [Section 338]

Liability for Fraudulent Conduct of Business[Section 339]

Power of Tribunal to Assess Damages Against Delinquent Directors, etc.[Section 340]

Liability Under Sections 339 and 340 to Extend to Partners or Directors in Firms or Companies [Section 341]

In other words:

- The section seeks to provide that the provisions of the section 337 to 341 relating to power to punish for contempt of Tribunal shall apply in relation to a fraudulent application made to the Tribunal for oppression and mismanagement.
- The provisions of section 337 – 341 deal with offences by officers, contributories and promoters of a company after its winding up and provide for penalties and recompense for falsification of books, frauds committed by officers, failure to keep proper accounts, fraudulent conduct of business, and the power to access damages against such delinquent officers, including partners and directors when a firm or a body is involved.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Astistav Private Limited is a company with ten shareholders. A member holding less than one-tenth of the share capital of the company apply to the Tribunal for relief against oppression and mismanagement? State whether a member have a right to apply to the tribunal in above situation:

(a) A single Member cannot apply to the Tribunal for relief against oppression and mismanagement

(b) A member cannot apply as he is holding less than one-tenth of the share capital of the company

(c) A member can apply being one-tenth of the total number of members.

(d) A member cannot apply as the requirement of atleast hundred members is not complied with.

2. With whom will the Central Government file an application if it is of the opinion that such a scheme is not in public interest or in the interest of the creditors?

(a) Cannot move an application

(b) it may file an application before the Tribunal

(c) it may file an application before the Parliament

(d) It may be through Special Petition before Supreme Court.

Descriptive Questions

Question 1

ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than one-tenth of the share capital of the company apply to the Tribunal for relief against oppression and mismanagement? Give your answer according to the provisions of the Companies Act, 2013.

Question 2

The issued and paid up capital of MNC Limited is ₹ 5 crores consisting of 5,00,000 equity shares of ₹ 100 each. The said company has 500 members. A petition was submitted before the Tribunal signed by 80 members holding 10,000 equity shares of the company for the purpose of relief against oppression and mismanagement by the majority shareholders. Examining the provisions of the Companies Act, 2013, decide whether the said petition is maintainable. Also explain the impact

on the maintainability of the above petition, if subsequently 40 members, who had signed the petition, withdrew their consent.

Question 3

A group of shareholders consisting of 25 members decide to file a petition before the Tribunal for relief against oppression and mismanagement by the Board of Directors of M/s Fly By Night Operators Ltd. The company has a total of 300 members and the group of 25 members holds one –tenth of the total paid –up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is the due to mismanagement by the board of directors, the company is incurring losses and the company has not declared any dividends even when profits were available in the past years for declaration of dividend. In the light of the provisions of the Companies Act, 2013, advise the group of shareholders regarding the success of (i) getting the petition admitted and (ii) obtaining relief from the Tribunal.

Question 4

A group of members of XYZ Limited has filed a petition before the Tribunal alleging various acts of oppression and mismanagement by the majority shareholders of the company. The Petitioner group holds 12% of the issued share capital of the company. During the pendancy of the petition, some of the petitioner group holding about 5% of the issued share capital of the company wish to disassociate themselves from the petition and they along with the other majority shareholders have submitted before the Tribunal that the petition may be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act, 2013.

ANSWER/SOLUTION

Answer to MCQ

1. (c) **Hint:** Under section 244 of the Companies Act, 2013, in the case of a company having share capital, the following member(s) have the right to apply to the Tribunal under section 241:

(a) Not less than 100 members of the company or not less than one-tenth of the total number of members, whichever is less; or

(b) Any member or members holding not less than one-tenth of the issued share capital of the company provided the applicant(s) have paid all the calls and other sums due on the shares.

In the given case, since there are ten shareholders. As per the condition (a) above, 10% of 10 i.e. 1 satisfies the condition. Therefore, a single member can present a petition to the Tribunal, regardless of the fact that he holds less than one-tenth of the company's share capital.

2. **(b)** **Hint:** As per section 241(2), the Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order under this Chapter XVI of the Companies Act, 2013.

Answer to Descriptive Questions

1. Under section 244 of the Companies Act, 2013, in the case of a company having share capital, the following member(s) have the right to apply to the Tribunal under section 241:

(a) Not less than 100 members of the company or not less than one-tenth of the total number of members, whichever is less; or

(b) Any member or members holding not less than one-tenth of the issued share capital of the company provided the applicant(s) have paid all the calls and other sums due on the shares.

In the given case, since there are eight shareholders. As per the condition (a) above, 10% of 8 i.e. 1 satisfies the condition. Therefore, a single member can present a petition to the Tribunal, regardless of the fact that he holds less then one-tenth of the company's share capital.

2. **Right to apply for oppression and mismanagement:** As per the provisions of Section 244 of the Companies Act, 2013, in the case of a company having share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

100 members; or

1/10th of the total number of members; or

Members holding not less than 1/10th of the issued share capital of the company.

The share holding pattern of MNC Limited is given as follows:

₹ 5,00,00,000 equity share capital held by 500 members

The petition alleging oppression and mismanagement has been made by some members as follows:

(i) No. of members making the petition – 80

(ii) Amount of share capital held by members making the petition – ₹ 10,00,000

The petition shall be valid if it has been made by the lowest of the following:

100 members; or

50 members (being $1/10^{th}$ of 500); or

Members holding ₹ 50,00,000 share capital (being $1/10^{th}$ of ₹ 5,00,00,000)

As it is evident, the petition made by 80 members meets the eligibility criteria specified under section 244 of the Companies Act, 2013 as it exceeds the minimum requirement of 50 members in this case. Therefore, the petition is maintainable.

The consent to be given by a shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by any shareholder during the course of proceedings shall not affect the maintainability of the petition [*Rajamundhry Electric Corporation Vs. V. Nageswar Rao A.I.R.*].

3. Section 244 of the Companies Act, 2013 provides the right to apply to the Tribunal for relief against oppression and mis-management. This right is available only when the petitioners hold the prescribed limit of shares as indicated below:

(i) In the case of company having a share capital, not less than 100 members of the Company or not less than one tenth of the total number of its members whichever is less or any member or members holding not less than one tenth of the issued share capital of the company, provided that the applicant(s) have paid all calls and other dues on the shares.

(ii) In the case of company not having share capital, not less than one-fifth of the total number of its members.

Since the group of shareholders do not number 100 or hold 1/10th of the issued share capital or constitute 1/10th of the total number of members, they have no right to approach the Tribunal for relief.

However, the Tribunal may, on an application made to it waive all or any of the requirements specified in (i) or (ii) so as to enable the members to apply under section 241.

As regards obtaining relief from Tribunal, continuous losses cannot, by itself, be regarded as oppression (*Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth*).

Similarly, failure to declare dividends or payment of low dividends also does not amount to oppression. (*Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd*).

Thus, the shareholders may not succeed in getting any relief from Tribunal.

4. The argument of the majority shareholders that the petition may be dismissed on the ground of non-maintability is not correct. The proceedings shall continue irrespective of withdrawl of consent by some petitioners. It has been held by the Supreme Court in *Rajmundhry Electric Corporation vs. V. Nageswar Rao, AIR (1956) SC 213* that if some of the consenting members have subsequent to the presentation of the petition withdraw their consent, it would not affect the right of the applicant to proceed with the petition. Thus, the validity of the petition must be judged on the facts as they were at the time of presentation. Neither the right of the applicants to proceed with the petition nor the jurisdiction of Tribunal to dispose it of on its merits can be affected by events happening subsequent to the presentation of the petition.

CHAPTER 7

WINDING UP

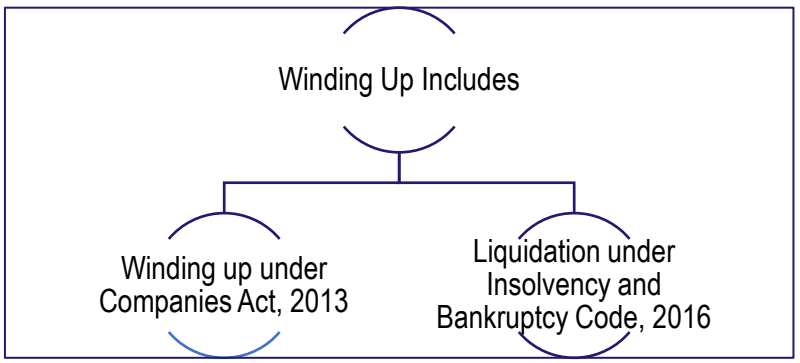
LEARNING OUTCOMES

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

- Introduction to Winding Up
- Winding up by the Tribunal
- Procedure for winding up to be monitored by the NCLT

1. INTRODUCTION

As per Section 2(94A) of the Companies Act, 2013, winding up" means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable.



2. MODES OF WINDING UP [SECTION 270]

The provisions of Part I shall apply to the winding up of a company by the Tribunal under this Act.

PART I: WINDING UP BY THE TRIBUNAL [SECTION 271 – 303]

3. CIRCUMSTANCES IN WHICH COMPANY MAY BE WOUND UP BY TRIBUNAL [SECTION 271]

A company may, on a petition under section 272, be wound up by the Tribunal,—

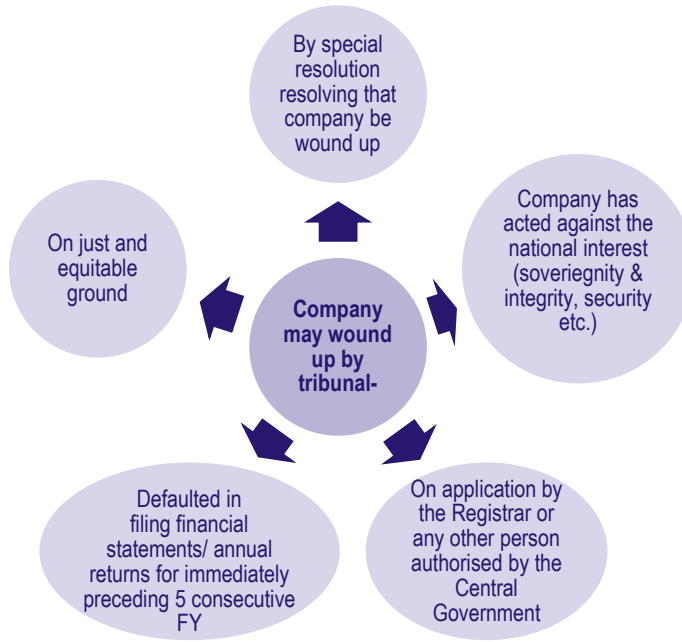
(a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

(c) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

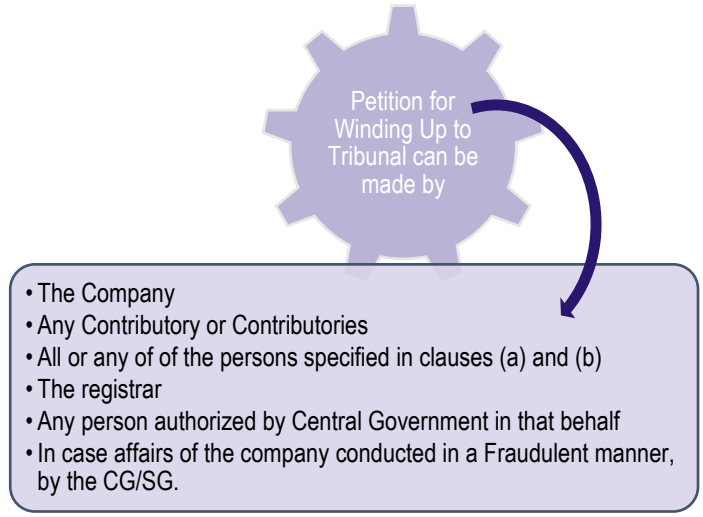
(d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

(e) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.



4. PETITION FOR WINDING UP [SECTION 272]

(1) Petition may be presented by:



Subject to the provisions of this section, a petition to the Tribunal for the winding up of a company shall be presented by—

(a) the company;

(b) any contributory or contributories;

(c) all or any of the persons specified in clauses (a) and (b);

(d) the Registrar;

(e) any person authorised by the Central Government in that behalf; or

(f) in a case falling under clause (b) of section 271, by the Central Government or a State Government.

(2) Petition by contributory: A contributory shall be entitled to present a petition for the winding up of a company.

Shares in respect of which he is a contributory or some of them were either originally allotted to him or have been held by him, and registered in his name, for at least six months during the eighteen months immediately before the commencement of the winding up or have devolved on him through the death of a former holder.

Contributory can file petition ignoring the following points

- He may be the holder of fully paid-up shares.
- The company may have no assets at all.
- The company may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities.

(3) Petition by registrar: The Registrar shall be entitled to present a petition for winding up under section 271, except on the grounds specified in clause (a) or clause (e) of that sub-section.

Provided that the Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition:

Provided further that the Central Government shall not accord its sanction unless the company has been given a reasonable opportunity of making representations.

(4) Petition presented by company: A petition presented by the company for winding up before the Tribunal shall be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.

(5) Copy of petition with registrar: A copy of the petition made under this section shall also be filed with the Registrar and the Registrar shall, without prejudice to any other provisions, submit his views to the Tribunal within sixty days of receipt of such petition.

5. POWERS OF TRIBUNAL [SECTION 273]

(1) Order passed by tribunal: The Tribunal may, on receipt of a petition for winding up under section 272 pass any of the following orders, namely:—

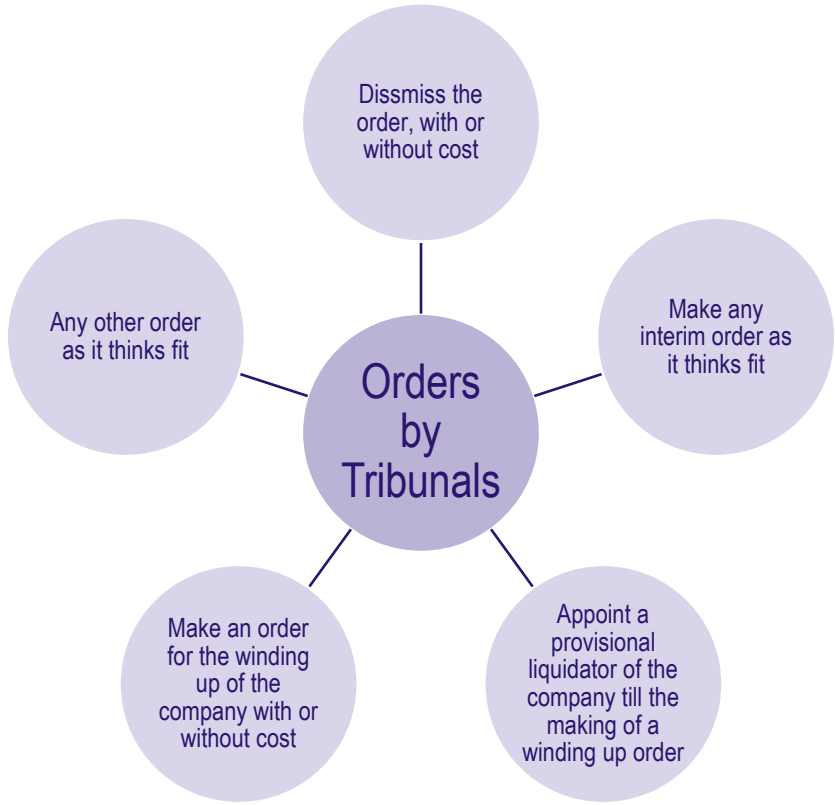
(a) dismiss it, with or without costs;

(b) make any interim order as it thinks fit;

(c) appoint a provisional liquidator of the company till the making of a winding up order;

(d) make an order for the winding up of the company with or without costs; or

(e) any other order as it thinks fit:



Time limit for passing of an order: An order under this sub-section shall be made within ninety days from the date of presentation of the petition.

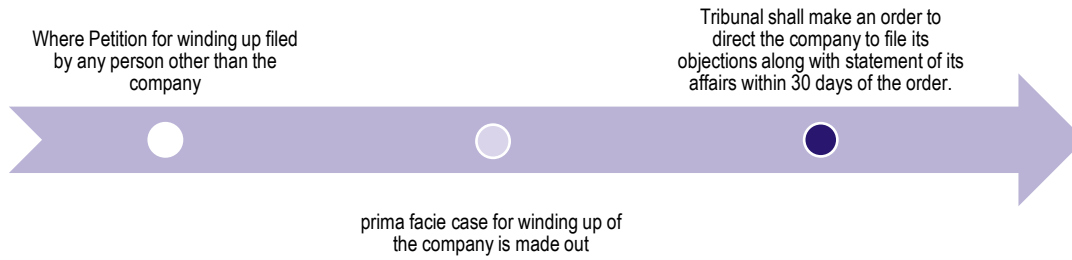
Notice to company on appointing of provisional liquidator: Before appointing a provisional liquidator under clause (c), the Tribunal shall give notice to the company and afford a reasonable opportunity to it to make its representations, if any, unless for special reasons to be recorded in writing, the Tribunal thinks fit to dispense with such notice.

Tribunal shall not refuse to make a winding up order: The Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged for an amount equal to or in excess of those assets, or that the company has no assets.

(2) **Tribunal make order for any other remedy on just and equitable ground:** Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing the other remedy.

6. DIRECTIONS FOR FILING STATEMENT OF AFFAIRS [SECTION 274]

(1) **Tribunal may order company to file a statement of its affairs:** Where a petition for winding up is filed before the Tribunal by any person other than the company, the Tribunal shall, if satisfied that a prima facie case for winding up of the company is made out, by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order in such form and in such manner as may be prescribed.



Extension of time for filing: The Tribunal may allow a further period of thirty days in a situation of contingency or special circumstances.

Deposit of security: The Tribunal may direct the petitioner to deposit such security for costs as it may consider reasonable as a precondition to issue directions to the company.

(2) **Punishment for not filing of the statement of affairs:** A company, which fails to file the statement of affairs as referred to in sub-section (1), shall forfeit the right to oppose the petition and such directors and officers of the company as found responsible for such non-compliance, shall be liable for punishment under sub-section (4).

(3) **Officers to pay cost of the company, book of accounts completed and audited to the Liquidator :** The directors and other officers of the company, in respect of which an order for winding up is passed by the Tribunal under clause (d) of sub-section (1) of section 273, shall, within a period of thirty days of such order, submit, at the cost of the company, the books of account of the company completed and audited up to the date of the order, to such liquidator and in the manner specified by the Tribunal.

(4) **Contravention of section:** If any director or officer of the company contravenes the provisions of this section, the director or the 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 but which may extend to ₹ five lakh, or with both.

(5) **Complaint to be presented before special court may be filed by:** The complaint may be filed in this behalf before the Special Court by Registrar, provisional liquidator, Company Liquidator or any person authorised by the Tribunal.

7. COMPANY LIQUIDATORS AND THEIR APPOINTMENTS [SECTION 275]

(1) **Appointment of official liquidator:** For the purposes of winding up of a company by the Tribunal, the Tribunal at the time of the passing of the order of winding up, shall appoint an Official Liquidator or a liquidator from the panel maintained as the Company Liquidator.

(2) **Appointment of provisional liquidator or the Company Liquidator by tribunal:** The provisional liquidator or the Company Liquidator, as the case may, shall be appointed by the Tribunal from amongst the insolvency professionals registered under the Insolvency and Bankruptcy Code, 2016.

(3) **Tribunal may limit the powers of a provisional liquidator:** Where a provisional liquidator is appointed by the Tribunal, the Tribunal may limit and restrict his powers by the order appointing him or it or by a subsequent order, but otherwise he shall have the same powers as a liquidator.

(4) **Tribunal to specify the terms and conditions of appointment of provisional liquidator:** The terms and conditions of appointment of a provisional liquidator or Company Liquidator and the fee payable to him or it shall be specified by the Tribunal on the basis of task required to be performed, experience, qualification of such liquidator and size of the company.

(5) **Filing of declaration by liquidator on appointment:** On appointment as provisional liquidator or Company Liquidator, as the case may be, such liquidator shall file a declaration within seven days from the date of appointment in the prescribed form disclosing conflict of interest or lack of independence in respect of his appointment, if any, with the Tribunal and such obligation shall continue throughout the term of his appointment.

(6) **Appointment of provisional liquidator as the company liquidator:** While passing a winding up order, the Tribunal may appoint a provisional liquidator, if any, appointed under clause (c) of sub-section (1) of section 273, as the Company Liquidator for the conduct of the proceedings for the winding up of the company.

8. REMOVAL AND REPLACEMENT OF LIQUIDATOR [SECTION 276]

(1) **Removal of provisional liquidator or the Company Liquidator:** The Tribunal may, on a reasonable cause being shown and for reasons to be recorded in writing, remove the

provisional liquidator or the Company Liquidator, as the case may be, as liquidator of the company on any of the following grounds, namely:—

(a) misconduct;

(b) fraud or misfeasance;

(c) professional incompetence or failure to exercise due care and diligence in performance of the powers and functions;

(d) inability to act as provisional liquidator or as the case may be, Company Liquidator;

(e) conflict of interest or lack of independence during the term of his appointment that would justify removal.

(2) Transfer of work of liquidators: In the event of death, resignation or removal of the provisional liquidator or as the case may be, Company Liquidator, the Tribunal may transfer the work assigned to him or it to another Company Liquidator for reasons to be recorded in writing.

(3) Recover of loss or damage from liquidator: Where the Tribunal is of the opinion that any liquidator is responsible for causing any loss or damage to the company due to fraud or misfeasance or failure to exercise due care and diligence in the performance of his or its powers and functions, the Tribunal may recover or cause to be recovered such loss or damage from the liquidator and pass such other orders as it may think fit.

(4) Reasonable opportunity of being heard to the provisional liquidator: The Tribunal shall, before passing any order under this section, provide a reasonable opportunity of being heard to the provisional liquidator or, as the case may be, Company Liquidator.

9. INTIMATION TO COMPANY LIQUIDATOR, PROVISIONAL LIQUIDATOR AND REGISTRAR [SECTION 277]

(1) Intimation of an order of tribunal: Where the Tribunal makes an order for-

- appointment of provisional liquidator or
- the winding up of a company,

it shall, within a period not exceeding seven days from the date of passing of the order, cause intimation thereof to be sent to the-

- Company Liquidator or provisional liquidator, as the case may be, and
- the Registrar.

(2) Registrar to intimate of an order:

With respect to all companies- On receipt of the copy of order of appointment of provisional liquidator or winding up order, the Registrar shall make an endorsement to that effect in his records relating to the company and notify in the Official Gazette that such an order has been made, and

In the case of a listed company, the Registrar shall intimate about such appointment or order, as the case may be, to the stock exchange or exchanges where the securities of the company are listed.

(3) Winding up order shall be deemed to be notice of discharge: The winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is continued.

(4) Constitution of winding up committee to monitor liquidation proceedings: Within three weeks from the date of passing of winding up order, the Company Liquidator shall make an application to the Tribunal for constitution of a winding up committee to assist and monitor the progress of liquidation proceedings by the Company Liquidator in carrying out the function as provided in sub-section (5) and such winding up committee shall comprise of the following persons, namely:—

(i) official Liquidator attached to the Tribunal;

(ii) nominee of secured creditors; and

(iii) a professional nominated by the Tribunal.

(5) Functions of winding up committee: The Company Liquidator shall be the convener of the meetings of the winding up committee which shall assist and monitor the liquidation proceedings in following areas of liquidation functions, namely:—

(i) taking over assets;

(ii) examination of the statement of affairs;

(iii) recovery of property, cash or any other assets of the company including benefits

derived therefrom;

(iv) review of audit reports and accounts of the company;

(v) sale of assets;

(vi) finalisation of list of creditors and contributories;

(vii) compromise, abandonment and settlement of claims;

(viii) payment of dividends, if any; and

(ix) any other function, as the Tribunal may direct from time to time.

(6) Submission of report & minutes of meetings of the committee before Tribunal: The Company Liquidator shall place before the Tribunal a report along with minutes of the meetings of the committee on monthly basis duly signed by the members present in the meeting for consideration till the final report for dissolution of the company is submitted before the Tribunal.

(7) Company liquidator to prepare draft final report: The Company Liquidator shall prepare the draft final report for consideration and approval of the winding up committee.

(8) Submission of approved final report before the tribunal for passing of dissolution order: The final report so approved by the winding up committee shall be submitted by the Company Liquidator before the Tribunal for passing of a dissolution order in respect of the company.

10. EFFECT OF WINDING UP ORDER [SECTION 278]

The order for the winding up of a company shall operate in favour of all the creditors and all contributories of the company as if it had been made out on the joint petition of creditors and contributories.

11. STAY OF SUITS, ETC., ON WINDING UP ORDER [SECTION 279]

(1) **Suit or legal proceeding can be commenced after winding up order/appointment of liquidator only with permission of tribunal:** When a winding up order has been passed or a provisional liquidator has been appointed, no suit or other legal proceeding shall be commenced, or if pending at the date of the winding up order, shall be proceeded with, by or against the company, except with the leave of the Tribunal and subject to such terms as the Tribunal may impose.

It is further provided that any application to the Tribunal seeking leave under this section shall be disposed of by the Tribunal within sixty days.

(2) In case proceeding pending in appeal: Nothing in sub-section (1) shall apply to any proceeding pending in appeal before the Supreme Court or a High Court.

12. JURISDICTION OF TRIBUNAL [SECTION 280]

The Tribunal shall have jurisdiction to entertain, or dispose of,—

(a) any suit or proceeding by or against the company;

(b) any claim made by or against the company, including claims by or against any of its branches in India;

(c) any application made under section 233 [Fast track merger];

(d) any question of priorities or any other question whatsoever, whether of law or facts, including those relating to assets, business, actions, rights, entitlements, privileges, benefits, duties, responsibilities, obligations or in any matter arising out of, or in relation to winding up of the company, whether such suit or proceeding has been instituted, or is instituted, or such claim or question has arisen or arises or such application has been made or is made or such scheme has been submitted, or is submitted, before or after the order for the winding up of the company is made.

13. SUBMISSION OF REPORT BY COMPANY LIQUIDATOR [SECTION 281]

(1) Particulars to be mentioned in the report of company liquidator: Where the Tribunal has made a winding up order or appointed a Company Liquidator, such liquidator shall, within sixty days from the order, submit to the Tribunal, a report containing the following particulars, namely:—

Contents of Liquidator's Report
• The nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank, if any, and the negotiable securities, if any, held by the company. The valuation of the assets shall be obtained from registered valuers for this purpose. The nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank, if any, and the negotiable securities, if any, held by the company. The valuation of the assets shall be obtained from registered valuers for this purpose.
• Amount of capital issued, subscribed and paid-up
• Amount of capital issued, subscribed and paid-up
• The existing and contingent liabilities of the company including names, addresses and

occupations of its creditors, stating separately the amount of secured and unsecured debts, and

- The existing and contingent liabilities of the company including names, addresses and occupations of its creditors, stating separately the amount of secured and unsecured debts, and
- In the case of secured debts, particulars of the securities given, whether by the company or an officer thereof, their value and the dates on which they were given In the case of secured debts, particulars of the securities given, whether by the company or an officer thereof, their value and the dates on which they were given
- The debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realised on account thereof The debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realised on account thereof
- Guarantees, if any, extended by the company
- List of contributories and dues, if any, payable by them and details of any unpaid call
- Details of trade marks and intellectual properties, if any, owned by the company
- Details of subsisting contracts, joint ventures and collaborations, if any
- Details of holding and subsidiary companies, if any
- Details of legal cases filed by or against the company
- Any other information which the Tribunal may direct or the Company Liquidator may consider necessary to include

(2) **Duties of liquidator to give desirable information in the report:** The Company Liquidator shall include in his report the manner in which the company was promoted or formed and whether in his opinion any fraud has been committed by any person in its promotion or formation or by any officer of the company in relation to the company since the formation thereof and any other matters which, in his opinion, it is desirable to bring to the notice of the Tribunal.

(3) **Report on viability of business of the company:** The Company Liquidator shall also make a report on the viability of the business of the company or the steps which, in his opinion, are necessary for maximising the value of the assets of the company.

(4) **Any other necessitated report:** The Company Liquidator may also, if he thinks fit, make any further report or reports.

(5) **Inspection of reports:** Any person describing himself in writing to be a creditor or a contributory of the company shall be entitled by himself or by his agent at all reasonable

times to inspect the report submitted in accordance with this section and take copies thereof or extracts therefrom on payment of the prescribed fees.

14. DIRECTIONS OF TRIBUNAL ON REPORT OF COMPANY LIQUIDATOR [SECTION 282]

(1) **Time limit for the proceeding shall be fixed:** The Tribunal shall, on consideration of the report of the Company Liquidator, fix a time limit within which the entire proceedings shall be completed and the company be dissolved:

Revision of time limit: The Tribunal may, if it is of the opinion, at any stage of the proceedings, or on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, that it will not be advantageous or economical to continue the proceedings, revise the time limit within which the entire proceedings shall be completed and the company be dissolved.

(2) **Order of tribunal:** The Tribunal may, on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, order sale of the company as a going concern or its assets or part thereof.

The Tribunal may, where it considers fit, appoint a sale committee comprising such creditors, promoters and officers of the company as the Tribunal may decide to assist the Company Liquidator in sale under this sub-section.

(3) **Tribunal may order for investigation against the company in respect of commission of fraud:** Where a report is received from the Company Liquidator or the Central Government or any person that a fraud has been committed in respect of the company, the Tribunal shall, without prejudice to the process of winding up, order for investigation under section 210, and on consideration of the report of such investigation it may pass order and give directions under sections 339 to 342 or direct the Company Liquidator to file a criminal complaint against persons who were involved in the commission of fraud.

(4) **Tribunal to take measures to safe guard the assets of the company:** The Tribunal may order for taking such steps and measures, as may be necessary, to protect, preserve or enhance the value of the assets of the company.

(5) **Tribunal may pass such other order /directions as it may consider fit:** The Tribunal may pass such other order or give such other directions as it considers fit.

15. CUSTODY OF COMPANY'S PROPERTIES [SECTION 283]

S. No.	Provision	It states that-
1.	Where a winding up order has been made or where a provisional liquidator has been appointed-	the liquidator, shall, on the order of the Tribunal immediately take into his or its custody or control – • all the property, • effects and • actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company.
2.	Computation of custody time period	all the property and effects of the company shall be deemed to be in the custody of the Tribunal from the date of the order for the winding up of the company
3.	On an application by the Company Liquidator, the tribunal may order to pay /deliver etc. any money, property etc. of the company to the Liquidator.	The Tribunal may, at any time after the making of a winding up order, require any contributory for the time being on the list of contributories, and any trustee, receiver, banker, agent, officer or other employee of the company,- • to pay, • deliver, • surrender or • transfer forthwith, or • within such time as the Tribunal directs, - to the Company Liquidator, • any money, property or books and papers in his custody or under his control to which the company is or appears to be entitled.

16. PROMOTERS, DIRECTORS, ETC., TO COOPERATE WITH COMPANY LIQUIDATOR [SECTION 284]

(1) **Persons to extend full cooperation to the liquidators:** The promoters, directors, officers and employees, who are or have been in employment of the company or acting or associated with the company shall extend full cooperation to the Company Liquidator in discharge of his functions and duties.

(2) **On failure to discharge obligations:** Where any person, without reasonable cause, fails to discharge his obligations under sub-section (1), he shall be punishable with imprisonment which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.

17. SETTLEMENT OF LIST OF CONTRIBUTORIES AND APPLICATION OF ASSETS [SECTION 285]

(1) **Tribunal to perform acts:** As soon as may be after the passing of a winding up order by the Tribunal, the Tribunal shall -

- settle a list of contributories,
- cause rectification of register of members in all cases where rectification is required in pursuance of this Act, and
- shall cause the assets of the company to be applied for the discharge of its liability.

Provided that where it appears to the Tribunal that it would not be necessary to make calls on or adjust the rights of contributories, the Tribunal may dispense with the settlement of a list of contributories.

(2) **Identifying contributories on the basis of nature of rights:** In settling the list of contributories, the Tribunal shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of, others.

(3) **Persons liable to contribute to the assets on certain conditions:** While settling the list of contributories, the Tribunal shall include every person, who is or has been a member, who shall be liable to contribute to the assets of the company an amount sufficient for payment of the debts and liabilities and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves, subject to the following conditions, namely:—

Sl. No.	Liabilities	Conditions describe the liabilities to contribute towards the assets
1.	a person who has been a member shall not be liable to contribute	If he has ceased to be a member for the preceding one year or more before the commencement of the winding up
2.	a person who has been a member shall not be liable to contribute in respect of any debt or liability of the company	If such debt or liability contracted after he ceased to be a member
3.	a person who has been a member shall be liable to contribute	When it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them

		in pursuance of this Act
4.	in the case of a company limited by shares	no contribution shall be required from any person, who is or has been a member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member;
5.	in the case of a company limited by guarantee	if the company has a share capital, such member shall be liable to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

18. OBLIGATIONS OF DIRECTORS AND MANAGERS [SECTION 286]

Unlimited liability of a person in the case of a limited company: In the case of a limited company, any person who is or has been a director or manager, whose liability is unlimited under the provisions of this Act, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were at the commencement of winding up, a member of an unlimited company:

Provided that —

(a) **Person ceased to hold office for a year or more:** A person who has been a director or manager shall not be liable to make such further contribution, if he has ceased to hold office for a year or upwards before the commencement of the winding up;

(b) **Persons not liable to contribute any debt/ liability of the company after he ceased to hold office:** A person who has been a director or manager shall not be liable to make such further contribution in respect of any debt or liability of the company contracted after he ceased to hold office;

(c) **Persons not liable unless tribunal deems it necessary to satisfy the debts and liabilities:** subject to the articles of the company, a director or manager shall not be liable to make such further contribution unless the Tribunal deems it necessary to require the contribution in order to satisfy the debts and liabilities of the company, and the costs, charges and expenses of the winding up.

19. ADVISORY COMMITTEE [SECTION 287]

(1) **Appointment of advisory committee:** The Tribunal may, while passing an order of winding up of a company, direct that there shall be, an advisory committee to advise the

Company Liquidator and to report to the Tribunal on such matters as the Tribunal may direct.

(2) **Composition:** The advisory committee appointed by the Tribunal shall consist of not more than twelve members, being-

- creditors and contributories of the company, or
- such other persons in such proportion

as the Tribunal may, keeping in view the circumstances of the company under liquidation, direct.

(3) **Conduct of meeting:** The Company Liquidator shall convene a meeting of creditors and contributories, as ascertained from the books and documents, of the company within thirty days from the date of order of winding up for enabling the Tribunal to determine the persons who may be members of the advisory committee.

(4) **Right to inspection of documents:** The advisory committee shall have the right to inspect the books of account and other documents, assets and properties of the company under liquidation at a reasonable time.

(5) **Procedure for the conduct of meeting and business shall be as prescribed by rules:** The provisions relating to the convening of the meetings, the procedure to be followed thereat and other matters relating to conduct of business by the advisory committee shall be such as may be prescribed.

(6) **Company liquidator shall be chairperson:** The meeting of advisory committee shall be chaired by the Company Liquidator.

20. SUBMISSION OF PERIODICAL REPORTS TO TRIBUNAL [SECTION 288]

(1) **Periodical reports to the tribunal:** The Company Liquidator shall make periodical reports to the Tribunal and in any case make a report at the end of each quarter with respect to the progress of the winding up of the company in such form and manner as may be prescribed.

(2) **Review of orders by tribunal:** The Tribunal may, on an application by the Company Liquidator, review the orders made by it and make such modifications as it thinks fit.

21. POWERS AND DUTIES OF COMPANY LIQUIDATOR [SECTION 290]

(1) **Powers of Company Liquidator:** Subject to directions by the Tribunal, if any, in this regard, the Company Liquidator, in a winding up of a company by the Tribunal, shall have the power—

(a) **to carry on the business** of the company so far as may be necessary for the beneficial winding up of the company;

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

(c) **to sell the immovable and movable property and actionable claims** of the company by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels;

(d) **to sell the whole of the undertaking** of the company as a going concern;

(e) **to raise any money r**equired on the security of the assets of the company;

(f) **to institute or defend any suit**, prosecution or other legal proceeding, civil or criminal, **in the name and on behalf of the company;**

(g) to invite and **settle claim of creditors, employees or any other claimant** and distribute sale proceeds in accordance with priorities established under this Act;

(h) to **inspect the records** and returns of the company on the files of the Registrar or any other authority;

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

(j) to **draw, accept, make and endorse any negotiable instruments** including cheque, bill of exchange, hundi or promissory note in the name and on behalf of the company, with the same effect with respect to the liability of the company as if such instruments had been drawn, accepted, made or endorsed by or on behalf of the company in the course of its business;

(k) **to take out, in his official name, letters of administration** to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot be conveniently done in the name of the company, and in all such cases, the money due shall, for the purpose of enabling the Company Liquidator to take out the letters of administration or recover the money, be deemed to be due to the Company Liquidator himself;

(l) **to obtain any professional assistance** from any person or appoint any professional, in discharge of his duties, obligations and responsibilities and for protection of the assets of the company, appoint an agent to do any business which the Company Liquidator is unable to do himself;

(m) **to take all such actions, steps, or to sign, execute and verify any paper, deed,**

document, application, petition, affidavit, bond or instrument as may be necessary,—

(i) for winding up of the company;

(ii) for distribution of assets;

(iii) in discharge of his duties and obligations and functions as Company Liquidator; and

(n) **to apply to the Tribunal for such orders or directions** as may be necessary for the winding up of the company.

(2) Powers of Liquidator shall be under control of tribunal: The exercise of powers by the Company Liquidator shall be subject to the overall control of the Tribunal.

(3) Other duties: the Company Liquidator shall perform such other duties as the Tribunal may specify in this behalf.

22. PROVISION FOR PROFESSIONAL ASSISTANCE TO COMPANY LIQUIDATOR [SECTION 291]

(1) Company liquidator to appoint one/more professionals: The Company Liquidator may, with the sanction of the Tribunal, appoint one or more chartered accountants or company secretaries or cost accountants or legal practitioners or such other professionals on such terms and conditions, as may be necessary, to assist him in the performance of his duties and functions under this Act.

(2) Disclose of conflict of interest: Any person appointed under this section shall disclose forthwith to the Tribunal in the prescribed form any conflict of interest or lack of independence in respect of his appointment.

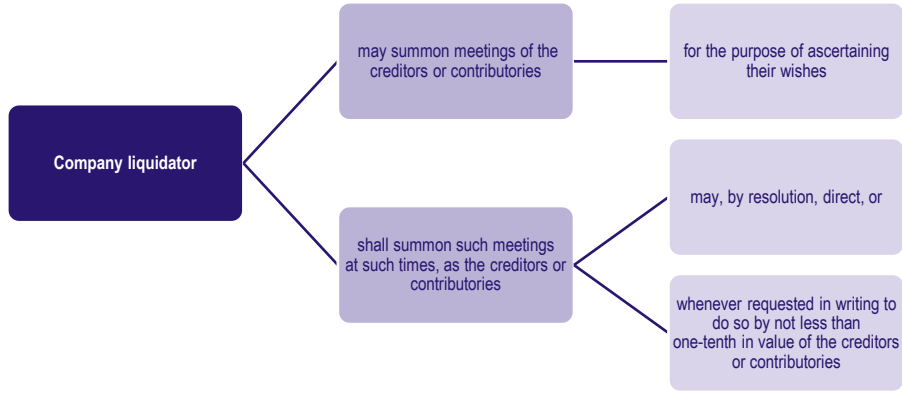
23. EXERCISE AND CONTROL OF COMPANY LIQUIDATOR'S POWERS [SECTION 292]

(1) Administration & Distribution of assets: The Company Liquidator shall, in the administration of the assets of the company and the distribution thereof among its creditors, have regard to any directions which may be given by-

- the resolution of the creditors or contributories at any general meeting, or
- by the advisory committee.

(2) Direction given by creditors or contributories shall override: Any directions given by the creditors or contributories at any general meeting shall, in case of conflict, be deemed to override any directions given by the advisory committee.

(3) Summons from Company Liquidator—



(4) **Apply to Tribunal against the decision of Company Liquidator:** Any person aggrieved by any act or decision of the Company Liquidator may apply to the Tribunal, and the Tribunal may confirm, reverse or modify the act or decision complained of and make such further order as it thinks just and proper in the circumstances.

24. BOOKS TO BE KEPT BY COMPANY LIQUIDATOR [SECTION 293]

(1) **Company liquidator to maintain proper books for records of entries or minutes:** The Company Liquidator shall keep proper books in such manner, as may be prescribed, in which he shall cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed.

(2) **Inspection of such books:** Any creditor or contributory may, subject to the control of the Tribunal, inspect any such books, personally or through his agent.

25. AUDIT OF COMPANY LIQUIDATOR'S ACCOUNTS [SECTION 294]

(1) **Maintenance of books of accounts:** The Company Liquidator shall maintain proper and regular books of account including accounts of receipts and payments made by him in such form and manner as may be prescribed.

(2) **Presentation of an account of the receipts and payments to the tribunal:** The Company Liquidator shall, at such times as may be prescribed but not less than twice in each year during his tenure of office, present to the Tribunal an account of the receipts and payments as such liquidator in the prescribed form in duplicate, which shall be verified by a declaration in such form and manner as may be prescribed.

(3) **Audit of accounts:** The Tribunal shall cause the accounts to be audited in such manner as it thinks fit, and for the purpose of the audit, the Company Liquidator shall furnish to the Tribunal with such vouchers and information as the Tribunal may require, and the Tribunal may, at any time, require the production of, and inspect, any books of account kept by the Company Liquidator.

(4) **Filing of copy of accounts with the tribunal and the registrar:** When the accounts of the company have been audited, one copy thereof shall be filed by the Company Liquidator with the Tribunal, and the other copy shall be delivered to the Registrar which shall be open to inspection by any creditor, contributory or person interested.

(5) **Accounts related to a government companies:** Where an account referred to in sub-section (4) relates to a Government company, the Company Liquidator shall forward a copy thereof—

(a) to the Central Government, if that Government is a member of the Government company; or

(b) to any State Government, if that Government is a member of the Government company; or

(c) to the Central Government and any State Government, if both the Governments are members of the Government company.

(6) **Summary of accounts to be communicated to every creditor and contributory:** The Company Liquidator shall cause the accounts when audited, or a summary thereof, to be printed, and shall send a printed copy of the accounts or summary thereof by post to every creditor and every contributory:

The Tribunal may dispense with the compliance of the provisions of this sub-section in any case it deems fit.

26. PAYMENT OF DEBTS BY CONTRIBUTORY AND EXTENT OF SET-OFF [SECTION 295]

(1) **Tribunal to pass an order to pay any money due:** The Tribunal may, at any time after passing of a winding up order, pass an order requiring any contributory for the time being on the list of contributories to pay, in the manner directed by the order, any money due to the company, from him or from the estate of the person whom he represents, exclusive of any money payable by him or the estate by virtue of any call in pursuance of this Act.

(2) **Order of Tribunal:** The Tribunal, in making an order, may,—

in the case of an unlimited company	allow to the contributory, by – • way of set-off, any money due to him, or • to the estate which he represents, from the company, on any independent dealing or contract with the company. But not any money due to him as a member of the company in respect of any dividend or profit;
in the case of a limited company	allow to any director or manager whose liability is unlimited, or to his estate, such set-off.

(3) **Payment of money due against any subsequent call:** In the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call.

27. POWER OF TRIBUNAL TO MAKE CALLS [SECTION 296]

The Tribunal may, at any time after the passing of a winding up order, and either before or after it has ascertained the sufficiency of the assets of the company,—

(a) **make calls on all or any of the contributories** for the time being on the list of the contributories, to the extent of their liability, for payment of any money which the Tribunal considers necessary to satisfy the debts and liabilities of the company, and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves; and

(b) **make an order for payment of any calls** so made.

28. ADJUSTMENT OF RIGHTS OF CONTRIBUTORIES [SECTION 297]

The Tribunal shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled thereto.

29. POWER TO ORDER COSTS [SECTION 298]

Assets of a company being insufficient to satisfy its liabilities: The Tribunal may, in the event of the assets of a company being insufficient to satisfy its liabilities, make an order for the payment out of the assets, of the costs, charges and expenses incurred in the winding up, in such order of priority inter se as the Tribunal thinks just and proper.

30. POWER TO SUMMON PERSONS SUSPECTED OF HAVING PROPERTY OF COMPANY, ETC. [SECTION 299]

(1) Summons: The Tribunal may,

- at any time after the appointment of a provisional liquidator, or
- the passing of a winding up order,

Summon before it –

- any officer of the company or
- person known or
- suspected to have in his possession any property or books or papers, of the company, or
- known or suspected to be indebted to the company, or
- any person whom the Tribunal thinks to be capable of giving information

concerning the promotion, formation, trade, dealings, property, books or papers, or affairs of the company.

(2) Examination: The Tribunal may examine any officer or person so summoned on oath concerning the matters aforesaid, either by –

- word of mouth or
- on written interrogatories or
- on affidavit and

may, in the first case, reduce his answers to writing and require him to sign them.

(3) Production of books and papers: The Tribunal may require any officer or person so summoned to produce any books and papers relating to the company in his custody or power, but, where he claims any lien on books or papers produced by him, the production shall be without prejudice to such lien, and the Tribunal shall have power to determine all questions relating to that lien.

(4) Liquidator to file a report in respect of debt or property of the company: The Tribunal may direct the liquidator to file before it a report in respect of debt or property of the company in possession of other persons.

(5) Order: If the Tribunal finds that—

(a) a **person is indebted to the company**, the Tribunal may order him to pay to the provisional liquidator or, as the case may be, the liquidator at such time and in such manner as the Tribunal may consider just, the amount in which he is indebted, or any

part thereof, either in full discharge of the whole amount or not, as the Tribunal thinks fit, with or without costs of the examination;

(b) a **person is in possession of any property belonging to the company**, the Tribunal may order him to deliver to the provisional liquidator or, as the case may be, the liquidator, that property or any part thereof, at such time, in such manner and on such terms as the Tribunal may consider just.

(6) Person summoned fails to appear: If any officer or person so summoned fails to appear before the Tribunal at the time appointed without a reasonable cause, the Tribunal may impose an appropriate cost.

(7) Execution of order: Every order made under sub-section (5) shall be executed in the same manner as decrees for the payment of money or for the delivery of property under the Code of Civil Procedure, 1908.

(8) Discharge of liability: Any person making any payment or delivery in pursuance of an order made under sub-section (5) shall by such payment or delivery be, unless otherwise directed by such order, discharged from all liability whatsoever in respect of such debt or property.

31. POWER TO ORDER EXAMINATION OF PROMOTERS, DIRECTORS, ETC. [SECTION 300]

(1) Power of tribunal to order the person to attend and be examined before the tribunal: Where an order has been made for the winding up of a company by the Tribunal, and the Company Liquidator has made a report to the Tribunal under this Act, stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal may, after considering the report, direct that-

- such person or officer shall attend before the Tribunal on a day appointed by it for that purpose, and
- be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct, and
- dealings as an officer thereof.

(2) Participation of Company liquidator in the examination: The Company Liquidator shall take part in the examination, and for that purpose he or it may, if specially authorised by the Tribunal in that behalf, employ such legal assistance as may be sanctioned by the Tribunal.

(3) **Examination on oath:** The person shall be examined on oath and shall answer all such questions as the Tribunal may put, or allow to be put, to him.

(4) **Rights available to the person to be examined:** A person ordered to be examined under this section—

(a) shall, before his examination**, be furnished at his own cost with a copy of the report** of the Company Liquidator; and

(b) **may at his own cost employ chartered accountants or company secretaries or cost accountants or legal practitioners** entitled to appear before the Tribunal under section 432, who shall be at liberty to put to him such questions as the Tribunal may consider just for the purpose of enabling him to explain or qualify any answers given by him.

(5) **Appearing of company liquidator on hearing of an application applied by person being freed from charges:** If any such person applies to the Tribunal to be exculpated from any charges made or suggested against him, it shall be the duty of the Company Liquidator to appear on the hearing of such application and call the attention of the Tribunal to any matters which appear to the Company Liquidator to be relevant.

(6) **Order for payment of costs:** If the Tribunal, after considering any evidence given or hearing witnesses called by the Company Liquidator, allows the application made under sub-section (5), the Tribunal may order payment to the applicant of such costs as it may think fit.

(7) **Records of the examinations in writing:** Notes of the examination shall be taken down in writing, and shall be read over to or by, and signed by, the person examined, a copy be supplied to him and may thereafter be used in evidence against him, and shall be open to inspection by any creditor or contributory at all reasonable times.

(8) **Adjournment:** The Tribunal may, if it thinks fit, adjourn the examination from time to time.

(9) **Examination can be before any person/authority:** An examination under this section may, if the Tribunal so directs, be held before any person or authority authorised by the Tribunal.

(10) **Exercise of tribunal powers by the concerned person /authority:** The powers of the Tribunal under this section as to the conduct of the examination, but not as to costs, may be exercised by the person or authority before whom the examination is held in pursuance of sub-section (9).

32. ARREST OF PERSON TRYING TO LEAVE INDIA OR ABSCOND [SECTION 301]

Any time either before or after passing a winding up order, if the Tribunal is satisfied that -

- a contributory, or
- a person having property, accounts or papers of the company in his possession

is about-

- to leave India or
- otherwise to abscond, or
- is about to remove or conceal any of his property, for evading payment of calls, or
- of avoiding examination respecting the affairs of the company,

the Tribunal may cause—

- the contributory to be detained until such time as the Tribunal may order; and
- his books and papers and movable property to be seized and safely kept until such time as the Tribunal may order.

33. DISSOLUTION OF COMPANY BY TRIBUNAL [SECTION 302]

S. No.	Condition	Effect
1.	When the affairs of a company have been completely wound up	the Company Liquidator shall make an application to the Tribunal for dissolution of such company
2.	Tribunal shall on an application filed by the Company Liquidator, or when the Tribunal is of the opinion that it is just and reasonable in the circumstances that an order for the dissolution of the company should be made	Tribunal shall make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly
3.	Copy of the order shall, within thirty days from the date thereof, be forwarded by the Company Liquidator to the Registrar	Registrar shall record in the register relating to the company a minute of the dissolution of the company
4.	If the Company Liquidator makes a default in forwarding a copy of the order within the period specified	the Company Liquidator shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues

34. APPEALS FROM ORDERS MADE BEFORE COMMENCEMENT OF ACT [SECTION 303]

Prospective effect: Nothing in this Chapter shall affect the operation or enforcement of any order made by any Court in any proceedings for the winding up of a company immediately before the commencement of this Act and an appeal against such order shall be filed before such authority competent to hear such appeals before such commencement.

(PART II- VOLUNTARY WINDING UP) SECTIONS 304- 323 (OMITTED)

Provisions under Companies Act, 2013 stands omitted due to section 255 of Insolvency & Bankruptcy Code, 2016 and section 59 covered under Chapter V of Insolvency & Bankruptcy Code, 2016 has been notified on 01.04.2017.

PART III—PROVISIONS APPLICABLE TO EVERY MODE OF WINDING UP

35. DEBTS OF ALL DESCRIPTIONS TO BE ADMITTED TO PROOF [SECTION 324]

In every winding up (subject, in the case of insolvent companies, to the application in accordance with the provisions of this Act or of the law of insolvency), -

- all debts payable on a contingency, and
- all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages,

shall be admissible to proof against the company, a just estimate being made, so far as possible, of the value of such debts or claims as may be subject to any contingency, or may sound only in damages, or for some other reason may not bear a certain value.

36. OVERRIDING PREFERENTIAL PAYMENTS [SECTION 326]

(1) **Debts to be paid in priority:** In the winding up of a company under this Act, the following debts shall be paid in priority to all other debts:—

(a) workmen's dues; and

(b) where a secured creditor has realised a secured asset, so much of the debts due to

such secured creditor as could not be realised by him or the amount of the workmen's portion in his security (if payable under the law), whichever is less, *pari passu* with the workmen's dues.

In case of the winding up of a company, the sums referred to in sub-clauses (i) and (ii) of clause (b) of the *Explanation*, which are payable for a period of two years preceding the winding up order or such other period as may be prescribed, shall be paid in priority to all other debts (including debts due to secured creditors), within a period of thirty days of sale of assets and shall be subject to such charge over the security of secured creditors as may be prescribed.

(2) Proviso mentioning the debts shall be paid in full: The debts payable under the proviso to sub-section (1) shall be paid in full before any payment is made to secured creditors and thereafter debts payable under that subsection shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Example

The value of the security of a secured creditor of a company is ₹ 1,00,000. The total amount of the workmen's dues is ₹ 1,00,000. The amount of the debts due from the company to its secured creditors is ₹ 3,00,000. The aggregate of the amount of workmen's dues and the amount of debts due to secured creditors is ₹ 4,00,000. The workmen's portion of the security is, therefore, one-fourth of the value of the security, that is ₹ 25,000.

Explanation—For the purposes of this section, and section 327—

(a) **"workmen"**, in relation to a company, means the employees of the company, being workmen within the meaning of clause (s) of section 2 of the Industrial Disputes Act, 1947;

(b) **"workmen's dues",** in relation to a company, means the aggregate of the following sums due from the company to its workmen, namely:—

(i) all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947.

(ii) all accrued holiday remuneration becoming payable to any workman or, in the case of his death, to any other person in his right on the termination of his employment before or by the effect of the winding up order or resolution;

(iii) unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company or unless the company has, at the commencement of the winding up, under such a contract with insurers as is mentioned in section 14 of the Workmen's Compensation Act, 1923 (19 of 1923), rights capable of being transferred to and vested in the workmen, all amount due in

respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company;

(iv) all sums due to any workman from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the workmen, maintained by the company;

(c) **"workmen's portion"**, in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of the debts due to the secured creditors.

37. PREFERENTIAL PAYMENTS [SECTION 327]

(1) In a winding up, subject to the provisions of section 326, there shall be paid in priority to all other debts,—

(a) all revenues, taxes, cesses and rates due from the company to the Central Government or a State Government or to a local authority at the relevant date, and having become due and payable within the twelve months immediately before that date;

(b) all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any employee in respect of services rendered to the company and due for a period not exceeding four months within the twelve months immediately before the relevant date, subject to the condition that the amount payable under this clause to any workman shall not exceed such amount as may be notified;

(c) all accrued holiday remuneration becoming payable to any employee, or in the case of his death, to any other person claiming under him, on the termination of his employment before, or by the winding up order, or, as the case may be, the dissolution of the company;

(d) unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company, all amount due in respect of contributions payable during the period of twelve months immediately before the relevant date by the company as the employer of persons under the Employees' State Insurance Act, 1948 or any other law for the time being in force;

(e) unless the company has, at the commencement of winding up, under such a contract with any insurer as is mentioned in section 14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any employee of the company:

Provided that where any compensation under the said Act is a weekly payment, the amount payable under this clause shall be taken to be the amount of the lump sum for which such weekly payment could, if redeemable, be redeemed, if the employer has made an application under that Act;

(f) all sums due to any employee from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the employees, maintained by the company; and

(g) the expenses of any investigation held in pursuance of sections 213 and 216, in so far as they are payable by the company.

(2) Payment in case of employee: Where any payment has been made to any employee of a company on account of -

- wages or salary, or
- accrued holiday remuneration, himself or,
- in the case of his death, to any other person claiming through him,
- out of money advanced by some person for that purpose, the person by whom the money was advanced

shall, in a winding up, have a right of priority in respect of the money so advanced and paid-up to the amount by which the sum in respect of which the employee or other person in his

right would have been entitled to priority in the winding up has been reduced by reason of the payment having been made.

(3) Payments of debts: The debts enumerated in this section shall—

(a) **rank equally among themselves and be paid in full**, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions; and

(b) so far as the assets of the company available for payment to general creditors are insufficient to meet them, have **priority over the claims of holders of debentures** under any floating charge created by the company, and be paid accordingly out of any property comprised in or subject to that charge.

(4) Discharged from payment of debts: Subject to the retention of such sums as may be necessary for the costs and expenses of the winding up, the debts under this section shall be discharged forthwith so far as the assets are sufficient to meet them, and in the case of the debts to which priority is given under clause (d) of sub-section (1), formal proof thereof shall not be required except in so far as may be otherwise prescribed.

(5) Debts to which priority is given, shall be a first charge on the goods: In the event of a landlord or other person distraining or having distrained on any goods or effects of the company within three months immediately before the date of a winding up order, the debts to which priority is given under this section shall be a first charge on the goods or effects so distrained on or the proceeds of the sale thereof:

Provided that, in respect of any money paid under any such charge, the landlord or other person shall have the same rights of priority as the person to whom the payment is made.

(6) Remuneration of holiday/ of absence from work: Any remuneration in respect of a period of holiday or of absence from work on medical grounds through sickness or other good cause shall be deemed to be wages in respect of services rendered to the company during that period.

(7) Non-applicability of sections 326 & 327: Sections 326 and 327 shall not be applicable in the event of liquidation under the Insolvency and Bankruptcy Code, 2016.

Explanation—For the purposes of this section,—

(a) the expression "**accrued holiday remuneration**" includes, in relation to any person, -

- all sums which, by virtue either of his contract of employment or of any enactment including any order made or direction given thereunder,
- are payable on account of the remuneration which would, in the ordinary course, have become payable to him in respect of a period of holiday, had his employment with the company continued until he became entitled to be allowed the holiday;

(b) the expression **"employee"** does not include a workman; and

(c) the expression **"relevant date"** means in the case of a company being wound up by the Tribunal-

- the date of appointment or first appointment of a provisional liquidator, or
- if no such appointment was made, the date of the winding up order,

unless, in either case, the company had commenced to be wound up voluntarily before that date under the Insolvency and Bankruptcy Code, 2016;

38. FRAUDULENT PREFERENCE [SECTION 328]

(1) **When any transaction may be treated as fraudulent preference:** Where a company has given preference to a person who is-

- one of the creditors of the company, or
- a surety or guarantor for any of the debts or other liabilities of the company,

and the company does anything or suffers anything done which has the effect of putting that person into a position which, in the event of the company going into liquidation, will be better than the position he would have been in if that thing had not been done prior to six months of making winding up application, -

the Tribunal, if satisfied that, such transaction is a fraudulent preference may order as it may think fit for restoring the position to what it would have been if the company had not given that preference.

(2) Order of tribunal: If the Tribunal is satisfied that there is a-

- preference transfer of property, movable or immovable, or
- any delivery of goods,
- payment,
- execution made, taken or done by or against a company within six months before making winding up application,

the Tribunal may order as it may think fit and may declare such transaction invalid and restore the position.

39. TRANSFERS NOT IN GOOD FAITH TO BE VOID [SECTION 329]

Any transfer of property, movable or immovable, or any delivery of goods, made by a company, not being –

- a transfer or delivery made in the ordinary course of its business, or

- in favour of a purchaser or encumbrancer in good faith and for valuable consideration,

if made within a period of one year before the presentation of a petition for winding up by the Tribunal under this Act.

Such transfer shall be void against the Company Liquidator.

40. CERTAIN TRANSFERS TO BE VOID [SECTION 330]

Any transfer or assignment by a company of all its properties or assets to trustees for the benefit of all its creditors shall be void.

41. LIABILITIES AND RIGHTS OF CERTAIN PERSONS FRAUDULENTLY PREFERRED [SECTION 331]

(1) **Determination of rights and liabilities of fraudulently preferred persons:** Where a company is being wound up and anything made, taken or done after the commencement of this Act is invalid under section 328 as a fraudulent preference of a person interested in property mortgaged or charged to secure the company's debt, then, without prejudice to any rights or liabilities arising, apart from this provision, the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as a surety for the debt,-

- to the extent of the mortgage or charge on the property, or
- the value of his interest,

whichever is less.

(2) **Value of interest shall be determined as at the date if the transaction constituting the fraudulent preference:** The value of the interest of the person preferred under sub-section (1) shall be determined as at the date of the transaction constituting the fraudulent preference, as if the interest were free of all encumbrances other than those to which the mortgage or charge for the debt of the company was then subject.

(3) **Application to tribunal to make payment:** On an application made to the Tribunal with respect to any payment on the ground that the payment was a fraudulent preference of a surety or guarantor, the Tribunal shall have jurisdiction to determine any questions with respect to the payment arising between the person to whom the payment was made and the surety or guarantor and to grant relief in respect thereof, notwithstanding that it is not necessary so to do for the purposes of the winding up, and for that purpose, may give leave to bring in the surety or guarantor as a third party as in the case of a suit for the recovery of the sum paid.

(4) The provisions of sub-section (3) shall apply *mutatis mutandis* in relation to transactions other than payment of money.

42. EFFECT OF FLOATING CHARGE [SECTION 332]

Where a company is being wound up,

- a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up,

shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except for the amount of any cash paid to the company at the time of, or subsequent to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of five per cent. per annum or such other rate as may be notified by the Central Government in this behalf.

43. DISCLAIMER OF ONEROUS PROPERTY [SECTION 333]

(1) **Disclaim of property by company liquidator:** Where any part of the property of a company which is being wound up consists of—

(a) land of any tenure, burdened with onerous covenants;

(b) shares or stocks in companies;

(c) any other property which is not saleable or is not readily saleable by reason of the possessor thereof being bound either to the performance of any onerous act or to the payment of any sum of money; or

(d) unprofitable contracts,

the Company Liquidator may, notwithstanding that he has endeavoured to sell or has taken possession of the property or exercised any act of ownership in relation thereto or done anything in pursuance of the contract, with the leave of the Tribunal and subject to the provisions of this section, -

by writing signed by him, at any time within twelve months after the commencement of the winding up or such extended period as may be allowed by the Tribunal, disclaim the property.

Where the Company Liquidator had not become aware of the existence of any such property within one month from the commencement of the winding up, the power of disclaiming the property may be exercised at any time within twelve months after he has become aware thereof or such extended period as may be allowed by the Tribunal.

(2) **Determination of rights, interest and liabilities in respect of the property disclaimed:** The disclaimer shall operate to determine, as from the date of disclaimer, the rights, interest and liabilities of the company in or in respect of the property disclaimed, but shall not, except so far as is necessary for the purpose of releasing the company and the property of the company from liability, affect the rights, interest or liabilities of any other person.

(3) **Notices to be given to the interested persons:** The Tribunal, before or on granting leave to disclaim, may require such notices to be given to persons interested, and impose such terms as a condition of granting leave, and make such other order in the matter as the Tribunal considers just and proper.

(4) **Application made in writing to disclaim/ not to disclaim:** The Company Liquidator shall not be entitled to disclaim any property in any case where an application in writing has been made to him by any person interested in the property requiring him to decide whether he will or will not disclaim and the Company Liquidator has not, within a period of twenty-eight days after the receipt of the application or such extended period as may be allowed by the Tribunal, give notice to the applicant that he intends to apply to the Tribunal for leave to disclaim, and in case the property is under a contract, if the Company Liquidator after such an application as aforesaid does not within the said period or extended period disclaim the contract, he shall be deemed to have adopted it.

(5) **Application of person who is entitled to benefit of a contract made with a company:** The Tribunal may, on the application of any person who is, as against the Company Liquidator, entitled to the benefit or subject to the burden of a contract made with the company, make an order-

- rescinding the contract on such terms as to payment by or to either party of damages for the non-performance of the contract, or
- otherwise as the Tribunal considers just and proper, and
- any damages payable under the order to any such person may be proved by him as a debt in the winding up.

(6) **Order of tribunal after hearing interested person on an application:** The Tribunal may, on an application by any person who either claims any interest in any disclaimed property or is under any liability not discharged under this Act in respect of any disclaimed property, and after hearing any such persons as it thinks fit, make an order for the –

- vesting of the property in, or

- the delivery of the property to,
- any person entitled thereto or to whom it may seem just that the property should be delivered by way of compensation for such liability as aforesaid,
- or a trustee for him, and

on such terms as the Tribunal considers just and proper, and on any such vesting order being made, the property comprised therein shall vest accordingly in the person named therein in that behalf without any conveyance or assignment for the purpose:

Where the property disclaimed is of a **leasehold nature**-

the Tribunal shall not make a vesting order in favour of any person claiming under the company, whether as under-lessee or as mortgagee or holder of a charge by way of demise, except upon the terms of making that person—

(a) subject to the same liabilities and obligations as those to which the company was subject under the lease in respect of the property at the commencement of the winding up; or

(b) if the Tribunal thinks fit, subject only to the same liabilities and obligations as if the lease had been assigned to that person at that date,

and in either event as if the lease had comprised only the property comprised in the vesting order, and any mortgagee or under-lessee declining to accept a vesting order upon such terms shall be excluded from all interest in, and security upon the property, and,

If there is no person claiming under the company who is willing to accept an order upon such terms, the Tribunal shall have power to vest the estate and interest of the company in the property in any person liable, either personally or in a representative character, and either alone or jointly with the company, to perform the covenants of the lessee in the lease, free and discharged from all estates, encumbrances and interests created therein by the company.

(7) Affected person shall be deemed creditor of company: Any person affected by the operation of a disclaimer under this section shall be deemed to be a creditor of the company to the amount of the compensation or damages payable in respect of such effect, and may accordingly prove the amount as a debt in the winding up.

44. TRANSFERS, ETC., AFTER COMMENCEMENT OF WINDING UP TO BE VOID [SECTION 334]

In the case of a winding up by the Tribunal, any disposition of the property including actionable claims, of the company and any transfer of shares in the company or alteration in the status of its

members, made after the commencement of the winding up shall, unless the Tribunal otherwise orders, be void.

45. CERTAIN ATTACHMENTS, EXECUTIONS, ETC., IN WINDING UP BY TRIBUNAL TO BE VOID [SECTION 335]

(1) Where any company is being wound up by the Tribunal,—

(a) **any attachment**, **distress or execution** put in force, without leave of the Tribunal a**gainst the estate or effects of the company**, after the commencement of the winding up; or

(b) **any sale held**, without leave of the Tribunal of **any of the properties or effects of the company**, after such commencement,

-shall be void.

(2) **Not applicable to proceedings for the recovery of any tax/dues:** Nothing in this section shall apply to any proceedings for the recovery of any tax or impost or any dues payable to the Government.

46. OFFENCES BY OFFICERS OF COMPANIES IN LIQUIDATION [SECTION 336]

Offences committed by Officers of Companies

- No disclosure of assets
- No deliver of property
- No deliver of books and papers
- No deliver of informations
- Material omissions
- Prevents the production of any book or paper
- Displays fictitious losses or expenses
- False representation

(1) If any person, who is or has been an officer of a company which, at the time of the commission of the alleged offence, is being wound up, by the Tribunal under this Act or which is subsequently ordered to be wound up by the Tribunal under this Act—

(a) **No disclosure of assets:** does not, to the best of his knowledge and belief, fully and truly disclose to the Company Liquidator all the property, movable and immovable, of the company, and how and to whom and for what consideration and when the company disposed of any part thereof, except such part as has been disposed of in the ordinary course of the business of the company;

(b) **No deliver of property** : does not deliver up to the Company Liquidator, or as he directs, all such part of the movable and immovable property of the company as is in his custody or under his control and which he is required by law to deliver up;

(c) **No deliver of books and papers:** does not deliver up to the Company Liquidator, or as he directs, all such books and papers of the company as are in his custody or under his control and which he is required by law to deliver up;

(d) **No deliver of informations**: within the twelve months immediately before the commencement of the winding up or at any time thereafter,—

(i) **conceals any part of the property** of the company to the value of one thousand rupees or more, or conceals any debt due to or from the company;

(ii) **fraudulently removes any part of the property** of the company to the value of one thousand rupees or more;

(iii) **conceals, destroys, mutilates or falsifies**, or is privy to the concealment, destruction, mutilation or falsification of, **any book or paper** affecting or relating to, the property or affairs of the company;

(iv) **makes, or is privy to the making of, any false entry** in any book or paper affecting or relating to, the property or affairs of the company;

(v) **fraudulently parts with, alters or makes any omission in**, or is privy to the fraudulent parting with, altering or making of any omission in, **any book or paper** affecting or relating to the property or affairs of the company;

(vi) by any **false representation or other fraud, obtains on credit**, for or on behalf of the company, any property which the company does not subsequently pay for;

(vii) under the **false pretence that the company is carrying on its business, obtains on credit**, for or on behalf of the company, any property which the company does not subsequently pay for; or

(viii) **pawns, pledges or disposes of any property of the company which has been obtained on credit and has not been paid** for, unless such pawning, pledging or disposing of the property is in the ordinary course of business of the company;

(e) **Material omissions:** makes any material omission in any statement relating to the affairs of the company;

(f) knowing or believing that a false debt has been proved by any person under the winding up, fails for a period of one month to inform the Company Liquidator thereof;

(g) **Prevents the production of any book or paper**: after the commencement of the

winding up, prevents the production of any book or paper affecting or relating to the property or affairs of the company;

(h) **Displays fictitious losses or expenses:** after the commencement of the winding up or at any meeting of the creditors of the company within the twelve months next before the commencement of the winding up, attempts to account for any part of the property of the company by fictitious losses or expenses; or

(i) **False representation**: is guilty of any false representation or fraud for the purpose of obtaining the consent of the creditors of the company or any of them, to an agreement with reference to the affairs of the company or to the winding up,

-he shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees:

It shall be a good defence if the accused proves that he had no intent to defraud or to conceal the true state of affairs of the company or to defeat the law.

(2) **Person who takes in pawn or pledge or otherwise receives the property, knowing it to be pawned, pledged, or disposed of in circumstances under sub-clause (viii) of clause (d) of sub-section (1) -**Where any person pawns, pledges or disposes of any property in circumstances which amount to an offence under sub-clause (viii) of clause (d) of sub-section (1), every person who takes in pawn or pledge or otherwise receives the property, knowing it to be pawned, pledged, or disposed of in such circumstances as aforesaid, shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than three lakh rupees but which may extend to five lakh rupees.

Explanation -For the purposes of this section, the expression "**officer"** includes any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

47. STATEMENT THAT COMPANY IS IN LIQUIDATION [SECTION 344]

(1) Statement of wound up: Where a company is being wound up, whether by

- the Tribunal or
- voluntarily,

- every invoice, order for goods or business letter issued-

- by or on behalf of the company or
- a Company Liquidator of the company, or

- a receiver or
- manager of the property of the company,

- being a document on or in which the name of the company appears, shall contain a statement that the company is being wound up.

(2) **If a company contravenes the above provisions**, the company, and every officer of the company, the Company Liquidator and any receiver or manager, who willfully authorises or permits the non-compliance, shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees.

48. BOOKS AND PAPERS OF COMPANY TO BE EVIDENCE [SECTION 345]

Books and Papers shall be prima facie evidence of truth: Where a company is being wound up, all books and papers of the company and of the Company Liquidator shall, as between the contributories of the company, be prima facie evidence of the truth of all matters purporting to be recorded therein.

49. INSPECTION OF BOOKS AND PAPERS BY CREDITORS AND CONTRIBUTORIES [SECTION 346]

(1) **Inspection of Books and Papers:** At any time after the making of an order for the winding up of a company by the Tribunal, any creditor or contributory of the company may inspect the books and papers of the company only in accordance with, and subject to such rules as may be prescribed.

(2) **No effect on the rights of the following persons:** Nothing contained in sub-section (1) shall exclude or restrict any rights conferred by any law for the time being in force—

(a) on the Central Government or a State Government;

(b) on any authority or officer thereof; or

(c) on any person acting under the authority of any such Government or of any such authority or officer.

50. DISPOSAL OF BOOKS AND PAPERS OF COMPANY [SECTION 347]

(1) **Disposal of books and papers:** When the affairs of a company have been completely wound up and it is about to be dissolved, the books and papers of such company and those of the Company Liquidator may be disposed of in such manner as the Tribunal directs.

(2) **Transfer of responsibility:** After the expiry of five years from the dissolution of the company, no responsibility shall devolve-

- on the company,
- the Company Liquidator, or
- any person

to whom the custody of the books and papers has been entrusted, by reason of any book or paper not being forthcoming to any person claiming to be interested therein.

(3) The Central Government may, by rules,—

(a) **prevent for such period** as it thinks proper **the destruction of the books and papers** of a company which has been wound up and of its Company Liquidator; and

(b) **enable any creditor or contributory of the company to make representations** to the Central Government in respect of the matters specified in clause (a) and **to appeal to the Tribunal** from any order which may be made by the Central Government in the matter.

(4) **If any person acts in contravention** of any rule framed or an order made under sub-section (3), he shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.

51. COMPANY LIQUIDATION DIVIDEND AND UNDISTRIBUTED ASSETS ACCOUNT [SECTION 352]

(1) **Money in the hands of the liquidator:** Where any company is being wound up and the liquidator has in his hands or under his control any money representing—

(a) **dividends payable to any creditor** but which had remained unpaid for six months after the date on which they were declared; or

(b) **assets refundable to any contributory** which have remained undistributed for six months after the date on which they become refundable, the liquidator shall forthwith deposit the said money into a separate special account to be known as the Company Liquidation Dividend and Undistributed Assets Account maintained in a scheduled bank.

(2) **Transfer of money into the Company Liquidation Dividend and Undistributed Assets Account:** The liquidator shall, on the dissolution of the company, pay into the Company Liquidation Dividend and Undistributed Assets Account any money representing unpaid dividends or undistributed assets in his hands at the date of dissolution.

(3) **Furnishing of statement all sums to registrar:** The liquidator shall, when making any payment referred to in sub-sections (1) and (2), furnish to the Registrar, a statement in the prescribed form, setting forth, in respect of all sums included in such payment, the nature of the sums, the names and last known addresses of the persons entitled to participate therein, the amount to which each is entitled and the nature of his claim thereto, and such other particulars as may be prescribed.

(4) **Receivable of receipt of money payment from scheduled bank:** The liquidator shall be entitled to a receipt from the scheduled bank for any money paid to it, and such receipt shall be an effectual discharge of the Company Liquidator in respect thereof.

(5) **In case of voluntary winding up of company:** Where a company is being wound up voluntarily, the Company Liquidator shall, when filing a statement as per section 348,

- indicate the sum of money which is payable, during the six months preceding the date on which the said statement is prepared, and

  shall, within fourteen days of the date of filing the said statement-

- pay that sum into the Company Liquidation Dividend and Undistributed Assets Account.

(6) **Application to registrar by the entitled person to any money paid:** Any person claiming to be entitled to any money paid into the Company Liquidation Dividend and Undistributed Assets Account, whether paid in pursuance of this section or under the provisions of any previous company law

- may apply to the Registrar for payment thereof, and
- the Registrar, if satisfied that the person claiming is entitled, may make the payment to that person of the sum due.

Period of settlement of claim: Provided that the Registrar shall settle the claim of such person within a period of sixty days from the date of receipt of such claim, failing which the Registrar shall make a report to the Regional Director giving reasons of such failure.

(7) **Unclaimed money in Company Liquidation Dividend and Undistributed Assets Account:** Any money paid into the Company Liquidation Dividend and Undistributed Assets Account in pursuance of this section, which remains unclaimed thereafter -

- for a period of fifteen years,
- shall be transferred to the general revenue account of the Central Government,
- but a claim to any money so transferred may be preferred under sub-section (6) and shall be dealt with as if such transfer had not been made and the order, if any, for payment on the claim will be treated as an order for refund of revenue.

(8) **In contravention:** Any liquidator retaining any money which should have been paid by him into the Company Liquidation Dividend and Undistributed Assets Account under this section shall—

(a) **pay interest on the amount so retained at the rate of twelve per cent per annum** and also pay such penalty as may be determined by the Registrar:

Provided that the Central Government may in any proper case remit either in part or in whole the amount of interest which the liquidator is required to pay under this clause;

(b) **be liable to pay any expenses** occasioned by reason of his default; and

(c) **where the winding up is by the Tribunal**, also be liable to have all or such part of his remuneration, as the Tribunal may consider just and proper, to be disallowed, and to be removed from his office by the Tribunal.

52. LIQUIDATOR TO MAKE RETURNS, ETC. [SECTION 353]

(1) **Company liquidator makes default in filing, delivering of documents etc.:** If any Company Liquidator who has made any default-

- in filing, delivering or making any return, account or other document, or
- in giving any notice which he is by law required to file, deliver, make or give, fails to make good the default
- within fourteen days after the service on him of a notice requiring him to do so,

the Tribunal may, on an application made to it by any-

- contributory or creditor of the company or
- by the Registrar,

make an order directing the Company Liquidator to make good the default within such time as may be specified in the order.

(2) **Cost to be bear by company liquidator:** Any order under sub-section (1) may provide that all costs of, and incidental to, the application shall be borne by the Company Liquidator.

(3) **This section is not effecting on the other enactment imposing penalty on company liquidator:** Nothing in this section shall prejudice the operation of any enactment imposing penalties on a Company Liquidator in respect of any such default as aforesaid.

53. MEETINGS TO ASCERTAIN WISHES OF CREDITORS OR CONTRIBUTORIES [SECTION 354]

(1) Ascertain the wishes: In all matters relating to the winding up of a company, the Tribunal may—

(a) **have regard to the wishes of creditors or contributories** of the company, as proved to it by any sufficient evidence;

(b) if it thinks fit for the purpose of ascertaining those wishes, **direct meetings of the creditors or contributories** to be called, held and conducted in such manner as the Tribunal may direct; and

(c) appoint a person to act as chairman of any such meeting, and

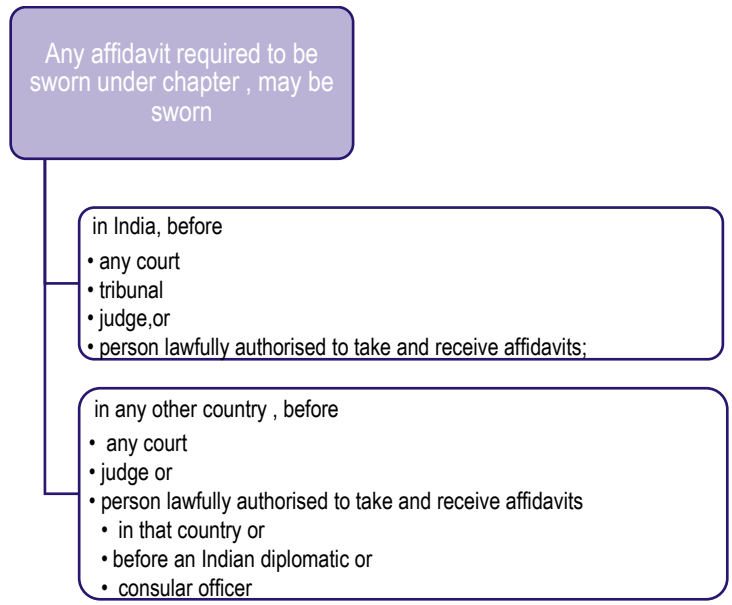
(d) **to report the result** thereof to the Tribunal.

(2) While ascertaining the wishes of creditors, regard shall be had to the value of each debt of the creditor.

(3) While ascertaining the wishes of contributories, regard shall be had to the number of votes which may be cast by each contributory.

54. COURT, TRIBUNAL OR PERSON, ETC., BEFORE WHOM AFFIDAVIT MAY BE SWORN [SECTION 355]

(1) **Affidavit:**



(2) **Judicial notice of the affidavit and other related documents:** All tribunals, judges, Justices, commissioners and persons acting judicially in India shall take judicial notice of the seal, stamp or signature, as the case may be, of any such court, tribunal, judge, person, diplomatic or consular officer, attached, appended or subscribed to any such affidavit or to any other document to be used for the purposes of this Chapter.

55. POWERS OF TRIBUNAL TO DECLARE DISSOLUTION OF COMPANY VOID [SECTION 356]

(1) **Power of tribunal to declare dissolution to be void**: Where a company has been dissolved, the Tribunal may -

- at any time within two years of the date of the dissolution,
- on application by the Company Liquidator of the company or
- by any other person who appears to the Tribunal to be interested,

-make an order, upon such terms as the Tribunal thinks fit, declaring the dissolution to be void, and thereupon such proceedings may be taken as if the company had not been dissolved.

(2) **Failure in fling of a certified copy of order of tribunal with registrar:** It shall be the duty of the Company Liquidator or the person on whose application the order was made, within thirty days after the making of the order or such further time as the Tribunal may allow, to file a certified copy of the order with the Registrar who shall register the same, and if the Company Liquidator or the person fails so to do, the Company Liquidator or the person shall be punishable with fine which may extend to ten thousand rupees for every day during which the default continues.

56. COMMENCEMENT OF WINDING UP BY TRIBUNAL [SECTION 357]

The winding up of a company by the Tribunal under this Act shall be deemed to commence at the time of the presentation of the petition for the winding up.

57. EXCLUSION OF CERTAIN TIME IN COMPUTING PERIOD OF LIMITATION [SECTION 358]

Notwithstanding anything in the Limitation Act, 1963, or in any other law for the time being in force, in computing the period of limitation specified for any suit or application in the name and on behalf of a company which is being wound up by the Tribunal, the period from the date of commencement of the winding up of the company to a period of one year immediately following the date of the winding up order shall be excluded.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. When can an application be made to Tribunal for constitution of a winding up committee to assist and monitor the progress of liquidation proceedings by the Company Liquidator in carrying out the function?

   (a) Within two weeks from the date of passing of winding up order

   (b) Within three weeks from the date of passing of winding up order

   (c) Within four weeks from the date of passing of winding up order

   (d) None of the above.

2. When can a winding up order not be called a notice of discharge?

   (a) when the business of the company is continued

   (b) when the business of the company is closed since 2 years.

   (c) On the discretion of the management

   (d) till a provisional Liquidator is appointed

ANSWER/SOLUTION

Answer to MCQ

1. (b) **Hint:** Section 277 (4) of the companies Act, 2013, states that within three weeks from the date of passing of winding up order, the Company Liquidator shall make an application to the Tribunal for constitution of a winding up committee to assist and monitor the progress of liquidation proceedings by the Company Liquidator in carrying out the function and such winding up committee shall comprise of the following persons, namely:—

   (i) Official Liquidator attached to the Tribunal;

   (ii) nominee of secured creditors; and

   (iii) a professional nominated by the Tribunal.

2. (a) **Hint:** As per section 277(3) of the Companies Act, 2013, the winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is continued.

Descriptive Questions

Question 1

Info-tech Overtrading Ltd. was ordered to be wound up compulsory by an order dated 10th March, 2019 by the Tribunal. The official liquidator who has taken control for the assets and other records of the company has noticed the following:

The Managing Director of the company has sold certain properties belonging to the company to a private company in which his son was interested causing loss to the company to the extent of INR 50 lakhs. The sale took place on 15th October, 2018.

Examine what action the official liquidator can take in this matter. Having regard to the provisions of the Companies Act, 2013.

Question 2

XYZ Limited is being would up by the tribunal. All the assets of the company have been charged to the company's bankers to whom the company owes ₹ 5 crores. The company owes following amounts to others:

- *Dues to workers – ₹ 1,25,00,000*
- *Taxes Payable to Government – ₹ 30,00,000*
- *Unsecured Creditors – ₹ 60,00,000*

You are required to compute with the reference to the provision of the Companies Act, 2013 the amount each kind of creditors is likely to get if the amount realized by the official liquidator from the secured assets and available for distribution among creditors is only ₹ 4,00,00,000/-

Answer to Descriptive Questions

1. The official liquidator can invoke the provisions contained in Section 328 of the Companies Act, 2013 to recover the sale of assets of the company. According to Section 328, if the Tribunal is satisfied that there is a preference transfer of property, movable or immovable, or any delivery of goods, payment, execution made, taken or done by or against a company within six months before making winding up application, the Tribunal may order as it may think fit and may declare such transaction invalid and restore the position.

   Since in the present case, the sale of immovable property took place on 15th October, 2018 and the company went into liquidation on 10th March, 2019 i.e., within 6 months before the winding up of the company and since the sale has resulted in a loss of INR 50 lakhs to the company.

   The official liquidator will be able to succeed in proving the case under Section 328 by way of fraudulent preference as the property was sold to a private company in which the son of the ex-managing was interested.

Hence, the transaction made will be regarded as invalid and restore the position of the company as if no transfer of immovable property has been made.

2. Section 326 of the Companies Act, 2013 is talks about the overriding preferential payments to be made from the amount realized from the assets to be distributed to various kind of creditors. According to the proviso given in the section 326 the security of every secured creditor shall be deemed to be subject to a pari passu change in favor of the workman to the extent of their portion.

$$\text{Workman's Share to Secured Asset} = \frac{\text{Amount Realied} * \text{Workman's Dues}}{\text{Workman's Dues} + \text{Secured Loan}}$$

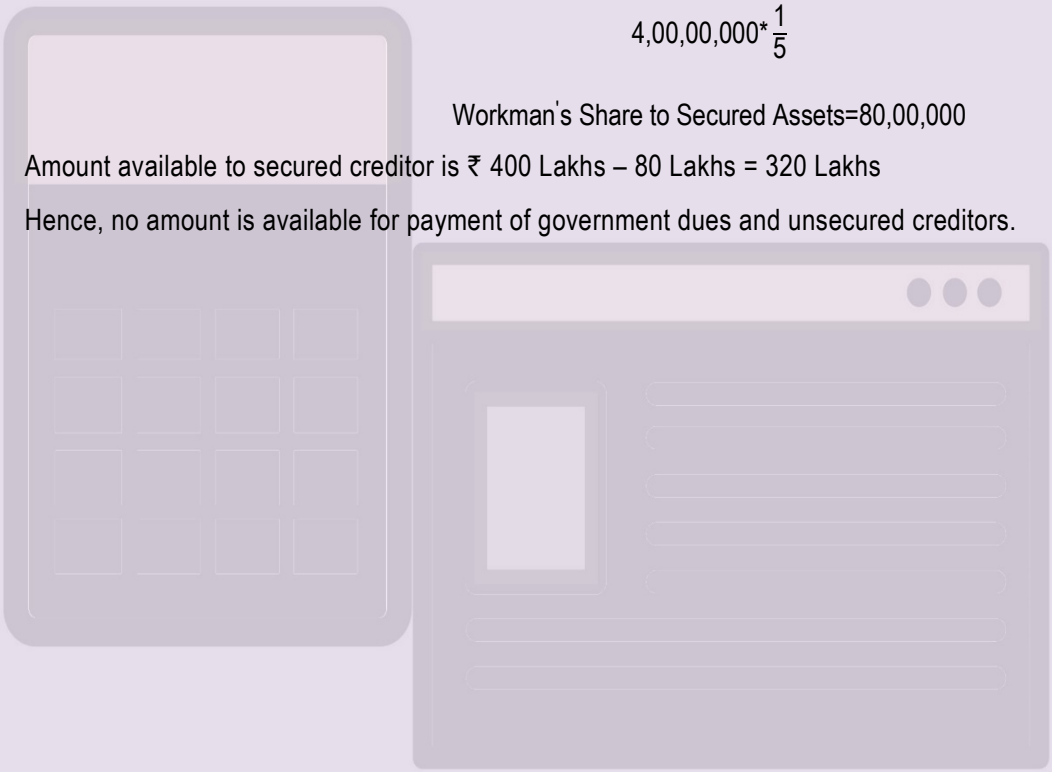
$$\text{Workman's Share to Secured Asset} = \frac{4,00,00,000 * 1,25,00,000}{1,25,00,000 + 5,00,00,000}$$

$$4,00,00,000 * \frac{1}{5}$$

Workman's Share to Secured Assets=80,00,000

Amount available to secured creditor is ₹ 400 Lakhs – 80 Lakhs = 320 Lakhs

Hence, no amount is available for payment of government dues and unsecured creditors.



CHAPTER 8

PRODUCER COMPANIES

IMPORTANT NOTE: SINCE THE PROVISIONS OF THIS CHAPTER ARE BASED ON THE COMPANIES ACT, 1956, SO THIS CHAPTER IS NOT APPLICABLE FOR EXAMINATION PERSECTIVE OF THE STUDENTS.

Final Course

(Revised Scheme of Education and Training)

Study Material

(Modules 1 to 3)

Paper 4

Corporate and Economic Laws

Part – I : Corporate Laws

Module – 2

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CHAPTER 9

COMPANIES INCORPORATED OUTSIDE INDIA

LEARNING OUTCOMES

After reading this chapter, you will be able to:

- ❑ Know the meaning of the Foreign Company and application of Act to it.
- ❑ Explain the provisions related to Accounts of Foreign company, service on foreign company
- ❑ Understand the provisions of debentures, annual return, registration of charges, books of account and their inspection in Foreign companies
- ❑ Analyze dating of prospectus and particulars to be contained therein, provisions as to expert's consent and allotment and registration of prospectus
- ❑ Know about offer of Indian Depository Receipts

1. INTRODUCTION

Foreign Company [Section 2(42)]: "Foreign company" means any company or body corporate incorporated outside India which-

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

According to the *Companies (Registration of Foreign Companies) Rules, 2014,* **"electronic mode"** means carrying out electronically based, whether main server is installed in India or not, including, but not limited to -

(a) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(b) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India;

(c) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;

(d) online services such as telemarketing, telecommuting, telemedicine, education and information research; and

(e) all related data communication services,

whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

2. APPLICATION OF ACT TO FOREIGN COMPANIES [SECTION 379]

According to this section:

(i) Sections 380 to 386 (both inclusive) and sections 392 and 393 shall apply to all foreign companies:

However, the Central Government may, by Order published in the Official Gazette, exempt any class of foreign companies, specified in the Order, from any of the provisions of sections 380 to 386 and sections 392 and 393 and a copy of every such order shall, as soon as may be after it is made, be laid before both Houses of Parliament.

(ii) Where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by:

(i) one or more citizens of India; or

(ii) by one or more companies or bodies corporate incorporated in India; or

(iii) by one or more citizens of India and one or more companies or bodies corporate incorporated in India,

whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXII and such other provisions of this Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

Note: Chapter XXII referred to above deals with the legal provisions for companies incorporated outside India.

3. DOCUMENTS, ETC., TO BE DELIVERED TO REGISTRAR BY FOREIGN COMPANIES [SECTION 380]

According to section 380 (1) of the Companies Act, 2013,

(i) Every foreign company shall, within 30 days of the establishment of its place of business in India, deliver to the Registrar for registration:

(a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company. If the instrument is not in the English language, a certified translation thereof in the English language;

(b) the full address of the registered or principal office of the company;

(c) a list of the directors and secretary of the company containing such particulars as may be prescribed;

In relation to the nature of particulars to be provided as above, the *Companies (Registration of Foreign Companies) Rules, 2014*, provide that the list of directors and secretary or equivalent (by whatever name called) of the foreign company shall contain the following particulars, for each of the persons included in such list, namely:

(1) personal name and surname in full;

(2) any former name or names and surname or surnames in full;

(3) father's name or mother's name and spouse's name;

(4) date of birth;

(5) residential address;

(6) nationality;

(7) if the present nationality is not the nationality of origin, his nationality of origin;

(8) passport Number, date of issue and country of issue; (if a person holds more than one passport then details of all passports to be given)

(9) income-tax permanent account number (PAN), if applicable;

(10) occupation, if any;

(11) whether directorship in any other Indian company, (Director Identification Number (DIN), Name and Corporate Identity Number (CIN) of the company in case of holding directorship);

(12) other directorship or directorships held by him;

(13) Membership Number (for Secretary only); and

(14) e-mail ID.

(d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;

(e) the full address of the office of the company in India which is deemed to be its principal place of business in India;

(f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;

(g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and

(h) any other information as may be prescribed.

(ii) According to the *Companies (Registration of Foreign Companies) Rules, 2014*, the above information shall be filed with the Registrar within 30 days of the establishment of its place of business in India, in Form *FC-1* along with prescribed fees and documents required to be furnished as provided in section 380(1). The application shall also be supported with an attested copy of approval from the Reserve Bank of India under the Foreign Exchange Management Act or Regulations, and also from other regulators, if any, approval is required by such foreign company to establish a place of business in India or a declaration from the authorised representative of such foreign company that no such approval is required.

(iii) Office where documents to be delivered and fee for registration of documents:

1. According to the *Companies (Registration of Foreign Companies) Rules, 2014*, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

2. It shall be accompanied with the prescribed fees.

3. If any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar, and from the date on which such notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

(iv) Under section 380 (2) every foreign company existing at the commencement of the Companies Act 2013, which has not delivered to the Registrar the documents and particulars specified in section 592(1) of the Companies Act, 1956, it shall continue to be subject to the obligation to deliver those documents and particulars in accordance with the Companies Act, 1956.

(v) Section 380 (3) provides that where any alteration is made or occurs in the documents delivered to the Registrar under section 380, the foreign company shall, within 30 days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form. The *Companies (Registration of Foreign Companies) Rules, 2014*, has prescribed that the return containing the particulars of the alteration shall be filed in form *FC-2* along with prescribed fees.

4. ACCOUNTS OF FOREIGN COMPANY [SECTION 381]

According to this section:

(i) Every foreign company shall, in every calendar year,—

(a) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having attached or annexed thereto such documents as may be prescribed, and

(b) deliver a copy of those documents to the Registrar.

According to the *Companies (Registration of Foreign Companies) Rules, 2014,* every foreign company shall prepare financial statement of its Indian business operations in accordance with Schedule III or as near thereto as possible for each financial year including:

(1) documents that are required to be annexed should be in accordance with Chapter IX i.e. Accounts of Companies.

(2) The documents relating to copies of latest consolidated financial statements of the parent foreign company, as submitted by it to the prescribed authority in the country of its incorporation under the applicable laws there.

(ii) The Central Government is empowered to direct that, in the case of any foreign company or class of foreign companies, the requirements of clause (a) given above shall not apply, or shall apply subject to such exceptions and modifications as may be specified in notification in that behalf [Section 381(1)].

(iii) If any of the specified documents are not in the English language, a certified translation thereof in the English language shall be annexed. [Section 381 (2)]

(iv) Every foreign company shall send to the Registrar along with the documents required to be delivered to him, a copy of a list in the prescribed form, of all places of business established by the company in India as at the date with reference to which the balance sheet referred to in section 381(1) is made.

According to the *Companies (Registration of Foreign Companies) Rules, 2014,* every foreign company shall file with the Registrar, along with the financial statement, in Form FC.3 with such fee as provided under *Companies (Registration Offices and Fees) Rules,*

2014 a list of all the places of business established by the foreign company in India as on the date of balance sheet.

According to the *Companies (Registration of Foreign Companies) Rules, 2014*, if any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar, and as from the date on which notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, if it does not have other place of business in India.

(v) According to the *Companies (Registration of Foreign Companies) Rules, 2014*,

(a) Further, every foreign company shall, along with the financial statement required to be filed with the Registrar, attach thereto the following documents; namely:-

(1) Statement of related party transaction

(2) Statement of repatriation of profits

(3) Statement of transfer of funds (including dividends, if any)

The above statements shall include such other particulars as are prescribed in the *Companies (Registration of Foreign Companies) Rules, 2014*.

(b) All these documents shall be delivered to the Registrar within a period of 6 months of the close of the financial year of the foreign company to which the documents relate.

(vi) **Audit of accounts of foreign company:** According to the *Companies (Registration of Foreign Companies) Rules, 2014,*

(a) Every foreign company shall get its accounts, pertaining to the Indian business operations prepared in accordance with section 381(1) and Rules thereunder, shall be audited by a practicing Chartered Accountant in India or a firm or limited liability partnership of practicing chartered accountants.

(b) The provisions of Chapter X i.e. Audit and Auditors and rules made there under, as far as applicable, shall apply, *mutatis mutandis*, to the foreign company.

5. DISPLAY OF NAME, ETC., OF FOREIGN COMPANY [SECTION 382]

Every foreign company shall—

(a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situate;

(b) cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, bill- heads and letter paper, and in all notices, and other official publications of the company; and

(c) if the liability of the members of the company is limited, cause notice of that fact—

(i) to be stated in every such prospectus issued and in all business letters, bill-heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and

(ii) to be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the language or one of the languages in general use in the locality in which the office or place is situated.

6. SERVICE ON FOREIGN COMPANY [SECTION 383]

Any process, notice, or other document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar under section 380 and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode.

7. DEBENTURES, ANNUAL RETURN, REGISTRATION OF CHARGES, BOOKS OF ACCOUNT AND THEIR INSPECTION [SECTION 384]

(i) The provisions of section 71 (Issue of Debentures) shall apply *mutatis mutandis* to a foreign company.

(ii) The provisions of section 92 (Preparation and filing of Annual return) and section 135 (Corporate Social Responsibility) shall, subject to such exceptions, modifications and adaptations as may be made therein by rules made under this Act, apply to a foreign company as they apply to a company incorporated in India.

According to the *Companies (Registration of Foreign Companies) Rules, 2014,* every foreign company shall prepare and file an annual return in Form *FC-4* along with prescribed fees, within a period of 60 days from the last day of its financial year, to the Registrar containing the particulars as they stood on the close of the financial year.

(iii) The provisions of section 128 (Books of account, etc., to be kept by company) shall apply to a foreign company to the extent of requiring it to keep at its principal place of business in India, the books of account referred to in that section, with respect to monies received and spent, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.

(iv) The provisions of Chapter VI (Registration of Charges) shall apply *mutatis mutandis* to charges on properties which are created or acquired by any foreign company.

(v) The provisions of Chapter XIV (Inspection, inquiry and investigation) shall apply *mutatis mutandis* to the Indian business of a foreign company as they apply to a company incorporated in India.

8. FEE FOR REGISTRATION OF DOCUMENTS [SECTION 385]

There shall be paid to the Registrar for registering any document required by the provisions of this Chapter to be registered by him, such fee, as may be prescribed.

According to the *Companies (Registration of Foreign Companies) Rules, 2014*, fee to be paid to the Registrar for registering any document relating to a foreign company shall be such as provided in the *Companies (Registration Offices and Fees) Rules, 2014*.

9. INTERPRETATION [SECTION 386]

For the purposes of the foregoing provisions of this Chapter, the expression:

(a) "Certified" means certified in the prescribed manner to be a true copy or a correct translation;

(b) "Director", in relation to a foreign company, includes any person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act; and

(c) "Place of business" includes a share transfer or registration office.

Example: Examine with reference to the provisions of the Companies Act, 2013 whether the following companies can be treated as foreign companies:

(i) A company incorporated outside India having a share registration office at Mumbai.

(ii) Indian citizens incorporated a company in Singapore for the purpose of carrying on business there.

Answer

Section 2(42) of the Companies Act, 2013 defines a "foreign company" as any company or body corporate incorporated outside India which:

(a) Has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) Conducts any business activity in India in any other manner.

According to section 386 of the Companies Act, 2013, for the purposes of Chapter XXII of the Companies Act, 2013 (Companies incorporated outside India), expression "Place of business" includes a share transfer or registration office.

Accordingly, to qualify as 'foreign company' a company must have the following features:

(a) it must be incorporated outside India; and

(b) it should have a place of business in India.

(c) That place of business may be either in its own name or through an agent or may even be through the electronic mode; and

(d) It must conduct a business activity of any nature in India.

(i) Therefore, a company incorporated outside India having a share registration office at Mumbai will be treated as a foreign company provided it conducts any business activity in India.

(ii) In the case of a company incorporated in Singapore for the purpose of carrying on business in Singapore will not fall within the definition of a foreign company. Its incorporation by Indian citizen is immaterial. In order to be a foreign company it has to have a place of business in India and must conduct a business activity in India.

10. DATING OF PROSPECTUS AND PARTICULARS TO BE CONTAINED THEREIN [SECTION 387]

According to this section:

(i) Prospectus to be dated and signed [Section 387(1)]: No person shall issue, circulate or distribute in India any prospectus offering to subscribe for securities of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, unless the prospectus is dated and signed, and—

(a) contains particulars with respect to the following matters, namely:—

(1) the instrument constituting or defining the constitution of the company

(2) the enactments or provisions by or under which the incorporation of the company was effected;

(3) address in India where the said instrument, enactments or provisions, or copies thereof, and if the same are not in the English language, a certified translation thereof in the English language can be inspected;

(4) the date on which and the country in which the company would be or was incorporated; and

(5) whether the company has established a place of business in India and, if so, the address of its principal office in India; and

(b) states the matters specified under section 26 (Matters to be stated in prospectus).

Provided that points (1), (2) and (3) of point (a) above shall not apply in the case of a prospectus issued more than 2 years after the date at which the company is entitled to commence business.

(ii) **No waiver of compliance in prospectus [Section 387(2)]:** Any condition requiring or binding an applicant for securities to waive compliance with any requirement imposed by virtue of section 387(1) or purporting to impute him with notice of any contract, documents or matter not specifically referred to in the prospectus, shall be void.

(iii) **Form of application for securities to be issued along with prospectus [Section 387(3)]:** No person shall issue to any person in India a form of application for securities of such a company or intended company as is mentioned in section 387(1), unless the form is issued with a prospectus which complies with the provisions of this Chapter (Chapter XXII) and such issue does not contravene the provisions of section 388:

Exception: If it is shown that the form of application was issued in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to securities.

(iv) Section 387(4) further provides that the provisions of section 387—

(a) shall not apply to the issue to existing members or debenture holders of a company of a prospectus or form of application relating to securities of the company, whether an applicant for securities will or will not have the right to renounce in favour of other persons; and

(b) except in so far as it requires a prospectus to be dated, to the issue of a prospectus relating to securities which are or are to be in all respects uniform with securities previously issued and for the time being dealt in or quoted on a recognised stock exchange,

but, subject as aforesaid, section 387 shall apply to a prospectus or form of application whether issued on or with reference to the formation of a company or subsequently.

(v) Nothing in section 387 shall limit or diminish any liability which any person may incur under any law for the time being in force in India or under the Companies Act, 2013 apart from section 387.

11. PROVISIONS AS TO EXPERT'S CONSENT AND ALLOTMENT [SECTION 388]

According to this section:

(i) No person shall issue, circulate or distribute in India any prospectus offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not been established, or when formed will or will not establish, a place of business in India,—

(a) if, where the prospectus includes a statement purporting to be made by an expert, he has not given, or has before delivery of the prospectus for registration withdrawn, his written consent to the issue of the prospectus with the statement included in the form and context in which it is included, or there does not appear in the prospectus a statement that he has given and has not withdrawn his consent as aforesaid; or

(b) if the prospectus does not have the effect, where an application is made in pursuance thereof, of rendering all persons concerned bound by all the provisions of sections 33 and 40, so far as applicable.

(ii) For the purposes of this section, a statement shall be deemed to be included in a prospectus, if it is contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

12. REGISTRATION OF PROSPECTUS [SECTION 389]

According to this section:

No person shall issue, circulate or distribute in India any prospectus offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, unless before the issue, circulation or distribution of the prospectus in India, a copy thereof certified by the chairperson of the company and two other directors of the company as having been approved by resolution of the managing body has been delivered for registration to the Registrar and the prospectus states on the face of it that a copy has been so delivered, and there is endorsed on or attached to the copy, any consent to the issue of the prospectus required by section 388 and such documents as may be prescribed.

According to the *Companies (Registration of Foreign Companies) Rules, 2014,* the following documents shall be annexed to the prospectus, namely:

(a) any consent to the issue of the prospectus required from any person as an expert;

(b) a copy of contracts for appointment of managing director or manager and in case of a contract not reduced into writing, a memorandum giving full particulars thereof;

(c) a copy of any other material contracts, not entered in the ordinary course of business, but entered within preceding 2 years;

(d) a copy of underwriting agreement; and

(e) a copy of power of attorney, if prospectus is signed through duly authorized agent of directors.

13. OFFER OF INDIAN DEPOSITORY RECEIPTS [SECTION 390]

For the purposes of this section, and according to the *Companies (Registration of Foreign Companies) Rules, 2014,* Indian Depository Receipts (IDR) means any instrument in the form of a depository receipt created by a Domestic Depository in India and authorized by a company incorporated outside India making an issue of such depository receipts.

According to section 390, notwithstanding anything contained in any other law for the time being in force, the Central Government may make rules applicable for—

(i) the offer of Indian Depository Receipts (IDR);

(ii) the requirement of disclosures in prospectus or letter of offer issued in connection with IDR;

(iii) the manner in which the IDR shall be dealt with in a depository mode and by custodian and underwriters; and

(iv) the manner of sale, transfer or transmission of IDR,

by a company incorporated or to be incorporated outside India, whether the company has or has not established, or will or will not establish, any place of business in India.

According to the *Companies (Registration of Foreign Companies) Rules, 2014,* no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India shall make an issue of Indian Depository Receipts (IDRs) unless it complies with the conditions mentioned under this rule, in addition to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

The Rules relating to offer, disclosure requirements and manner of transfer, sale etc., related to IDR are contained in *Companies (Registration of Foreign Companies) Rules, 2014*.

14. APPLICATION OF SECTIONS 34 TO 36 AND CHAPTER XX [SECTION 391]

Section 391 of the Companies Act, 2013 provides for Application of sections 34 to 36 and Chapter XX. According to this section:

According to sub-section (1), the provisions of sections 34 to 36 (both inclusive) shall apply to—

(i) the issue of a prospectus by a company incorporated outside India under section 389 as they apply to prospectus issued by an Indian company;

(ii) the issue of IDR by a foreign company.

Section 34 deals with criminal liability for mis-statements in prospectus

Section 35 deals with Civil Liability for mis-statement in prospectus

Section 36 deals with punishment for fraudulently inducing persons to invest money

Sub-section (2) provides that, subject to the provisions of section 376, the provisions of Chapter XX shall apply *mutatis mutandis* for closure of the place of business of a foreign company in India as if it were a company incorporated in India in case such foreign company has raised monies through offer or issue of securities under this Chapter which have not been repaid or redeemed.

15. PUNISHMENT FOR CONTRAVENTION [SECTION 392]

Without prejudice to the provisions of section 391, if a foreign company contravenes the provisions of Chapter XXII of the Companies Act, 2013 (i.e. Chapter on Companies incorporated outside India), the foreign company shall be punishable with fine which shall not be less than ₹ 1,00,000 but which may extend to ₹ 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to ₹ 50,000 for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5,00,000, or with both.

Thus, the punishment for contravention may be summed up as under:

1. Fine on defaulting foreign company in the range of 1 lac to 3 lac rupees.
2. In case of continuing default an additional fine on the foreign company to the tune of ₹ 50,000 per day after the first during which the contravention continues.
3. Punishment for every officer of the foreign company who is in default shall be:
   - (a) Imprisonment for a maximum term of 6 months, or
   - (b) Imposition of a fine of a minimum amount of ₹ 25,000, or
   - (c) Both - imprisonment and fine.

16. COMPANY'S FAILURE TO COMPLY WITH PROVISIONS OF THIS CHAPTER NOT TO AFFECT VALIDITY OF CONTRACTS, ETC [SECTION 393]

Any failure by a company to comply with the provisions of Chapter XXII of the Companies Act, 2013, shall not affect the validity of any contract, dealing or transaction entered into by the company or its liability to be sued in respect thereof. However, the company shall not be entitled to bring any suit, claim any set-off, make any counter-claim or institute any legal proceeding in respect of any such contract, dealing or transaction, until the company has complied with the provisions of the Companies Act, 2013, applicable to it.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Videshi Ltd., a foreign company established with a principal place of business at Kolkata, West Bengal. The company delivered various documents to Registrar of Companies. State the number of days and place where the said company shall deliver such documents:

   (a) Within 15 days to the Central Government

   (b) Within 15 days to the Registrar having jurisdiction over New Delhi

   (c) Within 30 days to the Registrar having jurisdiction over West Bengal

   (d) Within 30 days to the Registrar having jurisdiction over New Delhi

2. Aster Limited, a foreign company with a place of business in India was established to conduct the business online as to data interchange and other digital supply transactions. The said company failed to deliver within the prescribed time period, some desired documents to the Registrar of Companies in compliance to the Companies Act, 2013. State the penalty cast on Aster Limited for the cause of its failure.

   (a) Aster Ltd. punishable with fine upto ₹ 3,00,000 + additional fine upto ₹ 50,000 in case of continuing offence.

   (b) Aster Ltd. punishable with fine extending upto ₹ 25,000 + additional fine upto ₹ 50,000 in case of continuing offence.

   (c) Aster Ltd. punishable with fine extending upto ₹ 5,00,000 + additional fine upto ₹ 50,000 in case of continuing offence.

   (d) Aster Ltd. punishable with fine levied ₹ 1,00,000 to ₹ 3,00,000 + additional fine upto ₹ 50,000 in case of continuing offence

3. Radix Ltd. is a company registered in Thailand. Although, it has no place of business established in India, yet it is doing online business through remote delivery of healthcare services in India. State the incorrect statement as to the nature of the Radix Ltd. in the light of the Companies Act, 2013-

   (a) It is not a foreign company as it has no place of business established in India.

   (b) It is a foreign company being involved in business activity through telemedicine.

   (c) It is a foreign company as its doing business through electronic mode.

   (d) It is a foreign company as it conducts business activity in India.

Descriptive Questions

Question 1

(i) As per provisions of the Companies Act, 2013, what is the status of XYZ Ltd., a company incorporated in London, U.K., which has a share transfer office at Mumbai?

(ii) ABC Ltd., a foreign company having its Indian principal place of business at Kolkata, West Bengal is required to deliver various documents to Registrar of Companies under the provisions of the Companies Act, 2013. You are required to state, where the said company should deliver such documents.

(iii) In case, a foreign company does not deliver its documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013, state the penalty prescribed under the said Act, which can be levied.

Question 2

DEJY as Company Limited incorporated in Singapore desires to establish a place of business at Mumbai. You being a practicing Chartered Accountant have been appointed by the company as a liaison officer, for compliance of legal formalities on behalf of the company. Examining the provisions of the Companies Act, 2013, state the documents you are required to furnish on behalf of the company, on the establishment of a place of business at Mumbai.

Question 3

ABC Limited, a foreign company failed to deliver some desired documents to the Registrar of Companies as required under Section 380 of the Companies Act, 2013. State the provisions of penalty prescribed under the said Act, which can be levied on ABC Limited for its failure.

Question 4

Robertson Ltd. is a company registered in Thailand. Although, it has no place of business established in India, yet it is doing online business through telemarketing in India. Whether it will be treated as a Foreign Company under the Companies Act, 2013? Explain.

Question 5

Galilio Ltd. is a foreign company in Germany and it established a place of business in Mumbai. Explain the relevant provisions of the Companies Act, 2013 and rules made thereunder relating to preparation and filing of financial statements, as also the documents to be attached alongwith the financial statements by the foreign company.

ANSWERS/SOLUTION

Answer to MCQ

1. (d) **Hint:** The Companies Act, 2013 vide section 380 requires every foreign company to deliver to the Registrar for registration, within 30 days of the establishment of office in India, documents which have been specified therein. According to the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

2. (d) **Hint:** As per section 392 of the Companies Act, 2013, if a foreign company fails to deliver documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013, the foreign company shall be punishable with a fine which shall be not less than ₹ 1,00,000 but which may extend to ₹ 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to ₹ 50,000 for every day after the first during which the contravention continues.

3. (a) **Hint:** *A*ccording to section 2(42) of the Companies Act, 2013, "foreign company" means any company or body corporate incorporated outside India which –

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

According to the *Companies (Registration of Foreign Companies) Rules, 2014*, "electronic mode" means carrying out electronically based, whether main server is installed in India or not, including, but not limited to –

(a) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(b) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities in India or from citizens of India;

(c) financial settlements, web based marketing, advisory and transactional services, data base services and products, supply chain management;

(d) online services such as telemarketing, telecommuting, telemedicine, education and information research; and

(e) all related data communication services whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

Looking to the above description, it can be said that being involved in business activity through telemedicine, Radix Ltd., will be treated as foreign company.

Answer to Descriptive Questions

1. **(i)** In terms of the definition of a foreign company under section 2 (42) of the Companies Act, 2013 a "foreign company" means any company or body corporate incorporated outside India which:

(a) Has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) Conducts any business activity in India in any other manner

According to section 386 of the Companies Act, 2013, for the purposes of Chapter XXII of the Companies Act, 2013 (Companies incorporated outside India), "Place of business" includes a share transfer or registration office.

From the above definition, the status of XYZ Ltd. will be that of a foreign company as it is incorporated outside India, has a place of business in India and it may be presumed that it carries on a business activity in India.

(ii) The Companies Act, 2013 vide section 380 requires every foreign company is required to deliver to the Registrar for registration, within 30 days of the establishment of office in India, documents which have been specified therein. According to *the Companies (Registration of Foreign Companies) Rules, 2014*, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

(iii) The Companies Act, 2013 lays down the governing provisions for foreign companies in Chapter XXII which is comprised of sections 379 to 393. The penalties for non filing or for contravention of any provision for this chapter including for non filing of documents with the Registrar as required by section 380 and other sections in this chapter are laid down in section 392 of the Act which provides that if a foreign company contravenes the provisions of this Chapter, the foreign company shall be punishable with a fine which shall not be less than ₹ 1,00,000 but which may extend to ₹ 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to ₹ 50,000 for every day after the first during which the contravention continues and every officer of the foreign 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 ₹ 25,000 but which may extend to ₹ 5,00,000, or with both.

2. Under section 380(1) of the Companies Act, 2013 every foreign company shall, within 30 days of the establishment of place of business in India, deliver to the Registrar for registration the following documents:

(a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company. If the instruments are not in the English language, a certified translation thereof in the English language;

(b) the full address of the registered or principal office of the company;

(c) a list of the directors and secretary of the company containing such particulars as may be prescribed;

In relation to the nature of particulars to be provided as above, the *Companies (Registration of Foreign Companies) Rules, 2014*, provide that the list of directors and secretary or equivalent (by whatever name called) of the foreign company shall contain the following particulars, for each of the persons included in such list, namely:

(1) personal name and surname in full;

(2) any former name or names and surname or surnames in full;

(3) father's name or mother's name and spouse's name;

(4) date of birth;

(5) residential address;

(6) nationality;

(7) if the present nationality is not the nationality of origin, his nationality of origin;

(8) passport Number, date of issue and country of issue; (if a person holds more than one passport then details of all passports to be given)

(9) income-tax permanent account number (PAN), if applicable;

(10) occupation, if any;

(11) whether directorship in any other Indian company, (Director Identification Number (DIN), Name and Corporate Identity Number (CIN) of the company in case of holding directorship);

(12) other directorship or directorships held by him;

(13) Membership Number (for Secretary only); and

(14) e-mail ID.

(d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;

(e) the full address of the office of the company in India which is deemed to be its principal place of business in India;

(f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;

(g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and

(h) any other information as may be prescribed.

According to the *Companies (Registration of Foreign Companies) Rules, 2014*, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

3. If a foreign company fails to deliver documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013, the foreign company shall be punishable with a fine which shall be not less than ₹ 1,00,000 but which may extend to ₹ 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to ₹ 50,000 for every day after the first during which the contravention continues. Also, every officer of the foreign company who is in default shall be punishable with an imprisonment for a term which may extend to six months or with a fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5,00,000 or with both. The penalty is provided in section 392 and thus ABC Ltd. is liable for the contravention of section 380 of the Act.

4. According to section 2(42) of the Companies Act, 2013, "foreign company" means any company or body corporate incorporated outside India which –

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

According to the *Companies (Registration of Foreign Companies) Rules, 2014*, "electronic mode" means carrying out electronically based, whether main server is installed in India or not, including, but not limited to–

(a) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(b) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities in India or from citizens of India;

(c) financial settlements, web based marketing, advisory and transactional services, data base services and products, supply chain management;

(d) online services such as telemarketing, telecommuting, telemedicine, education and information research; and

(e) all related data communication services whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

Looking to the above description, it can be said that being involved in business activity through telemarketing, Robertson Ltd., will be treated as foreign company.

5. Preparation and filing of financial statements by a foreign company:

According to section 381 of the Companies Act, 2013:

(i) Every foreign company shall, in every calendar year,—

(a) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having attached or annexed thereto such documents as may be prescribed, and

(b) deliver a copy of those documents to the Registrar.

According to the *Companies (Registration of Foreign Companies) Rules, 2014*, every foreign company shall prepare financial statement of its Indian business operations in accordance with Schedule III or as near thereto as possible for each financial year including:

(1) documents that are required to be annexed should be in accordance with Chapter IX i.e. Accounts of Companies.

(2) The documents relating to copies of latest consolidated financial statements of the parent foreign company, as submitted by it to the prescribed authority in the country of its incorporation under the applicable laws there.

(ii) The Central Government is empowered to direct that, in the case of any foreign company or class of foreign companies, the requirements of clause (a) of section 381(1) shall not apply, or shall apply subject to such exceptions and modifications as may be specified in notification in that behalf.

(iii) If any of the specified documents are not in the English language, a certified translation thereof in the English language shall be annexed. [Section 381 (2)]

(iv) Every foreign company shall send to the Registrar along with the documents required to be delivered to him, a copy of a list in the prescribed form, of all places of business established by the company in India as at the date with reference to which the balance sheet referred to in section 381(1) is made.

According to the Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall file with the Registrar, along with the financial statement, in

Form FC-3 with such fee as provided under Companies (Registration Offices and Fees) Rules, 2014 a list of all the places of business established by the foreign company in India as on the date of balance sheet.

According to the Companies (Registration of Foreign Companies) Rules, 2014, if any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar, and as from the date on which notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, if it does not have other place of business in India.

(v) *According to the* Companies (Registration of Foreign Companies) Rules, 2014,

(a) Further, every foreign company shall, along with the financial statement required to be filed with the Registrar, attach thereto the following documents; namely:-

(1) Statement of related party transaction

(2) Statement of repatriation of profits

(3) Statement of transfer of funds (including dividends, if any)

The above statements shall include such other particulars as are prescribed in the *Companies (Registration of Foreign Companies) Rules, 2014.*

(b) All these documents shall be delivered to the Registrar within a period of 6 months of the close of the financial year of the foreign company to which the documents relate.

CHAPTER 10

MISCELLANEOUS PROVISIONS

LEARNING OUTCOMES

After reading this chapter, you will be able to:

- ❑ Know the provisions regarding Removal of names of companies from the Register of Companies
- ❑ Identify the Government companies and their Annual Reports
- ❑ Analyzing the concept of Nidhis and Dormant companies

1. INTRODUCTION

Ministry of Corporate Affairs vide Notifications dated 7th of December & 26th of December, 2016 notified various sections of the Companies Act, 2013. Besides, with the enforcement of the Insolvency and Bankruptcy Code, 2016, many consequential changes have also bring in the Companies Act, 2013.

2. REGISTERED VALUER

(i) Valuation: Where a valuation is required to be made in respect of any

- property,
- stocks,
- shares,
- debentures,
- securities or

- goodwill or
- any other assets (herein referred to as the assets) or
- net worth of a company or its liabilities

under the provision of this Act, it shall be valued by a person having such qualifications and experience, registered as a valuer and being a member of an organisation recognised, in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company.

(ii) **Role of Valuer:** The valuer appointed under sub-section (1) shall,—

(a) make an impartial, true and fair valuation of any assets which may be required to be valued;

(b) exercise due diligence while performing the functions as valuer;

(c) make the valuation in accordance with such rules as may be prescribed; and

(d) not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during a period of three years prior to his appointment as valuer or three years after the valuation of assets was conducted by him.

(iii) **Contravention**: If a valuer contravenes the provisions of this section or the rules made thereunder, the valuer shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 1 Lakh.

However, if the valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with imprisonment for a term which may extend to 1 year and with fine which shall not be less than ₹ 1 Lakh but which may extend to ₹ 5 lakhs.

(iv) Where a valuer has been convicted under point (iii), he shall be liable to—

(a) refund the remuneration received by him to the company; and

(b) pay for damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

COMPANIES (REGISTERED VALUERS AND VALUATION) RULES, 2017

Definitions

2. (1) In these rules, unless the context otherwise requires —

(*b*) "authority" means an authority specified by the Central Government under section 458 of the Companies Act, 2013 to perform the functions under these rules;

(*c*) "asset class" means a distinct group of assets, such as land and building, machinery and equipment, displaying similar characteristics, that can be classified and requires separate set of valuers for valuation;

(*f*) "partnership entity" means a partnership firm registered under the Indian Partnership Act, 1932 (9 of 1932) or a limited liability partnership registered under the Limited Liability Partnership Act, 2008 (6 of 2009);

(*i*) "valuation standards" means the standards on valuation referred to in rule 18; and

(*j*) "valuer" means a person registered with the authority in accordance with these rules and the term "registered valuer" shall be construed accordingly.

Eligibility for registered valuers

3. (1) A person shall be eligible to be a registered valuer if he-

(*a*) is a valuer member of a registered valuers organisation;

Explanation.— For the purposes of this clause, "a valuer member" is a member of a registered valuers organisation who possesses the requisite educational qualifications and experience for being registered as a valuer;

(*b*) is recommended by the registered valuers organisation of which he is a valuer member for registration as a valuer;

(*c*) has passed the valuation examination under rule 5 within three years preceding the date of making an application for registration under rule 6;

(*d*) possesses the qualifications and experience as specified in rule 4;

(*e*) is not a minor;

(*f*) has not been declared to be of unsound mind;

(*g*) is not an undischarged bankrupt, or has not applied to be adjudicated as a bankrupt;

(*h*) is a person resident in India;

Explanation.— For the purposes of these rules 'person resident in India' shall have the same meaning as defined in clause (*v*) of section 2 of the Foreign Exchange Management Act, 1999 as far as it is applicable to an individual;

(*i*) has not been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence:

Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;

(*j*) has not been levied a penalty under section 271J of Income-tax Act, 1961 and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal, as the case may be has expired, or such penalty has been confirmed by Income-tax Appellate Tribunal, and five years have not elapsed after levy of such penalty; and

(*k*) is a fit and proper person:

Explanation.— For determining whether an individual is a fit and proper person under these rules, the authority may take account of any relevant consideration, including but not limited to the following criteria-

(*i*) integrity, reputation and character,

(*ii*) absence of convictions and restraint orders, and

(*iii*) competence and financial solvency.

(2) No partnership entity or company shall be eligible to be a registered valuer if-

(*a*) it has been set up for objects other than for rendering professional or financial services, including valuation services and that in the case of a company, it is a subsidiary, joint venture or associate of another company or body corporate;

(*b*) it is undergoing an insolvency resolution or is an undischarged bankrupt;

(*c*) all the partners or directors, as the case may be, are not ineligible under clauses (c), (d), (e), (f), (g), (h), (i), (j) and (k) of sub-rule (1);

(*d*) three or all the partners or directors, whichever is lower, of the partnership entity or company, as the case may be, are not registered valuers; or

(*e*) none of its partners or directors, as the case may be, is a registered valuer for the asset class, for the valuation of which it seeks to be a registered valuer.

Qualifications and experience

4. An individual shall have the following qualifications and experience to be eligible for registration under rule 3, namely:-

(*a*) post-graduate degree or post-graduate diploma, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least three years of experience in the specified discipline thereafter; or

(*b*) a Bachelor's degree or equivalent, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least five years of experience in the specified discipline thereafter; or

(*c*) membership of a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession with at least three years' experience after such membership.

Explanation-I— For the purposes of this clause the 'specified discipline' shall mean the specific discipline which is relevant for valuation of an asset class for which the registration as a valuer or recognition as a registered valuers organisation is sought under these rules.

Conditions of Registration

7. The registration granted under rule 6 shall be subject to the conditions that the valuer shall -

(*a*) at all times possess the eligibility and qualification and experience criteria as specified under rule 3 and rule 4;

(*b*) at all times comply with the provisions of the Act, these rules and the Bye-laws or internal regulations, as the case may be, of the respective registered valuers organisation;

(*c*) in his capacity as a registered valuer, not conduct valuation of the assets or class(es) of assets other than for which he/it has been registered by the authority;

(*d*) take prior permission of the authority for shifting his/ its membership from one registered valuers organisation to another;

(*e*) take adequate steps for redressal of grievances;

(*f*) maintain records of each assignment undertaken by him for at least three years from the completion of such assignment;

(*g*) comply with the Code of Conduct of the registered valuers organisation of which he is a member;

(*h*) in case a partnership entity or company is the registered valuer, allow only the partner or director who is a registered valuer for the asset class(es) that is being valued to sign and act on behalf of it;

(*i*) in case a partnership entity or company is the registered valuer, it shall disclose to the company concerned, the extent of capital employed or contributed in the partnership entity or the company by the partner or director, as the case may be, who would sign and act in respect of relevant valuation assignment for the company;

(*j*) in case a partnership entity is the registered valuer, be liable jointly and severally along with the partner who signs and acts in respect of a valuation assignment on behalf of the partnership entity;

(*k*) in case a company is the registered valuer, be liable alongwith director who signs and acts in respect of a valuation assignment on behalf of the company;

(*l*) in case a partnership entity or company is the registered valuer, immediately inform the authority on the removal of a partner or director, as the case may be, who is a registered valuer along with detailed reasons for such removal; and

(*m*) comply with such other conditions as may be imposed by the authority.

Conduct of Valuation

8. (1) The registered valuer shall, while conducting a valuation, comply with the valuation standards as notified or modified under rule 18:

Provided that until the valuation standards are notified or modified by the Central Government, a valuer shall make valuations as per-

(*a*) internationally accepted valuation standards;

(*b*) valuation standards adopted by any registered valuers organisation.

(2) The registered valuer may obtain inputs for his valuation report or get a separate valuation for an asset class conducted from another registered valuer, in which case he shall fully disclose the details of the inputs and the particulars etc. of the other registered valuer in his report and the liabilities against the resultant valuation, irrespective of the nature of inputs or valuation by the other registered valuer, shall remain of the first mentioned registered valuer.

(3) The valuer shall, in his report, state the following:-

(a) background information of the asset being valued;

(b) purpose of valuation and appointing authority;

(c) identity of the valuer and any other experts involved in the valuation;

(d) disclosure of valuer interest or conflict, if any;

(e) date of appointment, valuation date and date of report;

(f) inspections and/or investigations undertaken;

(g) nature and sources of the information used or relied upon;

(h) procedures adopted in carrying out the valuation and valuation standards followed;

(i) restrictions on use of the report, if any;

(j) major factors that were taken into account during the valuation;

(k) conclusion; and

(l) caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

Temporary surrender

9. (1) A registered valuer may temporarily surrender his registration certificate in accordance with the bye-laws or regulations, as the case may be, of the registered valuers organisation and on such surrender, the valuer shall inform the authority for taking such information on record.

(2) A registered valuers organisation shall inform the authority if any valuer member has temporarily surrendered his/its membership or revived his/ its membership after temporary surrender, not later than seven days from approval of the application for temporary surrender or revival, as the case may be.

(3) Every registered valuers organisation shall place, on its website, in a searchable format, the names and other details of its valuers members who have surrendered or revived their memberships.

Functions of a Valuer

10. A valuer shall conduct valuation required under the Act as per these rules.

Eligibility for registered valuers organisations

12. (1) An organisation that meets requirements under sub-rule (2) may be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes if —

(*i*) it has been registered under section 25 of the Companies Act, 1956 or section 8 of the Companies Act, 2013 with the sole object of dealing with matters relating to regulation of valuers of an asset class or asset classes and has in its bye laws the requirements specified in **Annexure-III**;

(*ii*) it is a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession;

Provided that, subject to sub-rule (3), the following organisations may also be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes, namely:-

(*a*) an organisation registered as a society under the Societies Registration Act, 1860 or any relevant state law, or;

(*b*) an organisation set up as a trust governed by the Indian Trust Act, 1882.

(2) The organisation referred to in sub-rule (1) shall be recognised if it –

(a) conducts educational courses in valuation, in accordance with the syllabus determined by the authority, under rule 5, for individuals who may be its valuers members, and delivered in class room or through distance education modules and which includes practical training;

(b) grants membership or certificate of practice to individuals, who possess the qualifications and experience as specified in rule 4, in respect of valuation of asset class for which it is recognised as a registered valuers organisation;

(c) conducts training for the individual members before a certificate of practice is issued to them;

(d) lays down and enforces a code of conduct for valuers who are its members, which includes all the provisions specified in **Annexure-I**;

(e) provides for continuing education of individuals who are its members;

(f) monitors and reviews the functioning, including quality of service, of valuers who are its members; and

(g) has a mechanism to address grievances and conduct disciplinary proceedings against valuers who are its members.

(3) A registered valuers organisation, being an entity under proviso to sub-rule (1), shall convert into or register itself as a company under section 8 of the Companies Act, 2013, and include in its bye laws the requirements specified in **Annexure- III,** within one year from the date of commencement of these rules.

Complaint against a registered valuer or registered valuers organisation

16. A complaint may be filed against a registered valuer or registered valuers organisation before the authority in person or by post or courier along with a non-refundable fees of ₹ 1,000 in favour of the authority and the authority shall examine the complaint and take such necessary action as it deems fit:

Provided that in case of a complaint against a registered valuer, who is a partner of a partnership entity or director of a company, the authority may refer the complaint to the relevant registered valuers organisation and such organisation shall handle the complaint in accordance with its bye laws.

Valuation Standards

18. The Central Government shall notify and may modify (from time to time) the valuation standards on the recommendations of the Committee set up under rule 19.

Punishment for contravention

20. Without prejudice to any other liabilities where a person contravenes any of the provision of these rules he shall be punishable in accordance with sub-section (3) of section 469 of the Act.

Punishment for false statement

21. If in any report, certificate or other document required by, or for, the purposes of any of the provisions of the Act or the rules made thereunder or these rules, any person makes a statement,—

(a) which is false in any material particulars, knowing it to be false; or

(b) which omits any material fact, knowing it to be material, he shall be liable under section 448 of the Act.

3. REMOVAL OF NAMES OF COMPANIES FROM THE REGISTER OF COMPANIES

Provision related to removal of names of companies from the register of companies is covered in Chapter XVIII of the Companies Act, 2013. This chapter comprises of five sections being covered from Section 248 to 252.

[I] Power of Registrar to Remove Name of Company from Register of Companies [Section 248]

(1) **Power of registrar:** Where the Registrar has reasonable cause to believe that—

(a) a company has failed to commence its business within one year of its incorporation, or;

(b) omitted

(c) a company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455, or[1];

[2](d) the subscribers to the memorandum have not paid the subscription which they had undertaken to pay at the time of incorporation of a company and a declaration to this effect has not been filed within one hundred and eighty days of its incorporation under sub-section (1) of section 10A; or

(e) the company is not carrying on any business or operations, as revealed after the physical verification carried out under sub-section (9) of section 12,

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[1] Substituted for "section 455," by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. **2-11-2018**.
[2] Clauses (*d*) and (*e*) inserted by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. **2-11-2018**.

he shall send a notice to the company and all the directors of the company, of his intention to remove the name of the company from the register of companies and requesting them to send their representations along with copies of the relevant documents, if any, within a period of thirty days from the date of the notice.

(2) **Filing of application to registrar by company for removal of name:** A company may, after extinguishing all its liabilities, by-

- a special resolution, or
- consent of seventy-five per cent. members in terms of paid-up share capital,

file an application in the prescribed manner to the Registrar for removing the name of the company from the register of companies on all or any of the grounds specified in sub-section (1) and the Registrar shall, on receipt of such application, cause a public notice to be issued in the prescribed manner:

Approval of the regulatory body, in case of a company regulated under a special Act: Provided that in the case of a company regulated under a special Act, approval of the regulatory body constituted or established under that Act shall also be obtained and enclosed with the application.

(3) **Exemption to section 8 companies:** Nothing in sub-section (2) shall apply to a company registered under section 8.

(4) **Publishing of notice for general public:** A notice issued under sub-section (1) or sub-section (2) shall be published in the prescribed manner and also in the Official Gazette for the information of the general public.

(5) **Strike off of names from register of companies**: At the expiry of the time mentioned in the notice, the Registrar may, unless cause to the contrary is shown by the company, strike off its name from the register of companies, and shall publish notice thereof in the Official Gazette, and on the publication in the Official Gazette of this notice, the company shall stand dissolved.

(6) **Provisions for realisation of amount:** The Registrar, before passing an order under sub-section (5), shall satisfy himself that sufficient provision has been made for the realisation of all amount due to the company and for the payment or discharge of its liabilities and obligations by the company within a reasonable time and, if necessary, obtain necessary undertakings from the managing director, director or other persons in charge of the management of the company:

Provided that notwithstanding the undertakings referred to in this sub-section, the assets of the company shall be made available for the payment or discharge of all its liabilities and obligations even after the date of the order removing the name of the company from the register of companies.

(7) **Persistence of the liability**: The liability, if any, of every director, manager or other officer who was exercising any power of management, and of every member of the company dissolved under sub-section (5), shall continue and may be enforced as if the company had not been dissolved.

(8) **Not affecting on the power of tribunal:** Nothing in this section shall affect the power of the Tribunal to wind up a company the name of which has been struck off from the register of companies.

[II] Restrictions on making application under section 248 in certain situations [Section 249]

(1) An application under section 248 on behalf of a company shall not be made if, at any time in the previous three months, the company—

(a) has changed its name or shifted its registered office from one State to another;

(b) has made a disposal for value of property or rights held by it, immediately before cesser of trade or otherwise carrying on of business, for the purpose of disposal for gain in the normal course of trading or otherwise carrying on of business;

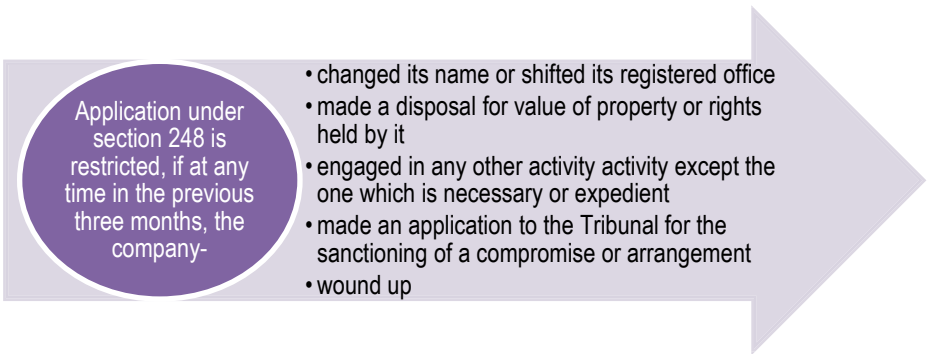
(c) has engaged in any other activity except the one which is necessary or expedient for the purpose of making an application under that section, or deciding whether to do so or concluding the affairs of the company, or complying with any statutory requirement;

(d) has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded; or

(e) is being wound up under Chapter XX of this Act or under the Insolvency and Bankruptcy Code, 2016.

(2) **Violation of above conditions on filing of application:** If a company files an application in violation of restriction as given in sub-section (1) as given above, it shall be punishable with fine which may extend to one lakh rupees.

(3) **Rights of registrar on non-compliance of conditions by the company:** An application filed under sub-section (2) of section 248 shall be withdrawn by the company or rejected by the Registrar as soon as conditions under sub-section (1) are brought to his notice.



[III] Effect of Company Notified as Dissolved [Section 250]

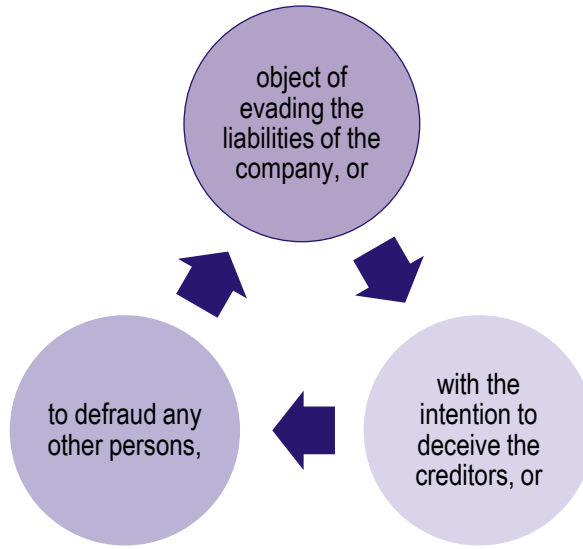
Where a company stands dissolved under section 248, it shall on and from the date mentioned in the notice –

- cease to operate as a company, and
- the Certificate of Incorporation issued to it shall be deemed to have been cancelled from such date.

For the purpose of realising the amount due to the company and for the payment or discharge of the liabilities or obligations of the company, this sub-section shall not effect. The company shall be continued in existence.

[IV] Fraudulent Application for Removal of Name [Section 251]

(1) **Intention of filing application:** Where it is found that an application by a company has been made with the-



the persons in charge of the management of the company shall, notwithstanding that the company has been notified as dissolved—

(a) be **jointly and severally liable** to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved; and

(b) be **punishable for fraud** in the manner as provided in section 447.

(2) **Recommendation for prosecution:** The Registrar may also recommend prosecution of the persons responsible for the filing of an application.

[V] Appeal to Tribunal [Section 252]

(1) **Aggrieved person to file an appeal against the order of registrar:** Any person aggrieved by an order of the Registrar, notifying a company as dissolved under section 248, may file an appeal to the Tribunal within a period of three years from the date of the order of the Registrar and if the Tribunal is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the company in the register of companies:

Reasonable opportunity of representations given to registrar: Before passing any order under this section, the Tribunal shall give a reasonable opportunity of making representations and of being heard to

- the Registrar,
- the company and
- all the persons concerned.

Restoration of name of company: If the Registrar is satisfied, that the name of the company has been struck off from the register of companies either inadvertently or on the basis of incorrect information furnished by the company or its directors, which requires restoration in the register of companies, he may within a period of three years from the date of passing of the order dissolving the company under section 248, file an application before the Tribunal seeking restoration of name of such company.

(2) **Order of tribunal to be filed with register:** A copy of the order passed by the Tribunal shall be filed by the company with the Registrar within thirty days from the date of the order and on receipt of the order, the Registrar shall cause the name of the company to be restored in the register of companies and shall issue a fresh certificate of incorporation.

(3) **Order of tribunal as it may deem just:** If a company, or any member or creditor or workman thereof feels aggrieved by the company having its name struck off from the register of companies, the Tribunal on an application made by

- the company,
- member,
- creditor or
- workman

before the expiry of twenty years from the publication in the Official Gazette of the notice under sub-section (5) of section 248 may, if satisfied that the company was, at the time of

its name being struck off, carrying on business or in operation or otherwise it is just that the name of the company be restored to the register of companies,

- order the name of the company to be restored to the register of companies,
- and the Tribunal may, by the order, give such other directions and make such provisions as deemed just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off from the register of companies.

4. GOVERNMENT COMPANIES

[I] Annual reports on Government companies [Section 394]

As per section 2(45) of the Companies Act, 2013, "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.

Section 394 of the Companies Act, 2013 provides for Annual reports on Government companies.

It provides for Annual reports on Government companies in the cases where the central government and the state Government is a member of the Government Company. According to this section:

(1) **Where the Central Government is a member of a Government company,** the Central Government shall cause an annual report on the working and affairs of that company to be—

(a) prepared within three months of its annual general meeting before which the comments given by the Comptroller and Auditor-General of India and the audit report are placed under the proviso to sub-section (6) of section 143; and

(b) as soon as may be after such preparation, laid before both Houses of Parliament together with a copy of the audit report and comments upon or supplement to the audit report, made by the Comptroller and Auditor-General of India.

(2) **Where in addition to the Central Government, any State Government is also a member of a Government company**, that State Government shall cause a copy of the annual report prepared under sub-section (1) to be laid before the House or both Houses of the State Legislature together with a copy of the audit report and the comments upon or supplement to the audit report referred above.

Example:

(i) Central Government and Government of Maharashtra together hold 40% of the paid-up share capital of MN Limited. A government company also holds 20% of the paid-up share capital in MN Limited.

(ii) PQ Limited is a subsidiary but not a wholly owned subsidiary of a government company.

Examine with reference to the provisions of the Companies Act, 2013 whether MN Limited and PQ Limited can be considered as Government Company.

Answer

According to section 2(45) of the Companies Act, 2013, "Government company" means any company in which not less than fifty-one per cent 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.

(i) The Central Government and Government of Maharashtra together hold 40% of the paid-up share capital of MN Limited. A government company also holds 20% of the paid-up share capital in MN Limited.

In this case, MN Limited is not a Government company because the holding of the Central Government and Government of Maharashtra is 40% which is less than the 51% prescribed under the definition of Government Company. The holding of the government company in MN Limited of 20% cannot be taken into account while counting the prescribed limit of 51%.

(ii) PQ Limited is a subsidiary but not a wholly owned subsidiary of a government company

In this case, PQ Limited is a government company as the definition of Government Company clearly specifies that a Government Company includes a company which is a subsidiary company of a Government company. Whether the subsidiary should be a wholly owned subsidiary or not is not clearly mentioned under the definition of the Government company under section 2(45).

[II] Annual reports where one or more State Governments are members of companies [Section 395]

Section 395 of the Companies Act, 2013 seeks to provide that one or more state governments who is a member of a company where no Central government is a member shall prepare annual reports on the working and affairs of the company. According to this section:

(1) **Where the Central Government is not a member of a Government company**, every State Government which is a member of that company, or where only one State Government is a member of the company, that State Government shall cause an annual report on the working and affairs of the company to be—

(a) Prepared within the time specified in sub-section (1) of section 394; and

(b) as soon as may be after such preparation, laid before the House or both Houses of the State Legislature together with a copy of the audit report and comments upon or supplement to the audit report referred to in sub-section (1) of that section.

(2) **Application of the provisions to the Government Company in liquidation:** The provisions of this section and section 394 shall, so far as may be, apply to a Government company in liquidation as they apply to any other Government company.

5. NIDHIS

Power to modify Act in its application to Nidhis (Section 406 of the Companies Act, 2013)

Section 406 of the Companies Act, provides Power to the Central Government to modify Act in its application to *Nidhis.* According to this section:

(i) **Definition:** Here, "Nidhi" means a company which has been incorporated as a Nidhi with the object of:

(a) cultivating the habit of thrift and savings amongst its members,

(b) receiving deposits from, and lending to, its members only, for their mutual benefit, and

(c) which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

(ii) The Central Government may, by notification, direct that any of the provisions of this Act shall not apply, or shall apply with such exceptions, modifications and adaptations as may be specified in that notification, to any Nidhi or Nidhis of any class or description as may be specified in that notification.

(iii) A copy of every notification proposed to be issued under point (ii), shall be laid in draft before each House of Parliament, while it is in session, for a total period of 30 days which may be comprised in one session or in two or more successive sessions, and if, before the

expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.

The *Nidhi Rules, 2014,* shall apply in relation to the following:

(i) **Application:** These rules shall apply to-

(a) every company which had been declared as a Nidhi or Mutual Benefit Society under sub - section (1) of Section 620A of the Companies Act, 1956,

(b) every company functioning on the lines of a Nidhi company or Mutual Benefit Society but has either not applied for or has applied for and is awaiting notification to be a Nidhi or Mutual Benefit Society under sub- Section (1) of Section 620A of the Companies Act, 1956; and

(c) every company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Act.

(ii) **Incorporation and incidental matters—**

(a) A Nidhi to be incorporated under the Act shall be a public company and shall have a minimum paid up equity share capital of 5 lakh rupees.

(b) On and after the commencement of the Act, no Nidhi shall issue preference shares.

(c) If preference shares had been issued by a Nidhi before the commencement of this Act, such preference shares shall be redeemed in accordance with the terms of issue of such shares.

(d) Except as provided under the proviso to sub-rule (e) to rule 6, no Nidhi shall have any object in its Memorandum of Association other than 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.

Exception as provided under the proviso to sub-rule (e) to rule 6: Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year.

(e) Every Company incorporated as a "Nidhi" shall have the last words 'Nidhi Limited' as part of its name.

(iii) **General restrictions or prohibitions**

No Nidhi shall—

(a) carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate;

(b) issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;

(c) open any current account with its members;

(d) acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi;

Explanation.—For the purposes of this sub-rule, "control" shall have the same meaning assigned to it in section 2(27) of the Act;

(e) carry on any business other than the business of borrowing or lending in its own name:

However, Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year.

(f) accept deposits from or lend to any person, other than its members;

(g) pledge any of the assets lodged by its members as security;

(h) take deposits from or lend money to any body corporate;

(i) enter into any partnership arrangement in its borrowing or lending activities;

(j) issue or cause to be issued any advertisement in any form for soliciting deposit:

However private circulation of the details of fixed deposit Schemes among the members of the Nidhi carrying the words "for private circulation to members only" shall not be considered to be an advertisement for soliciting deposits.

(k) pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

(iv) **Membership—**

(a) A Nidhi shall not admit a body corporate or trust as a member.

(b) Except as otherwise permitted under the rules, every Nidhi shall ensure that its membership is not reduced to less than 200 members at any time.

(c) A minor shall not be admitted as a member of Nidhi:

However, deposits may be accepted in the name of a minor, if they are made by the natural or legal guardian who is a member of Nidhi.

(v) **Rules relating to Directors—**

(a) The Director shall be a member of Nidhi.

(b) The Director of a *Nidhi* shall hold office for a term up to 10 consecutive years on the Board of *Nidhi*.

(c) The Director shall be eligible for re-appointment only after the expiration of 2 years of ceasing to be a Director.

(d) Where the tenure of any Director in any case had already been extended by the Central Government, it shall terminate on expiry of such extended tenure.

(e) The person to be appointed as a Director shall comply with the requirements of sub-section (4) of Section 152 of the Act and shall not have been disqualified from appointment as provided in section 164 of the Act.

(vi) **Dividend-** A Nidhi shall not declare dividend exceeding 25% or such higher amount as may be specifically approved by the Regional Director for reasons to be recorded in writing and further subject to the following conditions, namely:—

(a) an equal amount is transferred to General Reserve;

(b) there has been no default in repayment of matured deposits and interest; and

(c) it has complied with all the rules as applicable to Nidhis.

(vii) **Auditor—**

(a) No Nidhi shall appoint or re-appoint an individual as auditor for more than one term of 5 consecutive years.

(b) No Nidhi shall appoint or re-appoint an audit firm as auditor for more than 2 terms of 5 consecutive years:

Provided that an auditor (whether an individual or an audit firm) shall be eligible for subsequent appointment after the expiration of 2 years from the completion of his or its term:

Explanation: For the purposes of this proviso:

(1) in case of an auditor (whether an individual or audit firm), the period for which he or it has been holding office as auditor prior to the commencement of these

rules shall be taken into account in calculating the period of 5 consecutive years or 10 consecutive years, as the case may be;

(2) appointment includes re-appointment.

(viii) **Auditor's certificate—**The Auditor of the company shall furnish a certificate every year to the effect that the company has complied with all the provisions contained in the rules and such certificate shall be annexed to the audit report and in case of non-compliance, he shall specifically state the rules which have not been complied with.

(ix) **Penalty for non-compliance—**If a company to which *the Nidhi Rules, 2014* applies contravenes any of the provisions of the prescribed rules, the company and every officer of the company who is in default shall be punishable with fine which may extend to 5,000 rupees, and where the contravention is a continuing one, with a further fine which may extend to 500 rupees for every day after the first during which the contravention continues.

6. MISCELLANEOUS PROVISIONS

[I] Punishment for fraud [Section 447]

Section 447 of the Companies Act, 2013 provides for Punishment for fraud. According to this section:

(i) Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, 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 6 months but which may extend to 10 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 3 times the amount involved in the fraud.

(ii) Where the fraud in question involves public interest, the term of imprisonment shall not be less than 3 years.

(iii) Where the fraud involves an amount less than ₹ 10 Lakhs 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 [3]₹ 50 Lakhs or with both.

[3] Substituted for "twenty lakh rupees" by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. **2-11-2018**.

Explanation.— For the purposes of this section—

(a) "fraud" in relation to affairs of a company or anybody 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;

(b) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;

(c) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

[II] Punishment where no specific penalty or punishment is provided [Section 450]

(i) **Applicability of section 450**: The penalty under this section applies only in those cases where penalty or punishment is not provided elsewhere in this Act.

(ii) **Penalty under this section**: The company and every officer of the company who is in default or such other person:

(a) shall be punishable with fine which may extend to ₹ 10,000, and

(b) Where the contravention is continuing one, with a further fine which may extend to ₹ 1,000 for every day after the first during which the contravention continues.

(iii) **List of contraventions**: If a company or any officer of a company or any other person contravenes:

(a) any of the provisions of this Act; or

(b) the rules made thereunder; or

(c) any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded, given or granted.

[III] Dormant company [Section 455]

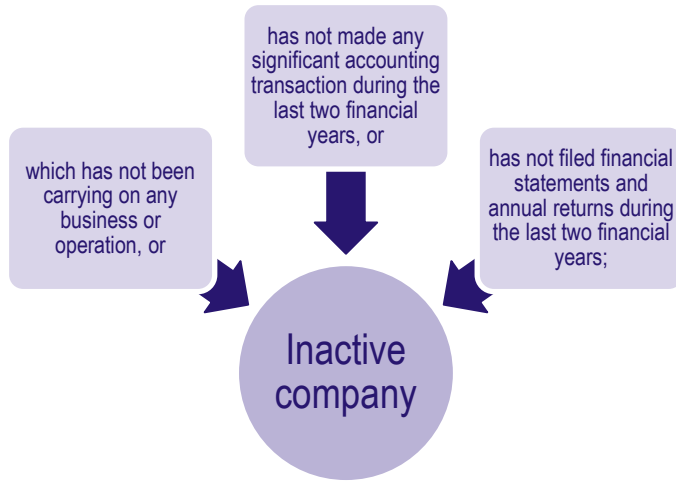
A new section 455 of the Companies Act, 2013 provides for Dormant Company. According to this section:

(i) **Status as a dormant company**: Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application

to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

Explanation.—For the purposes of this section,—

(a) "*inactive company*" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years;



(b) "*significant accounting transaction*" means any transaction other than—

(1) payment of fees by a company to the Registrar;

(2) payments made by it to fulfill the requirements of this Act or any other law;

(3) allotment of shares to fulfill the requirements of this Act; and

(4) payments for maintenance of its office and records.

According to the Rule 3 of the *Companies (Miscellaneous) Rules, 2014,* a company may make an application in Form *MSC-1* along with such fee as provided in the *Companies (Registration Offices and Fees) Rules, 2014* to the Registrar for obtaining the status of a Dormant Company in accordance with the provisions of section 455 after passing a special resolution to this effect in the general meeting of the company or after issuing a notice to all the shareholders of the company for this purpose and obtaining consent of at least 3/4th shareholders (in value).

A company shall be eligible to apply under this rule only, if-

(a) no inspection, inquiry or investigation has been ordered or taken up or carried out against the company;

(b) no prosecution has been initiated and pending against the company under any law;

(c) the company is neither having any public deposits which are outstanding nor the company is in default in payment thereof or interest thereon;

(d) the company is not having any outstanding loan, whether secured or unsecured:

However if there is any outstanding unsecured loan, the company may apply under this rule after obtaining concurrence of the lender and enclosing the same with Form *MSC-1*;

(e) there is no dispute in the management or ownership of the company and a certificate in this regard is enclosed with Form *MSC-1*;

(f) the company does not have any outstanding statutory taxes, dues, duties etc. payable to the Central Government or any State Government or local authorities etc.;

(g) the company has not defaulted in the payment of workmen's dues;

(h) the securities of the company are not listed on any stock exchange within or outside India.

(ii) **Certificate of status of dormant company:** The Registrar on consideration of the application shall allow the status of a dormant company to the applicant and issue a certificate in such form as may be prescribed to that effect.

According to the Rule 4 of the *Companies (Miscellaneous) Rules, 2014,* the Registrar shall, after considering the application filed in Form *MSC-1*, issue a certificate in Form *MSC-2* allowing the status of a Dormant Company to the applicant.

(iii) **Register of dormant company**: The Registrar shall maintain a register of dormant companies in such form as may be prescribed.

According to the Rule 5 of the *Companies (Miscellaneous) Rules, 2014,* the Register maintained under the portal maintained by the Ministry of Corporate Affairs on its web-site www.mca.gov.in or any other website notified by the Central Government, shall be the register for dormant companies.

(iv) **Consequences of non filing of annual returns or financial statements:** In case of a company which has not filed financial statements or annual returns for 2 financial years consecutively, the Registrar shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

According to the Rule 7 of the *Companies (Miscellaneous) Rules, 2014,* a dormant company shall file a "Return of Dormant Company" annually, *inter alia*, indicating financial position duly audited by a chartered accountant in practice in Form *MSC-3* along with such annual fee as provided in the *Companies (Registration Offices and Fees) Rules, 2014* within a period of 30 days from the end of each financial year.

The company shall also continue to file the return or returns of allotment and change in directors in the manner and within the time specified in the Act, whenever the company allots any security to any person or there is any change in the directors of the company.

(v) **Directors of dormant company**: A dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed to the Registrar to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and fee as may be prescribed.

According to Rule 6 of the *Companies (Miscellaneous) Rules, 2014,* a dormant company shall have a minimum number of 3 directors in case of a public company, 2 directors in case of a private company and 1 director in case of a One Person Company.

Rotation of auditors: According to Rule 6 the *Companies (Miscellaneous) Rules, 2014,* the provisions of the Act in relation to the rotation of auditors shall not apply on dormant companies.

Application for seeking status of an active company: According to the Rule 8 of the *Companies (Miscellaneous) Rules, 2014,*

(a) An application for obtaining the status of an active company shall be made in Form *MSC-4* along with fees as provided in the *Companies (Registration Offices and Fees) Rules, 2014* and shall be accompanied by a return in Form *MSC-3* in respect of the financial year in which the application for obtaining the status of an active company is being filed:

However, the Registrar shall initiate the process of striking off the name of the company if the company remains as a dormant company for a period of consecutive 5 years.

(b) The Registrar shall, after considering the application filed for obtaining the status of an active company, issue a certificate in Form *MSC-5* allowing the status of an active company to the applicant.

(c) Where a dormant company does or omits to do any act mentioned in the Grounds of application in Form *MSC-1* submitted to Registrar for obtaining the status of dormant company, affecting its status of dormant company, the directors shall within 7 days from such event, file an application for obtaining the status of an active company.

(d) Where the Registrar has reasonable cause to believe that any company registered as 'dormant company' under his jurisdiction has been functioning in any manner, directly or indirectly, he may initiate the proceedings for enquiry under section 206 of the Act and if, after giving a reasonable opportunity of being heard to the company in this regard, it is found that the company has actually been functioning, the Registrar may remove the name of such company from register of dormant companies and treat it as an active company.

(vi) **Striking off the name by the Registrar:** The Registrar shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Mr. Raman, is appointed as valuer in April, 2018 in ABC Ltd. He undertook the valuation of the assets of the company in 2018. In case Mr. Raman becomes interested in any property, stock etc of the company, he may be not be eligible to undertake valuation in such property of the company till:

   (a) 2019

   (b) 2020

   (c) 2021

   (d) He will never be appointed as Registered Valuer of ABC Ltd.

2. Aakaar Solar Energy Private Limited was allowed the status of a 'dormant company' after a certificate to this effect was issued on 1st July 2018 by the Registrar of Companies, Delhi and Haryana. Mention the latest date after which the Registrar is empowered to initiate the process of striking off the name of the company if Aakaar Solar Energy continues to remain as a dormant company.

   (a) After 30th June, 2023.

   (b) After 30th June, 2019.

   (c) After 30th June, 2020.

   (d) After 30th June, 2021.

3. Nanny Marcons Private Limited was incorporated on 9th June, 2017. For the financial year 2017-2018, it did not file its financial statements and annual returns. For the time being the company desires to be treated as 'inactive company' since it does not intend to carry on any business permitted by its Memorandum. As to when ROC can issue certificate of status of dormant company to 'Nanny Marcons' on the basis of non-submission of financial statements if the company makes an application to the Registrar in this respect.

   (a) After non-submission of financial statements for the two financial years i.e. 2018-19 and 2019-20.

   (b) After non-submission of financial statements for the next financial year i.e. 2018-19.

   (c) After non-submission of financial statements for the three financial years i.e. 2018-19, 2019-20 and 2020-21.

   (d) After non-submission of financial statements for the four financial years i.e. 2018-19, 2019-20, 2020-21 and 2021-22.

Descriptive Questions

Question 1

Explain the meaning of 'Fraud' in relation to the affairs of a company and the punishment provided for the same in Section 447 of the Companies Act, 2013.

Question 2

JKL Research Development Limited is a registered Public Limited Company. The company has a unique business idea emerging from research and development in a new area. However, it is a future project and the company has no significant accounting transactions and business activities at present. The company desires to obtain the status of a 'Dormant Company'. Advise the company regarding the provisions of the Companies Act, 2013 in this regard and the procedure to be followed in this regard.

ANSWER/SOULTION

Answers to MCQ

1. **(c)** **Hint:** As per section 247(2) of the Companies Act, 2013, the valuer appointed under sub-section (1) shall,— not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during a period of three years prior to his appointment as valuer or three years after the valuation of assets was conducted by him.

2. **(a)** **Hint:** Refer Proviso to Rule 8 (1) of the Companies (Miscellaneous) Rules, 2014 which states that the Registrar shall initiate the process of striking off the name of the company if such company remains as a dormant company for a period of consecutive five years.

3. **(b)** **Hint:** Refer Explanation (i) to Section 455 (1) which states that an 'inactive company' means a company which has not filed financial statements and annual returns during the last two financial years.

Answers to Descriptive Questions

1. As per the explanation given to section 447 of the Companies Act, 2013, 'Fraud' in relation to affairs of a company or anybody 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 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.

Punishment:

(i) Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, 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.

(ii) Where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

(iii) However, 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.

2. The provisions related to the Dormant companies is covered under section 455 of the Companies Act, 2013. According to provisions-

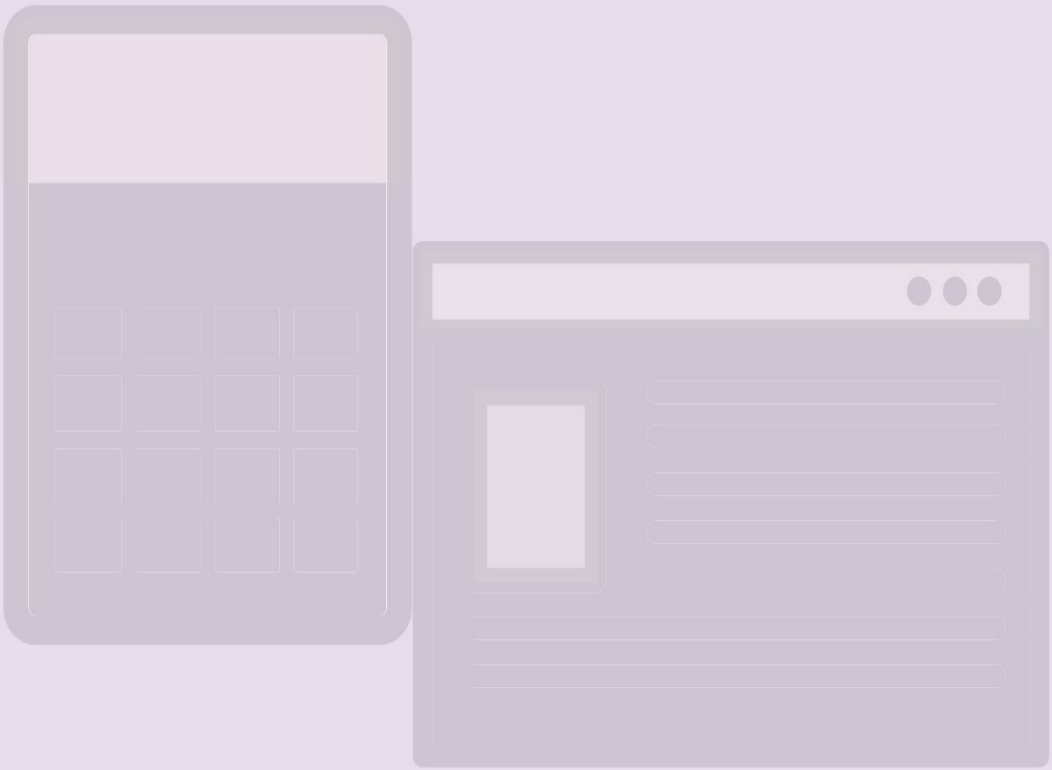
1. a company is formed and registered under this Act for the purpose of a future project or to hold an asset or intellectual property and has no significant accounting transaction.
2. Such company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.
3. The Registrar shall allow the status of a dormant company to the applicant and issue a certificate after consideration of the application.
4. The Registrar shall maintain a register of dormant companies in such form as may be prescribed.

In case of a company which has not filed financial statements or annual returns for two financial years consecutively, the Register shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

A dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed to the Registrar to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and fee as may be prescribed. However, the Registrar

shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section.

Thus, JKL Research Development Limited may follow the above procedure to obtain the status of a 'Dormant Company'.



CHAPTER 11

COMPOUNDING OF OFFENCES, ADJUDICATION AND SPECIAL COURTS

LEARNING OUTCOMES

At the end of this Chapter, students will be able to –

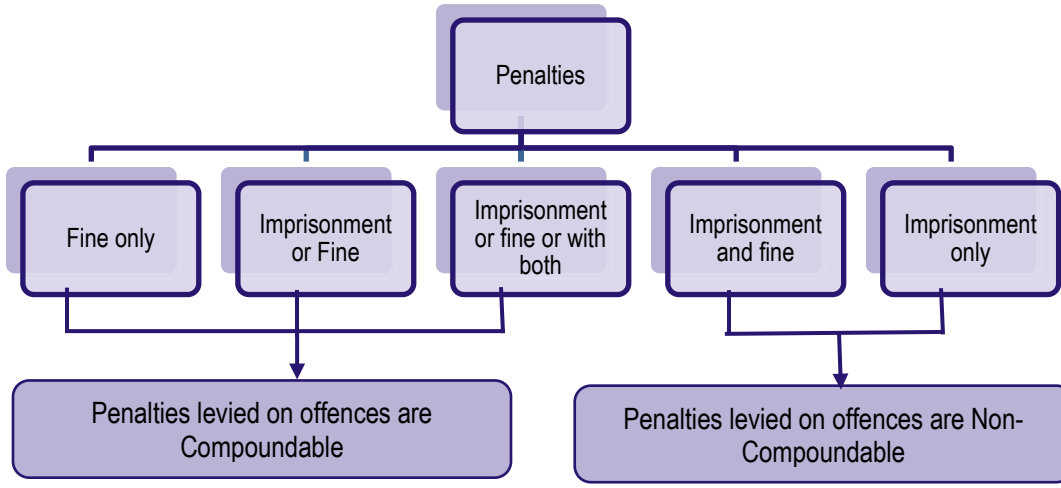
- Understand the types of penalties that can be levied for the commission of an offence under this Act.
- Know the compoundable and non-compoundable offences.
- Identify the establishment of special courts and its Jurisdiction.
- Know of the procedure of appeal and revision
- Know about the Mediation and Conciliation Panel
- Know of the power of Central Government to appoint company prosecutors, provisions related to appeal against acquittal, compensation for accusation and application that can be applied for imposing of fine.
- Explain the procedure related to adjudication of penalties.

1. INTRODUCTION

An offence is a commission of an act which is contrary to any law or forbidden by the law and is not confined to commission of crime only. Such commission of act against the law requires a particular punishment levied through the way of penalty.

TYPES OF PENALTIES

There are five types of penalties that can be levied on the commission of the offences that have been contemplated under the Companies Act, 2013. They are as follows:



Compoundable offences are those offences where, the complainant (one who has filed the case) enters into a compromise, and agrees to have the charges dropped against the accused.

Non-Compoundable offences are those which are not compoundable because of grievous nature of offence.

2. ESTABLISHMENT OF SPECIAL COURT [SECTION 435]

Section 435 of the Companies Act deals with the establishment of the Special Court. The provisions state the number of special court that may be established with the required number of judges for the working.

Establishment of number of special court: The Central Government may by notification-

- for the purpose of providing speedy trial of offences
- establish or designate as many Special Courts as may be necessary.

A Special Court shall consist of—

a single judge holding office as Session Judge or Additional Session Judge	**in case of offences punishable under this Act with imprisonment of two years or more; and**
a Metropolitan Magistrate or a Judicial Magistrate of the First Class	in the case of other offences,

who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

3. OFFENCES TRIABLE BY SPECIAL COURTS [SECTION 436]

(1) **Powers of special courts with respect to trail of offences:** Notwithstanding anything contained in the Code of Criminal Procedure, 1973,—

Powers of the special courts	Provisions
Offences triable by the special court	All offences specified under section 435(1) shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is committed.
In case of more than one Special Courts	Where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned;
Where a person accused of, or suspected of the commission of, an offence under this Act	Such person is forwarded to a Magistrate under section 167 of the Code of Criminal Procedure, 1973. (i) such Magistrate may authorise the detention of such person in such custody as he thinks fit for a period not exceeding fifteen days in the whole where such Magistrate is a Judicial Magistrate, (ii) and seven days in the whole where such Magistrate is an Executive Magistrate: Provided that where such Magistrate considers that the detention of such person (upon or before the expiry of the period of detention) is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction;
Vested with same power as provided under the Cr. P.C	the Special Court may exercise the same power which a Magistrate having jurisdiction to try a case may exercise under section 167 of the Code of Criminal Procedure, 1973 in relation to an accused person who has been forwarded to him under that section;
Cognizance of offence by special court	A Special Court may, upon perusal of the police report or upon a complaint in that behalf, take cognizance of that offence without the accused being committed to it for trial.

(2) **Special Court to try an offence other than an offence under this Act:** When trying an offence under this Act, a Special Court may also try an offence other than an offence under this Act with which the accused may, under the Code of Criminal Procedure, 1973 be charged at the same trial.

(3) **Summary Trial:** Notwithstanding anything contained in the Code of Criminal Procedure, 1973,

Power of special court on summary trail of an offence	Nature of summary trial
The Special Court may, if it thinks fit, try in a summary way any offence under this Act	Which is punishable with imprisonment for a term not exceeding three years
In the case of conviction in a summary trial	no sentence of imprisonment for a term exceeding one year shall be passed
When at the commencement of, or in the course of, a summary trial, it appears to the Special Court that – • the nature of the case is such that the 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 Special Court shall, after hearing the parties, record an order to that effect and thereafter recall any witnesses who may have been examined and proceed to hear or rehear the case in accordance with the procedure for the regular trial.

4. APPEAL AND REVISION [SECTION 437]

The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX which deals with appeals, Reference and Revision of the Code of Criminal Procedure, 1973 on a High Court-

As if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

5. APPLICATION OF CODE TO PROCEEDINGS BEFORE SPECIAL COURT [SECTION 438]

Save as otherwise provided in this Act, the provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session or the court of Metropolitan Magistrate or a

Judicial Magistrate of the First Class, as the case may be, and the person conducting a prosecution before a Special Court shall be deemed to be a Public Prosecutor.

6. OFFENCES TO BE NON-COGNIZABLE [SECTION 439]

This sections provides of the offences that are non-cognizable. According to this section:

Offence	Nature of offence
every offence under the Companies Act, 2013 except the offences referred to section 212(6)	shall be deemed to be non-cognizable within the meaning of the Cr.P.C
Court shall take cognizance of any offence under the Companies Act which is alleged to have been committed by any company or any officer thereof	Only on the written complaint of the Registrar, a shareholder or a member of the company, or of a person authorised by the Central Government in that behalf.
Cognizance of offences relating to issue and transfer of securities and non-payment of dividend	The court may take cognizance on a complaint in writing, by a person authorised by the Securities and Exchange Board of India.
Non-application of section 439(2)	To a prosecution by a company of any of its officers
Where the complainant is the Registrar or a person authorised by the Central Government	The presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial
Non-application of section 439(2)	To any action taken by the liquidator of a company in respect of any offence alleged to have been committed in respect of any of the matters in Chapter XX (Winding up) or in any other provision of this Act relating to winding up of companies. The liquidator of a company shall not be deemed to be an officer of the company.

As per the Notification G.S.R. 463(E) dated 5th June 2015, in case of a government companies, court shall take cognizance of an offence under this Act which is alleged to have been committed by any company or any officer thereof on the complaint in writing of a person authorized by the Central Government in that behalf

7. TRANSITIONAL PROVISIONS [SECTION 440]

According to the section, any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be tried by a Court of Session exercising jurisdiction over the area, notwithstanding anything contained in the Code of Criminal Procedure, 1973:

Provided that nothing contained in this section shall affect the powers of the High Court under section 407 of the Code to transfer any case or class of cases taken cognizance by a Court of Session under this section.

8. MEDIATION AND CONCILIATION PANEL [SECTION 442]

(1) **Maintenance of panel of experts:** The Central Government shall maintain a panel of experts to be called as the Mediation and Conciliation Panel.

Composition: It shall be consisting of such number of experts having such qualifications as may be prescribed for mediation between the parties during the pendency of any proceedings before-

- the Central Government or
- the Tribunal or
- the Appellate Tribunal under this Act.

(2) **Referring of matters by any parties to the proceedings to Mediation and Conciliation Panel:** Any of the parties to the proceedings may, at any time during the proceedings before the Central Government or the Tribunal or the Appellate Tribunal, apply to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in such form along with such fees as may be prescribed, for referring the matter pertaining to such proceedings to the Mediation and Conciliation Panel and the Central Government or Tribunal or the Appellate Tribunal, as the case may be, shall appoint one or more experts from the panel referred to in sub-section (1).

(3) ***Suo moto* referring of matters to Mediation and Conciliation Panel:** The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may, suo moto, refer any matter pertaining to such proceeding to such number of experts from the Mediation and Conciliation Panel as the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, deems fit.

(4) **Fees and other conditions of experts:** The fee and other terms and conditions of experts of the Mediation and Conciliation Panel shall be such as may be prescribed.

(5) **Procedure and disposal of matter:** The Mediation and Conciliation Panel shall follow such procedure as may be in Rule 11 of the Special Courts (Companies Mediation and Conciliation) Rules, 2016, and dispose of the matter referred to it within a period of three

months from the date of such reference and forward its recommendations to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

(6) **Objection to the recommendation of the Mediation and Conciliation Panel:** Any party aggrieved by the recommendation of the Mediation and Conciliation Panel may file objections to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

9. POWER OF CENTRAL GOVERNMENT TO APPOINT COMPANY PROSECUTORS [SECTION 443]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Central Government may appoint-

- generally, or
- for any case, or
- in any case, or
- for any specified class of cases in any local area,

-one or more persons, as company prosecutors for the conduct of prosecutions arising out of this Act.

The persons so appointed as company prosecutors shall have all the powers and privileges conferred by the Code on Public Prosecutors appointed under section 24 of the Code.

10. APPEAL AGAINST ACQUITTAL [SECTION 444]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Central Government may, in any case arising under this Act, direct any-

- company prosecutor or
- authorise any other person either by name or by virtue of his office,
- to present an appeal from an order of acquittal passed by any court, other than a High Court, and an appeal presented by such prosecutor or other person shall be deemed to have been validly presented to the appellate court.

11. COMPENSATION FOR ACCUSATION WITHOUT REASONABLE CAUSE [SECTION 445]

The provisions of section 250 of the Code of Criminal Procedure, 1973 shall apply *mutatis mutandis* to compensation for accusation without reasonable cause before the Special Court or the Court of Session.

12. APPLICATION OF FINES [SECTION 446]

According to this section, the court imposing any fine under this Act may direct that the whole or any part thereof shall be applied in or towards payment of the costs of the proceedings, or in or towards the payment of a reward to the person on whose information the proceedings were instituted.

13. FACTORS FOR DETERMINING LEVEL OF PUNISHMENT [SECTION 446A]

According to this section, the Court or the Special Court, while deciding the amount of fine or imprisonment under this Act, shall have due regard to the following factors, namely:—

(a) size of the company;

(b) nature of business carried on by the company;

(c) injury to public interest;

(d) nature of the default; and

(e) repetition of the default.

14. LESSER PENALTIES FOR ONE PERSON COMPANIES OR SMALL COMPANIES. [SECTION 446B]

According to this section, notwithstanding anything contained in this Act, if a One Person Company or a small company fails to comply with the provisions of sub-section (5) of section 92, sub-section (2) of section 117 or sub-section (3) of section 137, such company and officer in default of such company shall be [1]liable to a penalty which shall not be more than one half of the penalty specified in such sections.

15. ADJUDICATION OF PENALTIES [SECTION 454]

(1) The Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of this Act in the manner as provided in Rule 3 of *the Companies (Adjudication of Penalties) Rules, 2014.*

[1] Substituted by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. **2-11-2018.**

Manner of adjudication of Penalties

(i) [2]**Appointment of Adjudicating officers**: The Central Government may appoint any of its officers, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of the Act.

(ii) **Issue of written notice by an adjudicating officer:** Before adjudging penalty, the adjudicating officer shall issue a written notice in the specified manner-

- to the company and
- to officer of the company who is in default or
- any other person, as the case may be

to show cause, within such period as may be specified in the notice (not being less than fifteen days and more than thirty days from the date of service thereon), why the penalty should not be imposed on it or him:

(iii) **Manner of the written notice**: Every notice issued above shall clearly indicate the nature of non-compliance or default under the Act alleged to have been committed or made by

- such company,
- officer in default, or
- any other person, as the case may be

and also draw attention to the relevant penal provisions of the Act and the maximum penalty which can be imposed on the company, and each of the officers in default, or the other person.

(iv) **Period of filing reply to the notice***:* The reply to such notice shall be filed in electronic mode only within the period as specified in the notice:

Provided that the adjudicating officer may, for reasons to be recorded in writing, extend the period referred to above by a further period not exceeding fifteen days, if the company or officer in default or any person as the case may be. satisfies the adjudicating officer that it or he has sufficient cause for not responding to the notice within the stipulated period or the adjudicating officer has reason to believe that the company or the officer or the person has received a shorter notice and did not have reasonable time to give reply.

(v) **Physical appearance**: If, after considering the reply submitted by such company, its officer, or any other person, as the case may be, the adjudicating officer is of the opinion that physical appearance is required, he shall issue a notice, within a period

[2] Substituted by Companies (Adjudication of Penalties) Amendment Rules, 2019, w.e.f **19-2-2019**.

often working days from the date of receipt of reply fixing a date for the appearance of such company, through its authorised representative, or officer of such company, or any other person, whether personally or through his authorised representative.

Provided that if any person, to whom a notice is issued under point (ii), desires to make an oral representation, whether personally or through his authorised representative and has indicated the same while submitting his reply in electronic mode, the adjudicating officer shall allow such person to make such representation after fixing a date of appearance.

(vi) **Passing of an order by the adjudicating officer:** On the date fixed for hearing and after giving a reasonable opportunity of being heard to the person concerned, the adjudicating officer may, subject to reasons to be recorded in writing, pass any order in writing as he thinks fit including an order for adjournment.

Provided that after hearing, adjudicating officer may require the concerned person to submit his reply in writing on certain other issues related to the notice under point (ii) relevant for determination of the default.

(vii) **Period for passing the order***:* The adjudicating officer shall pass an order:

(a) within 30 days of the expiry of the period referred in point (ii) or of such extended period as referred therein, where physical appearance was not required under point (v);

(b) within 90 days of the date of issue of notice under point (ii), where any person appeared before the adjudicating officer under point (v):

However, in case an order is passed after the aforementioned duration, the reasons of the delay shall be recorded by the adjudicating officer and no such order shall be invalid merely because of its passing after the expiry of such 30 days or 90 days as the case may be.

(viii) **Date and sign on order***:* Every order of the adjudicating officer shall be duly dated and signed by him and shall clearly state the reasons for requiring the physical appearance under point (v).

(ix) **Forwarding of copy of an order**: The adjudicating officer shall send a copy of the order passed by him

- to the concerned company,
- officer who is in default or
- any other person or
- all of them and
- to the Central Government and

- a copy of the order shall also be uploaded on the website.

(x) **Powers of Adjudicating Authority:** While holding an inquiry, the adjudicating officer shall have the following powers, namely:-

(a) to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case after recording reasons in writing;

(b) to order for evidence or to produce any document, which in the opinion of the adjudicating officer, may be relevant to the subject matter.

(xi) **Failure to be present before the adjudicating authority:** If any person fails to reply or neglects or refuses to appear as required under point (v) or point (x) before the adjudicating officer, the adjudicating officer may pass an order imposing the penalty, in the absence of such person after recording the reasons for doing so.

(xii) **Consideration to following factors while levying penalty***:* While adjudging quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely: -

(a) size of the company;

(b) nature of business carried on by the company:

(c) injury to public interest;

(d) nature of the default;

(e) repetition of the default;

(f) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; and

(g) the amount of loss caused to an investor or group of investors or creditors as a result of the default:

However, in no case, the penalty imposed shall be less than the minimum penalty prescribed, if any, under the relevant section of the Act.

(xiii) **Fixed sum of penalty**: In case a fixed sum of penalty is provided for default of a provision, the adjudicating officer shall impose that fixed sum, in case of any default therein.

(xiv) **Payment of penalty***:* Penalty shall be paid through Ministry of Corporate Affairs portal only.

(xv) **Sum to be credited to the Consolidation Fund of India:** All sums realised by way of penalties under the Act shall be credited to the Consolidated Fund of India.

(2) The Central Government shall while appointing adjudicating officers, specify their jurisdiction in the order under sub-section (1).

[3]*(3) The adjudicating officer may, by an order—*

(a) impose the penalty on the company, the officer who is in default, or any other person, as the case may be, stating therein any non-compliance or default under the relevant provisions of this Act; and

(b) direct such company, or officer who is in default, or any other person, as the case may be, to rectify the default, wherever he considers fit.

(4) The adjudicating officer shall, before imposing any penalty, give a reasonable opportunity of being heard to [4]*such company, the officer who is in default or any other person* .

(5) Any person aggrieved by an order made by the adjudicating may prefer an appeal to the Regional Director having jurisdiction in the matter.

(6) Every appeal shall be filed within sixty days from the date on which the copy of the order made by the adjudicating officer is received by the aggrieved person and shall be in such form, manner and be accompanied by such fees In Rule 4 of *the Companies (Adjudication of Penalties) Rules, 2014.*

(7) The Regional Director may, after giving the parties to the appeal an opportunity of being heard, pass such order as he thinks fit, confirming, modifying or setting aside the order appealed against.

(8) (i) Where company [5]*fails to comply with the order made under sub-section (3) or sub-section (7), as the case may be* within a period of ninety days from the date of the receipt of the copy of the order, 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.

(ii) [6]*Where an officer of a company or any other person who is in default fails to comply with the order made under sub-section (3) or subsection (7), as the case may be,* within a period of ninety days from the date of the receipt of the copy of the order, such officer shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

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[3] Substituted by the Companies (Amendment) Ordinance, 2019, w.r.e.f. **2-11-2018**

[4] Substituted for words "such company and the officer who is in default" by the Companies (Amendment) Ordinance, 2019, w.r.e.f. **2-11-2018**

[5] Substituted for "does not pay the penalty imposed by the adjudicating officer or the Regional Director" by the Companies (Amendment) Second Ordinance, 2019, w.r.e.f. **2-11-2018**.

[6] Substituted by the Companies (Amendment) Ordinance, 2019, w.r.e.f. **2-11-2018**.

16. PENALTY FOR REPEATED DEFAULT [SECTION 454A][7]

Where a company or an officer of a company or any other person having already been subjected to penalty for default under any provisions of this Act, again commits such default within a period of three years from the date of order imposing such penalty passed by the adjudicating officer or the Regional Director, as the case may be, it or he shall be liable for the second or subsequent defaults for an amount equal to twice the amount of penalty provided for such default under the relevant provisions of this Act.

[7] Inserted by the Companies (Amendment) Ordinance, 2019, w.r.e.f. 2-11-2018.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Central Government for providing of speedy trial of offences under the Companies Act, 2013, shall establish/ designate such numbers of special courts in an area-

   (a) Only 1

   (b) Not more than 2

   (c) More than 2

   (d) As many as may be necessary

2. Which of the following courts shall be deemed to be a special court for the prevailing of the provisions of the Code of Criminal Procedure to the proceedings before a Special Court -

   (1) Court of Session

   (2) Metropolitan Magistrate

   (3) Judicial Magistrate of the First Class

   (4) Judicial Magistrate of the Second Class

   Choose the correct options-

   (a) 1, 2 & 4

   (b) 2, 3 & 4

   (c) 1, 2, & 3

   (d) 1, 3, & 4

(3) Which factors among the below given are taken into consideration while deciding the quantum of fine/ punishment levied under this Act:

   (1) failure in filing of any documents

   (2) size of the Company

   (3) injury to employees of the company

   (4) nature of business carried on by the company

   (a) 1 & 2 only

   (b) 2 & 4 only

   (c) 1 & 4 only

(4) Mr. Rudra, an employee of the company filed a complaint against the company for the illegal

issue and transfer of securities before the special court. State the correct basis for rejection of the said complaint:

(a) This is a non-cognizable offence, so out of the jurisdiction of the special court.

(b) The court is barred to entertain such complaint as is out of the jurisdiction of the special court.

(c) Employee is not a competent person to file a complaint against the company for an offence relating to issue and transfer of securities

(d) Compliant can be filed by the Registrar, a shareholder or a member of the company, or of a person authorised by the Central Government in respect to the same.

Descriptive Questions

Question 1

Which offences are deemed to be Non- cognizable under the Companies Act, 2013? Enumerate the relevant provisions.

Question 2

In the annual general meeting of XYZ Ltd., while discussing on the matter of retirement and reappointment of director Mr. X, allegations of fraud and financial irregularities were levelled against him by some members. This resulted into chaos in the meeting. The situation was normal only after the Chairman declared about initiating an inquiry against the director Mr. X, however, could not be re-appointed in the meeting. The matter was published in the newspapers next day. On the basis of such news, whether the court can take cognizance of the matter and take action against the director on its own?

Justify your answer with reference to the provisions of the Companies Act, 2013.

Question 3

What are provisions related to constitution and working of the Mediation and Conciliation Panel as per Section 442 of the Companies Act, 2013?

Question 4

What are the powers of the Central Government under the Companies Act, 2013 regarding:

(i) To appoint company prosecutors

(ii) To Appeal against acquittal

Question 5

What is the object of Constituting Panel for Mediation and Conciliation under the Companies Act, 2013? Who can file application for mediation and conciliation?

Question 6

Mr. Joseph, a member of Armaments Ltd., is aggrieved due to failure of the company to make payment of dividend declared in the AGM held in August, 2015. He makes a complaint, in writing, before the court of competent jurisdiction within the prescribed period of limitation, but the court refused to take cognizance of the alleged offence. Explain the legal position in this regard under the Companies Act, 2013.

Also state the offences under the Companies Act, 2013 which are cognizable and which are non-cognizable.

ANSWERS/SOLUTION

Answers to MCQ

1. **(d)** **Hint:** Section 435 of the Companies Act, 2013

2. **(c)** **Hint:** Section 438 of the Companies Act, 2013

3. **(b)** **Hint:** section 446A of the Companies Act, 2013

4. **(c)** **Hint:** As per section 439(3) of the Companies Act, 2013, no court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder or a member of the company, or of a person authorised by the Central Government in that behalf.

   Provided that the court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the Securities and Exchange Board of India.

   Provided further that nothing in this sub-section shall apply to a prosecution by a company of any of its officers.

Answers to Descriptive Questions

1. **Offences to be non-cognizable:** According to section 439 of the Companies Act, 2013:

   (i) Notwithstanding anything in the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Code.

   (ii) No court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder or a member of the company, or of a person authorised by the Central Government in that behalf.

Whereas in case of a government companies, court shall take cognizance of an offence under this Act which is alleged to have been committed by any company or any officer thereof on the complaint in writing of a person authorized by the Central Government in that behalf. [Vide Notification G.S.R. 463(E) dated 5th June 2015]

(iii) The court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the Securities and Exchange Board of India.

(iv) Nothing in this sub-section shall apply to a prosecution by a company of any of its officers.

(v) Where the complainant is the Registrar or a person authorised by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial.

(vi) The above provisions shall not apply to any action taken by the liquidator of a company in respect of any offence alleged to have been committed in respect of any of the matters in Chapter XX or in any other provision of this Act relating to winding up of companies.

(vii) The liquidator of a company shall not be deemed to be an officer of the company.

2. Section 439 of the Companies Act, 2013 provides that offences under the Act shall be non-cognizable. As per this section:

1. Notwithstanding anything in the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in sub section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Code.

2. No court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder or a member of the company, or of a person authorized by the Central Government in that behalf.

Thus, in the given situation, the court shall not initiate any suo moto action against the director Mr. X without receiving any complaint in writing of the Registrar of Companies, a shareholder of the company or of a person authorized by the Central Government in this behalf.

3. **Mediation and Conciliation Panel:** In common parlance, Mediation means intervention of some third party in a dispute with the intention to resolve the dispute.

Conciliation means the process of adjusting or settling disputes in a friendly manner through extra judicial means. This new provision introduced by the Companies Act, 2013 has come into force with effect from 1st April, 2014 vide notification dated 26th of March, 2014. Section 442 of the Companies Act, 2013 deals with the constitution and functioning of the mediation and conciliation panel in order to dispose the matter.

Section 442 lays the following law with respect to the constitution and working of the Mediation and Conciliation Panel:

(1) **Central Government to maintain the Panel of Mediators:** The Central Government shall maintain a panel of experts to be known as Mediation and conciliation panel for mediation between the parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal under this Act.

Hence, it is important that the case should be pending before the Central Government or the Tribunal or the Appellate Tribunal under this Act.

(2) **Panel consisting of experts:** The panel shall consist of such number of experts having such qualification as may be prescribed.

(3) **Filing of application:** Application for mediation and conciliation can be made by:

(i) any parties to the proceedings. (It shall be accompanied with such fees and in such form as may be prescribed.)

(ii) The Central Government or the Tribunal or the Appellate Tribunal before which any
proceeding is pending may, *suo motu* refer any matter pertaining to such proceeding to such number of experts as it may deem fit.

(4) **Appointment of expert/s from panel:** The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may appoint one or more experts from the Panel as may be deemed fit.

(5) **Fees, terms and conditions of the experts:** The fee and other terms and conditions of experts of the Mediation and Conciliation Panel shall be such as may be prescribed.

(6) **Procedure for the disposal of matter:** In order to dispose the matter, the Mediation and Conciliation Panel shall follow such procedure as may be prescribed.

(7) **Period for the disposal of matter:** The Mediation and Conciliation Panel shall dispose of the matter referred to it within a period of three months from the date of such reference and forward its recommendations to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

(8) **Filing of objection on the recommendation of the panel:** Any party aggreived by the recommendation of the Mediation and Conciliation Panel may file objections to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

4. (i) **Power of Central Government to appoint company prosecutors:** This section 443 of the Companies Act, 2013 has come into force with effect from 12th September, 2013. This section lays down the provisions seeking to provide that the Central Government may appoint company prosecutors with the same powers as given under the Cr. PC on Public Prosecutors.

(a) **Appointment of company prosecutors:** The Central Government may appoint (generally, or for any case, or in any case, or for any specified class of cases in any local area) one or more persons, as company prosecutors for the conduct of prosecutions arising out of this Act; and

(b) **Powers and Privileges:** The persons so appointed as company prosecutors shall have all the powers and privileges conferred on Public Prosecutors appointed under section 24 of the Cr. PC.

(ii) **Appeal against acquittal:** According to section 444 of the Companies Act, 2013, the Central Government may, in any case arising under this Act, direct –

(a) any company prosecutor, or

(b) authorise any other person either by name or by virtue of his office, to present an appeal from an order of acquittal passed by any court, other than a High Court.

Appeal presented by such prosecutor or other person shall be deemed to have been validly presented to the appellate court.

5. Under section 442 of the Companies Act, 2013, it is provided that the Central Government shall maintain a panel of experts for mediation between the parties during pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal under the Act. In common parlance, mediation means intervention of some third party in a dispute with the intention to resolve the dispute. Similarly, conciliation means the powers of adjusting or settling disputes in a friendly manner through extra judicial means. The object behind the panel is to dispose the matter pending before the Government / Tribunal as mentioned above.

Filing of application: Application for mediation and conciliation can be made by:

(A) any parties to the proceedings (It shall be accompanied with such fees and in such form as may be prescribed)

(B) The Central Government or the Tribunal or the Appellate Tribunal before which any proceeding is pending may, suo moto refer any matter pertaining to such proceeding to such number of experts as it may deem fit.

6. **Cognizance of offence:** A court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof only on the written complaint of -

(a) The Registrar,

(b) A shareholder of the company

(c) A member of the company, or

(d) Of a person authorised by the Central Government in that behalf.

Provided that the court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the Securities and Exchange Board of India.

In the present case, Mr. Joseph, a member of Armaments Ltd. is aggrieved due to failure of the company to make payment of dividend declared in the AGM held in August 2015. He makes a complaint, in writing, before the court of competent jurisdiction within the prescribed period of limitation, but the court refused to take cognizance of the alleged offence.

Here, the Court shall take cognizance of the offence relating to non payment of dividend as the shareholders have made a complaint in writing before the competent jurisdiction.

Cognizable and non-cognizable offences: Overriding the provisions given under the Code of Criminal Procedure, 1973, every offence under the Companies Act, 2013 except the offences referred to in section 212(6) of the Companies Act, 2013, which deals with the investigation into affairs of company by serious fraud investigation office, shall be deemed to be non-cognizable within the meaning of the said Code.

Therefore, the offences as covered under section 212(6) shall now be deemed to be cognizable where police officer may arrest person without warrant and are non-bailable. The Companies Act, 2013 establishes the offence covered under section 212(6) as a public wrong which has to be prevented and controlled. This non-bailable nature of the offences deter the offender and the others from committing further and similar offences.

CHAPTER 12

NATIONAL COMPANY LAW TRIBUNAL AND APPELLATE TRIBUNAL

LEARNING OUTCOMES

After reading this chapter, you will be able to:

- Understand the importance and need of NCLT
- Know what orders can be passed by the NCLT and NCLAT timelines for appeal against the order and provisions related to transfer of pending proceedings.

1. INTRODUCTION

In the past there were number of quasi-judicial forums and tribunals to provide specialized judicial settlement in a wide range of business issues for dispensation of justice to companies.

The Companies Act, 2013 provides for the constitution of National Company Law Tribunal (NCLT) & National Company Law Tribunal and Appellate Tribunal (NCLAT). NCLT is set up to bring all lawsuits pertaining to companies under one body. It has replaced the Company Law Board (CLB), the Board for Industrial and Financial Reconstruction (BIFR) and the Appellate Authority for Industrial and Financial Reconstruction and will have judicial and technical members.

Vide Ministry of Corporate Affairs Notification S.O.1936 (E) dated 1st June 2016 read with section 434(1) (a) of the Companies Act, 2013 , the Central Government hereby appoints the 1st day of June, 2016, on which all matters or proceedings or cases pending before the Board of Company Law Administration (Company Law Board) shall stand transferred to the National Company Law Tribunal and it shall dispose of such matters or proceedings or cases in accordance with the provisions of the Companies Act, 2013 or the Companies Act, 1956.

The provisions dealing with the various parts of NCLT and NCLAT are covered under the Chapter XXVII of the Companies Act, 2013.

NCLT AND NCLAT

NCLT is a quasi- judicial body that adjudicats matters pertaining to companies in India. The Central Government shall, by notification, constitute with effect from such date as may be specified therein, a Tribunal to be known as the National Company Law Tribunal consisting of a President and such number of (Judicial and Technical) members, as the Central Government may deem necessary, to be appointed by notification, to exercise and discharge such powers and functions as conferred on it by or under this Act or any other law for the time being in force.

Any person aggrevied by the decision of NCLT may prefer an appeal to NCLAT. The Central Government shall, by notification constitute with effect from such date as may be specified therein, an Appellate Tribunal to be known as the National Company Law Appellate Tribunal consisting of a Chairperson and such number of judicial and technical members, not exceeding 11, as the Central Government may deem fit.

NCLT and NCLAT has provided a single window for settlement of all disputes relating to companies. Further, the provisions of the Insolvency and Bankruptcy Code, 2016 have already been incorporated in the Companies Act, thereby providing a complete harmony in working of NCLT in line with the Insolvency and Bankruptcy Code, 2016.Thus, NCLT and NCLAT is providing a one stop solution to almost all the disputes of the companies under the Companies Act, 2013.

2. DEFINITIONS [SECTION 407]

Section 407 of the Companies Act, 2013 provides the definitions of chairperson, judicial members, member, president and technical member. The section defines the following key members constituting the NCLT & NCLAT-

Members		Definitions
Chairperson	Means	the Chairperson of the Appellate Tribunal
Judicial Member		a member of the Tribunal or the Appellate Tribunal appointed as such and includes the President or the Chairperson, as the case may be.
Member		a member, whether Judicial or Technical of the Tribunal or the Appellate Tribunal and includes the President or the Chairperson, as the case may be.
President		the President of the Tribunal
Technical Member		a member of the Tribunal or the Appellate Tribunal appointed as such

3. ORDER OF TRIBUNAL [SECTION 420]

(1) **Reasonable opportunity of being heard:** The Tribunal may, after giving the parties to any proceeding before it, a reasonable opportunity of being heard, pass such orders thereon as it thinks fit.

(2) **Amendment in order:** The Tribunal may, at any time within 2 years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment, if the mistake is brought to its notice by the parties:

Provided that no such amendment shall be made in respect of any order against which an appeal has been preferred under this Act.

(3) **Send the copy of order to parties concerned:** The Tribunal shall send a copy of every order passed under this section to all the parties concerned.

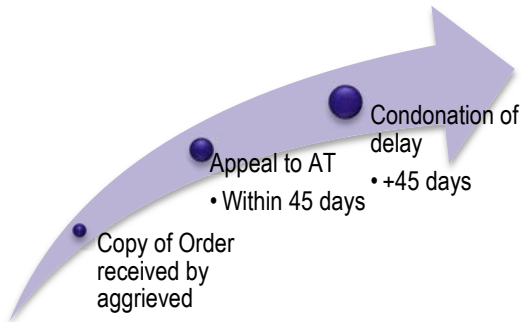
4. APPEAL FROM ORDERS OF TRIBUNAL [SECTION 421]

(1) **Appeal to AT:** Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal (AT).

(2) **When order made by consent of parties:** No appeal shall lie to the Appellate Tribunal from an order made by the Tribunal with the consent of parties.

(3) **Period for filing of appeal:** Every appeal under sub-section (1) (i.e. appeal to AT against order of Tribunal) shall be filed within a period of 45 days from the date on which a copy of the order of the Tribunal is made available to the person aggrieved and shall be in such form, and accompanied by such fees, as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days from the date aforesaid, but within a further period not exceeding 45, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.



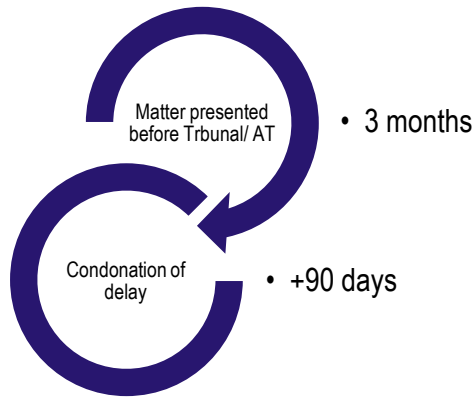
(4) **Pass order after giving of reasonable opportunity of being heard:** On the receipt of an appeal under sub-section (1), the Appellate Tribunal shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(5) **Copy of order to tribunal and parties to appeal:** The Appellate Tribunal shall send a copy of every order made by it to the Tribunal and the parties to appeal.

5. EXPEDITIOUS DISPOSAL BY TRIBUNAL AND APPELLATE TRIBUNAL [SECTION 422]

(1) **Speedy disposal:** Every application or petition presented before the Tribunal and every appeal filed before the Appellate Tribunal shall be dealt with and disposed of by it as expeditiously as possible and every endeavour shall be made by the Tribunal or the Appellate Tribunal, as the case may be, for the disposal of such application or petition or appeal within 3 months from the date of its presentation before the Tribunal or the filing of the appeal before the Appellate Tribunal.

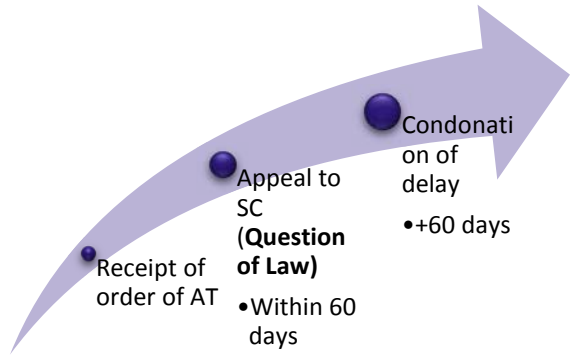
(2) **Reasons to be recorded for delay:** Where any application or petition or appeal is not disposed of within the period specified in sub-section (1), the Tribunal or, as the case may be, the Appellate Tribunal, shall record the reasons for not disposing of the application or petition or the appeal, as the case may be, within the period so specified; and the President or the Chairperson, as the case may be, may, after taking into account the reasons so recorded, extend the period referred to in sub-section (1) by such period not exceeding ninety days as he may consider necessary.



6. APPEAL TO SUPREME COURT [SECTION 423]

Any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of receipt of the order of the Appellate Tribunal to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.



7. PROCEDURE BEFORE TRIBUNAL AND APPELLATE TRIBUNAL [SECTION 424]

(1) **Tribunal regulate their own procedure based on natural justice:** The Tribunal and the Appellate Tribunal shall not, while disposing of any proceeding before it or, as the case may be, an appeal before it, be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principals of natural justice, and, subject to the other provisions of this Act or the Insolvency and Bankruptcy Code, 2016 and of any rules made there under, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.

(2) **Vested with same power as that of a civil court:** The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging their functions under this Act or under the Insolvency and Bankruptcy Code, 2016, 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:—

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or a copy of such record or document from any office;

(e) issuing commissions for the examination of witnesses or documents;

(f) dismissing a representation for default or deciding it *ex parte*;

(g) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and

(h) any other matter which may be prescribed.

(3) **Nature of decree and its execution:** Any order made by the Tribunal or the Appellate Tribunal may be enforced by that Tribunal in the same manner as if it were a decree made by a court in a suit pending therein, and it shall be lawful for the Tribunal or the Appellate Tribunal to send for execution of its orders to the court within the local limits of whose jurisdiction,—

(a) in the case of an order against a company, the registered office of the company is situate; or

(b) in the case of an order against any other person, the person concerned voluntarily resides or carries on business or personally works for gain.

(4) **Nature of proceedings:** All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

8. POWER TO PUNISH FOR CONTEMPT [SECTION 425]

The Tribunal and the Appellate Tribunal shall have the same jurisdiction, powers and authority in respect of contempt of themselves as the High Court has and may exercise, for this purpose, the powers under the provisions of the Contempt of Courts Act, 1971, which shall have the effect subject to modifications that—

(a) the reference therein to a High Court shall be construed as including a reference to the Tribunal and the Appellate Tribunal; and

(b) the reference to Advocate-General in section 15 of the said Act shall be construed as a reference to such Law Officers as the Central Government may, specify in this behalf.

9. DELEGATION OF POWERS [SECTION 426]

The Tribunal or the Appellate Tribunal may, by general or special order, direct, subject to such conditions, if any, as may be specified in the order, any of its officers or employees or any other person authorised by it to inquire into any matter connected with any proceeding or, as the case may be, appeal before it and to report to it in such manner as may be specified in the order.

10. PROTECTION OF ACTION TAKEN IN GOOD FAITH [SECTION 428]

No suit, prosecution or other legal proceeding shall lie against the Tribunal, the President, Member, officer or other employee, or against the Appellate Tribunal, the Chairperson, Member, officer or other employees thereof or liquidator or any other person authorised by the Tribunal or the Appellate Tribunal for the discharge of any function under this Act in respect of any loss or damage caused or likely to be caused by any act which is in good faith done or intended to be done in pursuance of this Act.

11. CIVIL COURT NOT TO HAVE JURISDICTION [SECTION 430]

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered to determine by or under this Act or any other law for the time being in force and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act or any other law for the time being in force, by the Tribunal or the Appellate Tribunal.

12. VACANCY IN TRIBUNAL OR APPELLATE TRIBUNAL NOT TO INVALIDATE ACTS OR PROCEEDINGS [SECTION 431]

No act or proceeding of the Tribunal or the Appellate Tribunal shall be questioned or shall be invalid merely on the ground of the existence of any vacancy or defect in the constitution of the Tribunal or the Appellate Tribunal, as the case may be.

13. RIGHT TO LEGAL REPRESENTATION [SECTION 432]

A party to any proceeding or appeal before the Tribunal or the Appellate Tribunal, as the case may be, may either appear in person or authorise one or more Chartered Accountants or Company Secretaries or Cost Accountants or Legal Practitioners or any other person to present his case before the Tribunal or the Appellate Tribunal, as the case may be.

14. LIMITATION [SECTION 433]

The provisions of the Limitation Act, 1963 shall, as far as may be, apply to proceedings or appeals before the Tribunal or the Appellate Tribunal, as the case may be.

15. TRANSFER OF CERTAIN PENDING PROCEEDINGS. [SECTION 434]

(1) On such date as may be notified by the Central Government in this behalf,—

(a) all matters, proceedings or cases pending before the Board of Company Law Administration (herein in this section referred to as the Company Law Board) constituted under sub-section (1) of section 10E of the Companies Act, 1956, immediately before such date shall stand transferred to the Tribunal and the Tribunal shall dispose of such matters, proceedings or cases in accordance with the provisions of this Act;

(b) any person aggrieved by any decision or order of the Company Law Board made before such date may file an appeal to the High Court within 60 days from the date of communication of the decision or order of the Company Law Board to him on any question of law arising out of such order:

Provided that the High Court may if it is satisfied that the appellant was prevented by sufficient cause from filing an appeal within the said period, allow it to be filedwithin a further period not exceeding 60 days; and

(c) all proceedings under the Companies Act, 1956, including proceedings relating to arbitration, compromise, arrangements and reconstruction and winding up of companies, pending immediately before such date before any District Court or High Court, shall stand transferred to the Tribunal and the Tribunal may proceed to deal with such proceedings from the stage before their transfer:

Provided that only such proceedings relating to the winding up of companies shall be transferred to the Tribunal that are at a stage as may be prescribed by the Central Government.

Provided also that only such proceedings relating to cases other than winding-up, for which orders for allowing or otherwise of the proceedings are not reserved by the High Courts shall be transferred to the Tribunal:

Provided further that –

(i) all proceedings under the Companies Act, 1956 other than the cases relating to winding up of companies that are reserved for orders for allowing or otherwise such proceedings; or

(ii) the proceedings relating to winding up of companies which have not been transferred from the High Courts;

shall be dealt with in accordance with provisions of the Companies Act, 1956 and the Companies (Court) Rules, 1959.

(2) The Central Government may make rules consistent with the provisions of this Act to ensure timely transfer of all matters, proceedings or cases pending before the Company Law Board or the courts, to the Tribunal under this section.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Any person who is aggrieved by the order of Appellate Tribunal may approach to the Supreme Court on any question of law within:-

   (a) 30 Days

   (b) 45 Days

   (c) 60 Days

   (d) 90 days

Descriptive Questions

Question 1

What is the procedure to file an appeal from orders of the Tribunal under the Companies Act, 2013?

ANSWERS/SOLUTION

Answers to MCQ

1. (c) Hint: As per section 423 of the Companies Act, 2013, any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the Appellate Tribunal to him on any question of law arising out of such order:

Answers to Descriptive Questions

1. Appeal from Orders of Tribunal [Section 421]

(1) **Appeal to AT:** Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal (AT).

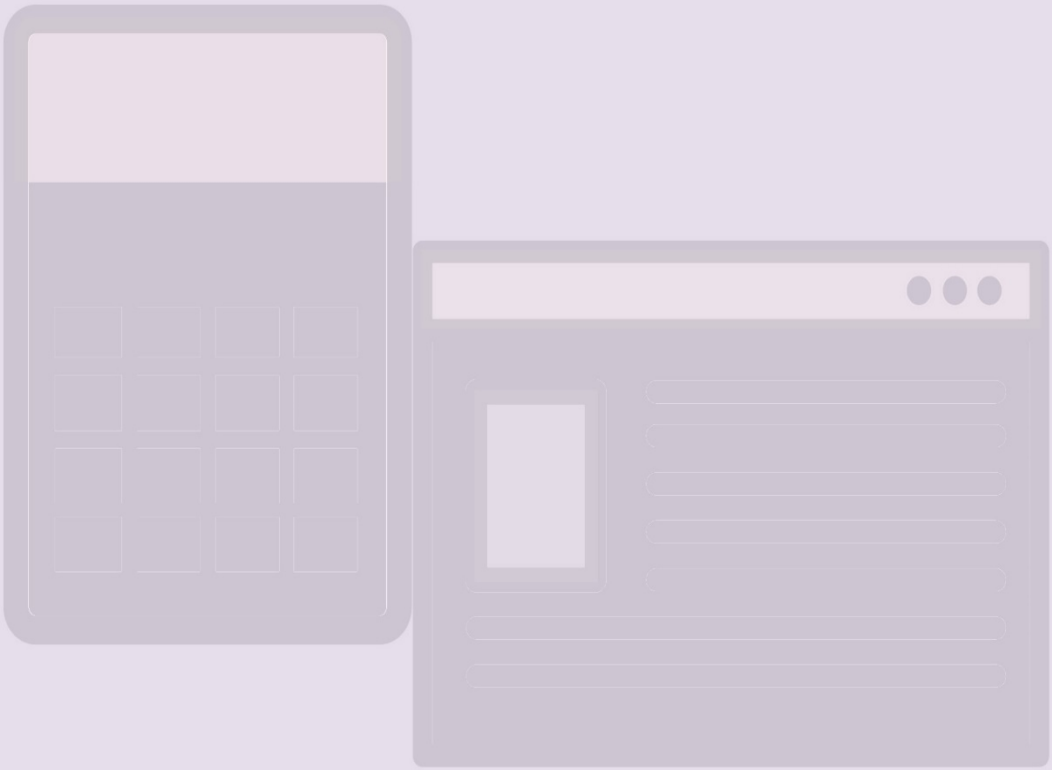
(2) **When order made by consent of parties:** No appeal shall lie to the Appellate Tribunal from an order made by the Tribunal with the consent of parties.

(3) **Period for filing of appeal:** Every appeal under sub-section (1) (i.e. appeal to AT against order of Tribunal) shall be filed within a period of 45 days from the date on which a copy of the order of the Tribunal is made available to the person aggrieved and shall be in such form, and accompanied by such fees, as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days from the date aforesaid, but within a further period not exceeding 45, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.

(4) **Pass order after giving of reasonable opportunity of being heard:** On the receipt of an appeal under sub-section (1), the Appellate Tribunal shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(5) **Copy of order to tribunal and parties to appeal:** The Appellate Tribunal shall send a copy of every order made by it to the Tribunal and the parties to appeal.



CHAPTER 13

CORPORATE SECRETARIAL PRACTICE – DRAFTING OF NOTICES, RESOLUTIONS, MINUTES AND REPORTS

LEARNING OUTCOMES

After reading this chapter, you will be able to:

- Know the basics of drafting of some major documents such as reports, notices, minutes and resolutions
- Know the law relating to drafting, laying and preserving these documents.

1. INTRODUCTION

The Companies Act, 2013 mandates holding of at least one Annual General Meeting and minimum 4 Board meetings in a year. When any of these business meetings are to be held, it will necessarily consist of 4 major components:

(i) Notice of the meeting

(ii) Agenda for the meeting

(iii) Resolutions at the meeting

(iv) Minutes of the meeting

The law also recognizes the importance of these documents and has laid various rules for drafting, laying and preserving the above documents. Hence, it becomes imperative to properly draft these documents, which may even be used in future as reference.

2. GENERAL HINTS ON DRAFTING REPORTS

Reports are too numerous to be governed by precise rules. However, a few general hints for drafting them are given below:

(a) Collection of material or data being the foundation on which the report stands; the writer must collect them by referring to office records, interviewing people, visiting different places, etc., as may be necessary.

(b) The material collected as aforesaid has to be arranged in a logical sequence so that the report, when made out, may read like a narrative.

(c) The report should have a leading and a preface explaining its purpose and nature.

(d) Its language has to be simple, clear and unequivocal short sentences are to be preferred to long ones. It should be drafted in an impersonal manner, making use of 'third person'.

(e) If the report is likely to be lengthy, it should be divided into parts and appropriate sub-heading should be used. The report must then contain a summary also. Many people adopt the practice of giving the gist in one page and the matter in detail later in the report.

(f) Where the directors are not technical persons, technical phraseology should be eschewed, yielding place to plain and simple phraseology, the idea being to make the report, as far as practicable, easily understandable by those for whom it is meant.

(g) The conclusions put forward should be founded on the material or data collected; also these should be unbiased in character.

3. NOTICE OF BOARD MEETING

Notice of Board meeting is required pursuant to Section 173(3) of the Companies Act, 2013. According to this section, a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Further, a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting.

In case of absence of independent directors from such a meeting of the Board, decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any.

As per section 173(4) of the Companies Act, 2013, every officer of the company whose duty is to give notice under this section and who fails to do so shall be liable to a penalty of ₹ 25,000.

Specimen notice

Board Meeting

Section 173(3) of the Companies Act, 2013: 'Notice' convening a Board Meeting

Paper Wood Limited

Palkaji,
Bombay-400 012.

Dated..... 20....

To

Mr. XYZ,
Nagpur-440 012.

Dear Sir,

Notice is hereby given that a meeting of the Board of Director which will be held at the registered office of the company at Palkaji, Bombay- 400 012 on..... the..... 20..... at.....a.m./p.m.

You are requested to make it convenient to attend the meeting.

A copy of the agenda of the businesses which are likely to be transacted at the meeting is enclosed for your perusal.

Yours faithfully

For PAPER WOOD LIMITED

Secretary
(Each director should be individually addressed with a copy of agenda of the meeting)

4. AGENDA

The various items of business to be transacted constitute the agenda, literally "things to be done" is called the meeting. Though it is common practice to send to directors or members an agenda or a list of items of business proposed to be transacted at the meeting, the Act does not lay down any such requirement. The current practice is, to lay down the agenda preferably in the form of proposed resolutions. It is usually prepared by the secretary but issued however, after it has been approved by the managing director or an executive of an equal rank.

Preparation of agenda: The preparation of agenda requires considerable care. An ideal agenda is the one which is so worded that only by altering a few words of an item to convert it into past tense, it would form the minutes. It may be, and is often drawn up on loose sheets of foolscap Paper. However, it is also preferable to write in bond book specially kept for that purpose. The order in which various items appear in the agenda is generally the order in which the business is to be transacted at the meeting. As it is customary to discuss routine matters first such items as relate to it come first in the agenda. They are followed by important items which, it is expected would provoke discussion among members. At the end, the item which require only to be noted by the members are listed. Such an order generally has the merit of dividing equitably the time of the meeting among various items according to their importance. It must be added, however, that the chairman has the discretion to take up item for consideration by the meeting in the order he considers convenient for the disposal of the business. The various items listed on the agenda are numbered serially for convenience of recording minute and for future reference.

AGENDA for the Board Meeting (Summary Form)

Agenda for Board Meeting to be held at……. on…… day, of …… 20……. at……. [a.m.]

…….. Ltd.

1. The Chairman to announce that the quorum for the meeting is present.
2. The Chairman to address the meeting, and to move that, with the permission of the members present, the notice of the meeting and the Directors' Report be taken as read, and to call on the Secretary to read the Auditors' Report.
3. The Chairman to make a statement commenting upon the working of the company.
4. The Chairman to propose:

   "Resolved that the audited Balance Sheet as at…….. 20…… at the Profit and Loss Account for the year ending…….. 20……. together with the Directors' Report and Auditors' Report thereon, be and the same are hereby received and adopted".

Mr…….. to second.

The Chairman to invite members to put questions regarding working of the company under review. After the members have spoken and their queries answered, put motion to meeting and declare result.

5. Mr…….. a Director to propose:

"Resolved that pursuant to the recommendation of the directors, dividend at the rate of Rupees…….. per share on the equity share capital of the company for the year ended…….. 20…… be and is hereby declare out of the current profits [or out of the accumulated profits] of the company and that the same be paid, after deduction of income-tax at source, to those shareholder whose names appear on the company's register of members on…….. 20…… and that divided warrants be posted within 30 days hereof only to those shareholders who are entitled to receive payment".

Mr…….. to second.

Put motion to meeting and declare result.

6. Mr…….. a Director to propose:

"Resolved that Mr…….. who retires by rotation and is eligible for re-appointment, be and is hereby re-appointment as a Director of the Company".

Mr…….. to second.

Put motion to meeting and declare result.

7. The Chairman to declare the meeting closed.

5. RESOLUTIONS

A meeting is an important instrument in the corporate decision-making process. The business at a meeting is preceded by a notice containing the agenda. The resolution is the event that takes place in the meeting.

Dictionary meaning of the word 'resolution', is 'a formal proposal put before a public assembly or the formal determination of such proposal on any matter'. Derived from this meaning, a resolution is a formal agreement as to adoption of proposal put before an assembly of persons or meeting. In the context of company management, it is either a Board meeting or a General meeting of the members. The passing of a resolution should be construed as the manner in which a meeting formally acts expressing the intent and purpose of the meeting and if it is a meeting of members, it means the will of the company, and if it is a meeting of the Board of directors, it means the exposition of the intent of the executive action initiated or to be initiated subject to the limiting and regulatory force of the different statute.

Hints on drafting of resolution

While framing resolution, it is to be ensured that:

(i) They should be expressed clearly and in precise terms, and not vaguely, whether they embody the decisions of the directors or are those passed at general meeting.

(ii) All identification of instruments, persons, etc., referred to in the resolution are properly made.

(iii) If the resolution is being passed in pursuance to the provisions of the Act, it refers to relevant section or sections.

(iv) If the resolution is such as requires the approval of the Central Government/National Company Law Tribunal or confirmation of the Court, it states that effect.

(v) If the resolution is to be effective immediately, it is drawn to show that effect.

(vi) The resolution is confined to one subject matter.

Wherever possible, lengthy resolutions should be divided into paragraphs and arranged in their logical order having regard to the subject matter of the resolution.

Members' resolution

Resolutions that may be passed by a company are of two kinds:

(i) Ordinary resolution and

(ii) Special resolutions

Specimen General Meeting Resolutions- Ordinary

Sections 149, 150 and 152 of the Companies Act, 2013- Appointment of Independent Director – Ordinary Resolution

"RESOLVED that pursuant to the provisions of Sections 149, 150, 152 and any other applicable provisions of the Companies Act, 2013 and the rules made thereunder (including any statutory modification(s) or re-enactment thereof for the time being in force) read with Schedule IV to the Companies Act, 2013, Mr. ----- (holding DIN -------), Director of the Company who retires by rotation at the Annual General Meeting and in respect of whom the Company has received a notice in writing from a member proposing his candidature for the office of Director, be and is hereby appointed as an Independent Director of the Company to hold office for five consecutive years for a term up to ---, 20---."

Specimen General Meeting Resolutions- Special

Section 232 of the Companies Act, 2013: Approval of scheme of arrangement between company and class of shareholders – Special resolution

"*Resolved* that, subject to sanction by the Tribunal at....., a scheme of arrangement in terms of the draft laid before this meeting and for the purpose of identification signed by the Chairman thereof, or with such alteration or modification thereof as may be directed by the said Tribunal, between the company and the holders of the promoters shares and the holders of the equity shares for the purpose of eliminating existing..... promoters shares of ₹..... each by converting them into..... equity shares of ₹..... be and is hereby approved."

Section 180 of the Companies Act, 2013: Power of Board of directors to borrow money– Special resolution

"RESOLVED that pursuant to Section 180(1)(c) and any other applicable provisions of the Companies Act, 2013 and the rules made thereunder (including any statutory modification(s) or re-enactment thereof for the time being in force), the consent of the Company be and is hereby accorded to the Board of Directors to borrow moneys in excess of the aggregate of the paid up share capital, free reserves and securities premium of the Company, provided that the total amount borrowed and outstanding at any point of time, apart from temporary loans obtained/to be obtained from the Company's Bankers in the ordinary course of business, shall not be in excess of ₹ ___Crores (Rupees ____ crores) over and above the aggregate of the paid up share capital, free reserves and securities premium of the Company."

Directors' Resolutions

Resolutions passed in a Board meeting.

As a general rule, the directors act/ exercise their powers by resolutions passed at Board meetings. These resolutions may be resolution requiring:

(a) *Adoption by majority:* The articles usually provide for a simple majority of votes to secure adoption of directors' resolution.

(b) *Unanimous adoption:* The resolution must be passed unanimously where the Act requires as such. For example: Third Proviso to section 203(3) of the Companies Act, 2013

(c) Resolution by circulation

1. The Act allows the Board of directors to pass resolution by Circulation also. A resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation if:

   (i) The resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or members of the committee, as the case may be,

   (ii) The resolution should be sent at their addresses registered with the company in India,

(iii) It can be sent by hand delivery or by post or by courier, or through such electronic means as may be prescribed, and

The Companies (Meetings of Board and its Powers) Rules, 2014 provides that a resolution in draft form may be circulated to the directors together with the necessary papers for seeking their approval, by electronic means which may include E-mail or fax.

(iv) It has been approved by a majority of the directors or members, who are entitled to vote on the resolution.

2. If atleast 1/3rd of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the chairperson shall put the resolution to be decided at a meeting of the Board instead of being decided by circulation.

3. A resolution that has been passed by circulation shall have to be necessarily be noted in the next meeting of board or the committee, as the case may be, and made part of the minutes of such meeting.

Note: Please refer section 175 of the Companies Act, 2013, for detail discussion on 'Passing of Resolution by Circulation'.

Specimen Board Resolution passed in the Meeting

Section 202 of the Companies Act, 2013: Compensation for loss of office – Board Resolution

"*WHEREAS* Mr. NBS was employed for a period of three years as the Managing Director of the company from…….. 20….. and Whereas the company wanted to dispense with the services of the said Managing Director, and WHEREAS the company has duly served notice to the said Managing Director in terms of clause…… of the agreement between the company and the said Mr. NBS governing his terms and condition as the Managing Director of the company, it is hereby resolved that an amount of ₹……., be paid to Mr. NBS as compensation for the loss of his office as the Managing Director of the company."

Specimen Board Resolution – Passed by Circulation

……..Ltd.

To

Mr……., Director

……

……

(Address in India only).

Dear Sir,

The following resolution, which is intended to be passed as a resolution by circulation as provided in Section 175 of the Companies Act, 2013, is circulated herewith as per the provisions of the said section.

If only you are *Not Interested* in the resolution, you may please indicate by appending your signature in the space provided beneath the resolution appearing herein below as a separate perforated slip if you are in favour or against the said resolution. The perforated slip may please be returned if and when signed within…….. days of this letter.

However, it need not be returned if you are interested in the resolution.

Yours faithfully,

(Secretary)

……..Ltd.

Resolution by circulation passed by the directors as per circulation effected…… 20…..

Resolved that……

[Set out the resolution intended to passed]

*For/Against

Signature

*Strike off whichever is inapplicable.

6. MINUTES

The minute in a literal sense means a note to preserve the memory of anything. The minutes of a meeting are a written record of the business transacted; decisions and resolutions arrived at the meeting. Section 118 of the Companies Act, 2013 imposes a statutory obligation on every company to cause minutes of all proceedings of general meetings, board meetings and other meeting and resolution passed by postal ballot. Section 119 of the Companies Act, 2013 provides for inspection of minutes-books of general meeting. The statutory requirements relating to keeping of the minutes of meeting are:

(1) **Preparation of the minutes of the proceedings of meetings:** 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 thirty 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.

(2) **Contain fair and correct summary:** The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat.

(3) **Appointments to be included in the minutes:** All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.

(4) **Other details:** In the case of a meeting of the Board of Directors or of a committee of the Board, the minutes shall also contain—

(a) the names of the directors present at the meeting; and

(b) 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.

(5) **Exemptions to matters from inclusion in the minutes:** There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting,—

(a) is or could reasonably be regarded as defamatory of any person; or

(b) is irrelevant or immaterial to the proceedings; or

(c) is detrimental to the interests of the company.

(6) **Absolute discretion of chairman:** 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 point (5) above.

(7) **Considered as evidence of the proceedings:** The minutes kept in accordance with the provisions of this section shall be evidence of the proceedings recorded therein.

(8) **Minutes signifies the validity of the procedure:** Where the minutes have been kept in accordance with this section then, 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.

(9) **Matter contained in the minutes shall be circulated:** 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 required by this section to be contained in the minutes of the proceedings of such meeting.

(10) **Adherence of secretarial standards by company:** Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute

of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

(11) Default in compliance: 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 twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

(12) Tampering with the minutes: If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

Drafting of minutes: The minutes may be drafted in a tabular form or they may be drafted in the form of a series of paragraphs, numbered consecutively and with relevant headings. However, all minutes whether of general meetings, or board meetings, should contain the following particulars:

Particulars of the Meeting

(1) Name of the meeting.

(2) Place, date and time of meeting.

(3) How the meeting was constituted.

Constitution of the Meeting - Present

(a) name of person in the Chair.

(b) names of directors and Secretary.

(c) names of persons in attendance……. Solicitor,…….auditor (in a board meeting).

(d) together with number of members (in general meeting).

Contents of minutes

(4) Serial number of the minute.

(5) Brief subject heading or index of each minute.

(6) Full terms of resolutions adopted.

(7) All statistical figures, amounts, dates, rate of interest, Nos. of Shares, etc.

(8) Specific business upon which decisions were taken.

(9) All appointments of officers, salaries, etc.

(10) Financial and contractual transactions considered by the meeting.

(11) In the case of special resolution number of votes for and against.

(12) Objections and protests raised by members together with the Chairman's rulings when members insist on their recording in the minutes, e.g., Mr. A objected to the proposed motion on the ground that it was *ultra vires*, the Chairman ruled that the motion was in order.

(13) Names of directors dissenting or not concurring with any resolution passed at a Board Meeting.

(14) Reference about interested directors abstaining from voting is necessary.

(15) The Chairman's signature and date of verification of minutes as correct.

Specimen Minutes

Minutes of…….. meeting of the Board of Directors of ABC Limited

held on…….. the…….. 2019, at New Delhi

Present:

1. …….. Chairman
2. …….. Director
3. …….. Director

In attendance Secretary

Item No. 1: Leave of absence:

Leave of absence was granted to Saravashri…….. directors.

Item No. 2: Confirmation of minutes of the…….. Board meeting:

The minutes of the…….. meeting of the Board of Directors held on…….. were considered and confirmed.

Item No. 3: Appointment of Managing Director:

The Board noted the appointment of Shri…….. director of the company as the Managing Director of the company. In this connection, the following resolutions were passed:

"*Resolved* that Shri…….. who fulfils the conditions specified in Parts I and II of Schedule V to the Companies Act, 2013, be and is here by appointed as the Managing Director of the company for a period of five years effective from…….. and that he may be paid remuneration by way of salary, commission and perquisites in accordance with Part II of Schedule V to the Act.

Resolved further that the Secretary of the company be and is hereby directed to file the necessary returns with the Registrar of Companies and to all acts and things as may be necessary in this connection."

Item No. 4: Next Board Meeting:

The next meeting of the Board will be held on…….. the…….. 20…… at the registered office of the company. The meeting ended with a vote of thanks to the chair.

TEST YOUR KNOWLEDGE

Descriptive Questions

Question 1

Draft a resolution proposed to be passed at a General Meeting of a Public Company giving consent to the Board of Directors for borrowing upto a specified amount in excess of the limits laid down under Section 180(1)(c) of the Companies Act, 2013.

Question 2

Answer the following:

(i) Board of Directors of DBM Limited held a board meeting on 2nd May, 2018 at its registered office. You are required to state the salient points to be taken into account while drafting the minutes of the said board meeting.

(ii) Draft a board resolution for appointment of Mr. Paul as the managing director for 5 years with effect from 1st June, 2019 of DBM Limited passed in the above stated board meeting.

Question 3

Morbani Woods Limited decide to appoint Mr. Wahid as its Managing Director for a period of 5 years with effect from 1st May, 2019. Mr. Wahid fulfils all the conditions as specified under Schedule V to the Companies Act, 2013.

The terms of appointment are as under:

(i) Salary ₹1 lakh per month;

(ii) Commission, as may be decided by the Board of Directors of the company;

(iii) Perquisites;

Free Housing,

Medical reimbursement upto ₹10,000 per month,

Leave Travel concession for the family,

Club membership fee,

Personal Accident Insurance ₹10 lakh,

Gratuity, and Provident Fund as per Company's policy.

You being the Secretary of the said Company, are required to draft a resolution to give effect to the above, assuming that Mr. Wahid is already the Managing Director in a public limited company.

Question 4

The members of XYZ Limited decided to pass a resolution for appointing Mr. Smith as an Independent director of the company. Draft a specimen resolution to be passed at the said meeting.

Question 5

Mr. N is appointed as an additional Director by the Board of Directors of MNR Company Limited at its meeting held on 1st October, 2018 for a period as permitted by law.

Draft a resolution and state the body which appoints N.

Question 6

The Board of Directors of RPS Limited decides to pass a resolution by circulation for allotment of 1,000 equity shares to Mr. A. Draft a specimen Board Resolution to be passed by circulation for this purpose.

Question 7

Elaborate the provisions of the Companies Act, 2013 regarding Notice of Board Meeting. Draft a notice for the first meeting of the Board of Directors of India Timber Ltd.

Question 8

R Ltd. wants to constitute an Audit Committee. Draft a board resolution covering the following matters [compliance with Companies Act, 2013 to be ensured].

(1) Member of the Audit Committee

(2) Chairman of the Audit Committee

(3) Any 2 functions of the said Committee

Question 9

(i) 17th Board meeting of Jai Entertainment Ltd. was held at its registered office situated at B-17, Industrial Area, Suncity. While discussing the matter of appointment of Mr. Kaabil as Managing Director of the company, certain defamatory remarks were made by Mr. X, one of the directors. The draft minutes submitted by the Company Secretary also incorporated the indecent remarks of Mr. X. The chairman wants to remove those undesirable remarks from the minutes. Can he do so?

(ii) Draft the minutes of above referred meeting containing the matter regarding appointment of Managing Director in addition to the usual items.

ANSWERS/SOLUTION

Answers to Descriptive Questions

1. Draft of special resolution under Section 180 (1) (c) of the Companies Act, 2013

"Resolved that the company hereby accords the consent of members to the Board of Directors for borrowing money together with the monies already borrowed by the company for an aggregate sum not exceeding ₹……(Rupees……..) in excess of the aggregate of the paid-up capital of the company, its free reserves and securities premium, that is to say reserves apart from temporary loans taken by the company from its bankers in the ordinary course of business, as provided in Section 180(1)(c) of the Companies Act, 2013.

Resolved further that the powers given as above shall be exercised by the Board of Directors at a duly convened meeting of the Board and not by passing resolution by circulation".

2. (i) While drafting the minutes of a board meeting following salient points should be kept in mind:

(a) the minutes may be drafted in a tabular form or they may be drafted in the form of a series of paragraphs, numbered consecutively and with relevant headings.

(b) the place, date and time of the meeting should be stated.

(c) The chairman of the meeting must be mentioned. The general phrase used in the Minutes is "Mr.---, chairman of the meeting took the chair and called the meeting to order".

(d) the minutes should clearly mention the attendance and the constitution of the meeting, i.e., persons present and the capacity in which present, e.g. name of the person chairing the meeting, names of the directors and secretary, identifying them as director or secretary, names of persons in attendance like auditor, internal auditor etc. The minutes should also contain the subject of leave of absence granted, if any, to any of the board members.

(e) The adoption of the Minutes of the previous Board Meeting must be the first item on the Agenda by the directors giving their approval and the Chairman signing the Minutes as proof of approval of the Minutes.

(f) Conduct of the business at the meeting should be recorded in the chronological sequence as per the Agenda.

(g) In respect of each item of business the names of the directors dissenting or not concurring with any resolution passed at the board meeting should be mentioned.

(h) Reference about interested directors abstaining from voting is also required to be stated in the minutes.

(i) Chairman's signature and date of verification of minutes as correct.

(ii) Resolution passed at the meeting of board of directors of DBM Limited held at its registered office situated at ..... on 2nd May, 2019 at ..... A.M.

"RESOLVED that subject to the approval by the shareholders in a general meeting and pursuant to the provisions of the applicable provisions of the Companies Act, 2013, Mr. Paul be and is hereby appointed as the Managing Director of the Company with effect from 1st June, 2019 for a period of five years on a remuneration approved by the Remuneration Committee as enumerated below:

(1) Salary: ₹ ..... per month

(2) Perquisites, Benefits and Facilities .....

RESOLVED FURTHER that Mr. Paul, so long as he functions as the Managing Director of the Company shall not be entitled to any sitting fee for attending the meeting of the board of directors or any committee thereof and that he shall not be liable to retire by rotation.

RESOLVED FURTHER that the Secretary of the company be and is hereby directed and authorized to file necessary returns with the Registrar of Companies and to do all other necessary things required under the provisions of the Companies Act, 2013."

3. Resolution passed at the meeting of board of directors of Morbani Woods Limited held at its registered office situated at ..... on .....(day) at ..... A.M

"Resolved that consent of all the directors present at the meeting be and is hereby accorded to the appointment of Mr. Wahid, who is already the Managing Director of another public limited company, and fulfils the conditions as specified in Schedule V of the Companies Act, 2013, as the Managing Director of the company for a period of 5 years effective from 1st May, 2019 subject to approval by a resolution of shareholders in a general meeting and that Mr. Wahid may be paid remuneration as follows:

(i) Salary of ₹ 1 Lakh per month

(ii) Commission

(iii) Perquisites: Free Housing, Medical reimbursement upto ₹ 10,000, Leave Travel Concession for the family, Club membership fee, Personal Accident Insurance of ₹ 10 Lakhs, Gratuity, Provident Fund etc.

Resolved further that in the event of loss or inadequacy of profits, the salary payable to him shall be subject to the limits specified in Schedule V.

Resolved further that the Secretary of the company be and is hereby authorize to prepare and file with the Registrar of Companies necessary forms and returns in respect of the above appointment."

Sd/

Board of Directors

Morbani Woods Limited

4. Resolution passed at the meeting of XYZ Limited held at its registered office situated at _____ on _____ (day) at _____ A.M.

"RESOLVED that pursuant to the provisions of Sections 149, 150, 152 and any other applicable provisions of the Companies Act, 2013 and the rules made thereunder (including any statutory modification(s) or re-enactment thereof for the time being in force) read with Schedule IV to the Companies Act, 2013, Mr. Smith (holding DIN -------), Director of the Company who retires by rotation at the Annual General Meeting and in respect of whom the Company has received a notice in writing from a member proposing his candidature for the office of Director, be and is hereby appointed as an Independent Director of the Company to hold office for five consecutive years for a term up to ---, 20---."

5. Appointment of Additional Director: Resolution (Section 161 of the Companies Act, 2013)

According to section 161(1) of the Companies Act, 2013, the articles of a company may confer on its Board of Directors the power to appoint any person as an additional director at any time.

Board Resolution

Resolution passed at the meeting of the board of directors of MNR Company Limited held at its registered office situated at _____ on _____ (day) at _____ A.M.

"Resolved that pursuant to the Articles of Association of the company and section 161(1) of the Companies Act, 2013, Mr. N is appointed as an Additional Director of the MNR Company Limited with effect from 1st October, 2018 to hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

Resolved further that Mr. N will enjoy the same powers and rights as other directors.

Resolved further that Mr._____ Secretary of MNR Company Limited be and is hereby authorised to electronically file necessary returns with the Registrar of Companies and to do all other necessary things required under the Act."

Assumption: As the question is silent about the Articles of Association, it is assumed that Articles of Association has conferred the power to appoint the additional director on the Board of Directors of MNR Company Limited.

6.

RPS Limited

_____(Place)

To

Mr. X (Director)

(Address in India only)

Dear Sir,

The following resolution which is intended to be passed as a resolution by circulation as provided in Section 175 of the Companies Act, 2013 is circulated herewith as per the provisions of the said section.

If only you are Not Interested in the resolution, you may please indicate by appending your signature in the space provided beneath the resolution appearing herein below as a separate perforated slip, if you are in favour or against the said resolution. The perforated slip may please be returned if and when signed within seven days of this letter.

However, it need not be returned if you are interested in the resolution.

Yours faithfully,
(Secretary)
RPS Limited

Resolution by circulation passed by directors as per circulation effected

……..20……..

Resolved that 1,000 equity shares in the company be and hereby allotted to Mr. A. 202, Kher Gali, Sher Mark, Ludhiana, Punjab from whom full amount has been received.

It is further resolved that necessary return of allotment be filed in the office of the ROC under the signature of Mr. Y, a Director.

For / Against

Signature

7. Notice of Board Meeting:

- Notice of Board Meeting is required pursuant to Section 173(3) of the Companies Act, 2013. According to this section, a meeting of the Board shall be called by giving

not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

- Further, a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting.
- In case of absence of independent directors from such a meeting of the Board, decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any.
- The *Companies (Meetings of Board and its Powers) Rules, 2014*, further provides that the notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means.
- On receiving such a notice, a director intending to participate through video conferencing or audio visual means shall communicate his intention to the Chairperson or the company secretary of the company. He shall give prior intimation to the effect sufficiently in advance so that the company is able to make suitable arrangements in this behalf.
- If the director does not give any intimation of his intention to participate that he wants to participate through the electronic mode, it shall be assumed that the director shall attend the meeting in person.
- As per section 173(4) of the Companies Act, 2013, every officer of the company whose duty is to give notice under this section and who fails to do so shall be liable to a penalty of ₹ 25,000.

Draft Notice

India Timber Limited

Address: _____

_____

Dated_____

To

Mr._____

Address: _____

_____ (each director to be addressed individually)

Dear Sir,

Notice is hereby given that first meeting of the Board of Directors will be held at the registered office of the company at…….(address)……..(place) on…..(day), the .....(date) at……AM/PM.

You are requested to make it convenient to attend the meeting. An option is also available to you to participate in the Board Meeting through video conferencing or audio visual means. Kindly communicate your preference in this regard.

A copy of the agenda of the meeting is enclosed for your perusal.

Yours faithfully,

For India Timber Ltd.

(Secretary)

8. Audit Committee – Board's Resolution:

"Resolved that pursuant to Section 177 of the Companies Act, 2013 an Audit Committee consisting of the following Directors be and is hereby constituted.

1. Mr. ---- Independent Director
2. Mr. ---- Independent Director
3. Mr. ---- Independent Director
4. Mr. ---- Independent Director
5. Mr. ---- Managing Director.
6. Mr. ---- Chief Financial Officer"

"Further resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves and shall be an independent director'.

"Further resolved that the quorum for a meeting of the Audit committee shall be three directors (other than the Managing Director), out of which at least two must be independent directors".

"Resolved further that the Audit Committee shall perform all the functions as laid down in section 177(4) of the Companies Act, 2013 including but not limited to:

a. make the recommendation for appointment, remuneration and terms of appointment of the auditors of the company;

b. review and monitor the independence and performance of auditors of the company and the effectiveness of the audit process".

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations if any".

9. (i) The minutes of a meeting are a written record of the business transacted; decisions and resolutions arrived at the meeting.

Section 118 of the Companies Act, 2013, deals with Minutes of Proceedings of General Meeting, Meetings of Board of Directors and Other Meetings and Resolutions Passed by Postal Ballot. The section provides certain exemptions to matters from inclusion in the minutes.

Exemptions from inclusion in minutes of the meeting: There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting, -

(a) is or could reasonably be regarded as defamatory of any person; or

(b) is irrelevant or immaterial to the proceedings; or

(c) is detrimental to the interests of the company.

Absolute discretion of chairman: The Chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds as specified above.

Hence, the Chairman can exercise his discretion of not including the undesirable remarks from the minute of the 17th Board meeting of Jai Entertainment Ltd.

(ii) Draft Minutes

Minutes of 17th meeting of the Board of Directors of Jai Entertainment Limited held on _____ the _____ 2018, at B-17, Industrial Area, Suncity

Present :

1._____ Chairman

2. _____ Director

3. _____ Director

In attendance Secretary

Item No. 1 : Leave of Absence

Leave of absence was granted to _____ Director.

Item No. 2 : Confirmation of minutes of the 16th Board meeting :

The minutes of the 16th meeting of the Board of Directors held on _____ were considered and confirmed.

Item No. 3: Appointment of Managing Director:

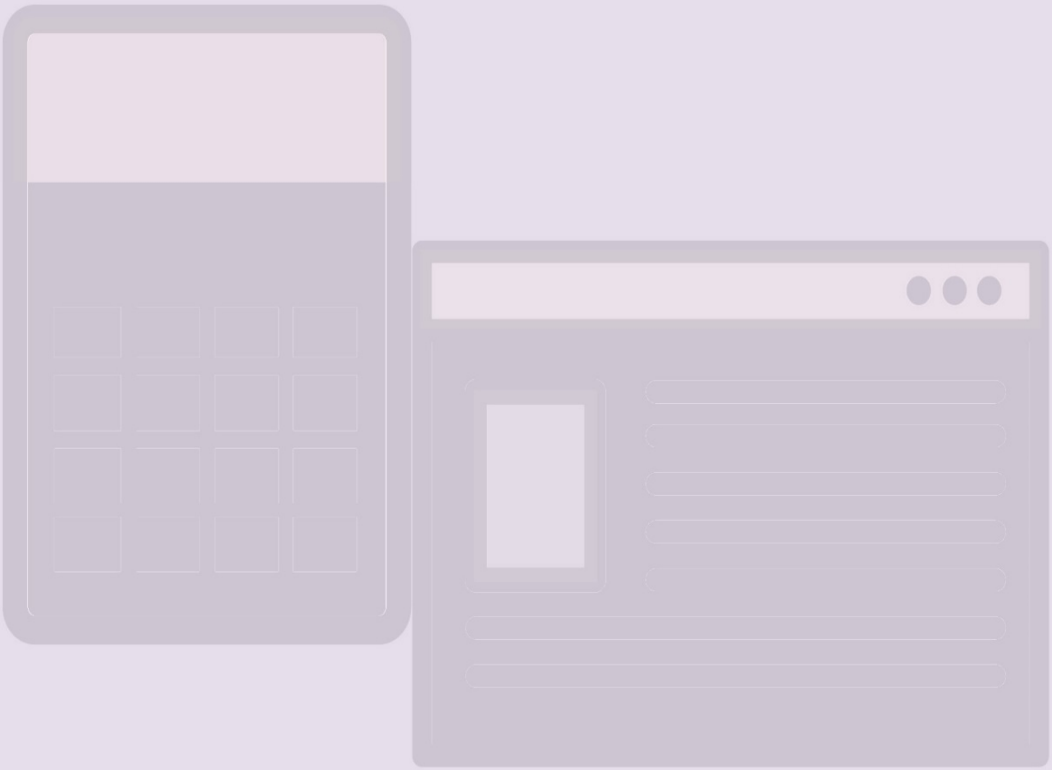
The Board noted the appointment of Mr. Kaabil, director of the company as the Managing Director of the company. In this connection, the following resolutions were passed:

"*Resolved* that Mr. Kaabil who fulfils the conditions specified in Parts I and II of Schedule V to the Companies Act, 2013, be and is here by appointed as the Managing Director of the company for a period of five years effective from _____ and that he may be paid remuneration by way of salary, commission and perquisites in accordance with Part II of Schedule V to the Act.

Resolved further that the Secretary of the Company be and is hereby directed to file the necessary returns with the registrar of Companies and to do all acts and things as may be necessary in this connection."

Item No. 4: Next Board Meeting:

The next meeting of the Board will be held on _____the _____20____ at the registered office of the company. The meeting ended with a vote of thanks to the chair.



CHAPTER 1

SECURITIES CONTRACT (REGULATION) ACT, 1956 AND SCR RULES, 1957

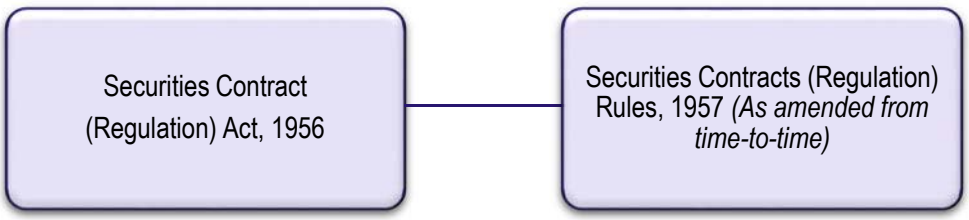
LEARNING OUTCOMES

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

- Know the meaning of securities and the history of introducing the law in India
- Learn what is Corporatisation and Demutualisation of Securities
- Know how does the listing of securities take place
- Explain what are the penalties and offences under the Securities Contract (Regulation) Act, 1956

1. INTRODUCTION

To begin with, let us first take the structure the Act and its corresponding Rules, which will make the study of the provisions and their interpretation easier –



Applicability – Whole of India

Objective – To prevent undesirable transactions in securities by regulating the business of dealing therein, by providing certain other matters connected therewith.

Non-Applicability (Section 28) – The provisions of this Act shall not apply to –

(a) The Government,

(b) the Reserve Bank of India (RBI),

(c) any local authority, or

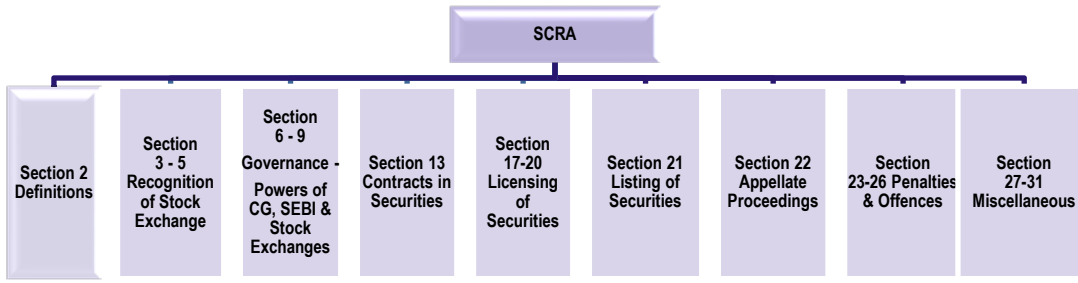
(d) any corporation set-up by a special law or any person who has effected any transaction with or through the agency of any such authority as is referred to in this clause;

(e) Any convertible bond or share warrant or any option or right in relation thereto, in so far as it entitles the person in whose favour any of the former has been issued to obtain at his option from the company or other body corporate, issuing the same or from any of its shareholders' or duly appointed agents, shares of the company or other body corporate, whether by conversion of the bond or warrant or otherwise on the basis of the price agreed upon when the same was issued.

(f) Central Government may, by notification in the Official Gazette, specify any class of contracts as contracts to which this Act or any provision contained therein shall not apply, and also the conditions, limitations or restrictions, if any, subject to which it shall not so apply.

While Act discusses the provisions of recognition of stock exchanges, licensing of dealers, listing of security requirements and the penalties and offences in case of contraventions; the corresponding rules, i.e. Securities Contract (Regulation) Rules, 1957, which are amended from time-to-time by the Central Government, and contains the mannerism and the procedure to perform those tasks.

Structure of the Act



2. DEFINITIONS (SECTION 2)

Contract

"Means a contract for or relating to the purchase or sale of securities." **[Section 2(a)]**

In simple terms, a contract document is one, which sets out the details of a proposed transaction. In our context, a contract for the investment means a contract in equity or preference shares or

subscribing to debentures of a company, whether convertible or not. Every investment contract begins with a 'term sheet', i.e. a bullet-point (non-binding) document, which outlines the terms of a proposed agreement. The parties to the contract exchange the 'term sheet' to negotiate the issues, and once finalized, definitive agreements in the form of 'Share Holder Agreement' and/or 'Share Purchase Agreement' are exchanged.

Here in the definition, note the term - contract 'relating to the purchase or sale of securities'. This is best explained by an example of *Share Purchase Agreement*, commonly known as SPA, and is an agreement that sets out the terms and conditions relating to the sale and purchase of shares in a company. Certain SPAs can be used to buy or sell a business as a going concern. Such an agreement principally outlines the market price of shares, (including the premium amount, if any) and the duties and responsibilities of the parties with respect to powers of the board.

Example

A company Cookies Private Limited has two shareholders, Mr. Rock and Mr. Salt. Mr. Rock decides to sell his part of shares in Cookies Private Limited to another company, Crispy Private Limited for a specified monetary consideration. How should Mr. Rock proceed to document the transaction so as to make it legally binding on both the parties?

Answer

Such an understanding of transfer of the shares of Mr. Rock to Crispy Private Limited shall be recorded in SPA, which is a legally binding contract, and lists down all the terms and conditions which are relevant to the sale of shares, such as –

- the exact description of shares, i.e. the number of shares, price per share, premium amount, if any;
- the conditions that must be satisfied before the sale takes place;
- the date on which the sale will be completed;
- the manner in which the transfer will be made;
- any indemnities or protections available to the parties;
- the representations and warranties made by either party; and
- the conditions upon which the agreement will terminate.

Another document that is executed when a contract for shares and securities takes place, is the Share Holder Agreement ('SHA'), which basically is a supplementary document to SPA. However, this document is not necessary in all the cases. The agreement lists down the right and obligations of each shareholder on different matters like, the manner in which the shareholders can exit the company; the procedure for transfer of shares, the procedure of winding-up of the company in case of liquidation, the procedure to resolve a disparity between the shareholders, the day-to-day

operations of the company and the corresponding rights of the shareholders, and the composition of board of directors.

Corporatisation

"Means the succession of a recognised stock exchange, being a body of individuals, or a society registered under the Societies Registration Act, 1860, by another stock exchange, being a company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society." **[Section 2(aa)]**

The stock exchanges in India during the early 1950's were operating either as body of individuals or in the form of registered Societies. This meant that the stock exchanges worked primarily for the benefit of the members of the society instead of working for the investors. In this regard, on the recommendations made by the committee established under M.H. Kania, with a view to expediting the reorganisation, the Central Government made changes in the law to facilitate the corporatisation of the stock exchanges. This was done in order to separate the ownership, management and trading rights from each other. According to the recommendations of the M.H. Kania Committee, SEBI, in 2003, had asked all the stock exchanges to submit a scheme within 6 months to implement the corporatisation scheme. Hence the SCRA was amended in 2004 to compel the stock exchanges to corporatize and demutualise.

Stock Exchange Trading Floor in 1950's

Corporatized Stock Exchange in 2004

Demutualisation

"Means the segregation of ownership and management from the trading rights of the members of a recognised stock exchange in accordance with a scheme approved by the Securities and Exchange Board of India." **[Section 2(ab)]**

First, let us understand what is meant by demutualisation. In simple words, it is a term used to describe the transition from mutual association of exchange members operating on a not-for-profit basis to a limited liability, for-profit company, accountable to shareholders. Essentially, demutualisation separates ownership (and voting right) from the right of access to trading.

As mentioned above, the stock exchanges in India were operating as a body of individuals in the form of private clubs and registered societies, whose objective was primarily to work for the benefit the members. The members of these stock exchanges were known as the stock brokers, who had a

'seat', i.e. a right to trade on the floor of the exchange. So in effect, the stock exchanges in the country, were dominated by the stock brokers, who did not pay much heed to the concept of governance. They just focused on increasing their wealth and snubbed the protection of investors. That resulted in the attrition of investor's wealth and consequently their confidence in the stock market. Thus, the demutualisation of stock exchanges was made mandatory by the Central Government in 2003, to end the broker's control over the exchanges. Post that, the access to trading became a matter of contract with the stock exchange, wherein the dealers were just operating as users or participants. The stock exchanges, which were previously operating as an unorganised sector, started acting a service provider to market intermediaries and listed companies, after adopting the scheme of demutualisation.

India's two largest demutualised stock exchanges are the National Stock Exchange ('NSE') was formed in 1992 and Bombay Stock Exchange. Its shareholders are largely the state-owned banks and it is run for-profit and is not tax sheltered.

The above two pictures show how the concept of demutualisation has changed the operations of stock exchange in India. The first picture shows the traditional trading floor, wherein the members of the stock exchange, were the stock brokers themselves and they operated for the benefit of their own interests. The second picture depicts the current scenario of stock exchanges, wherein the contracts relating to sale and purchase of shares are automated online and the stock brokers are mere intermediaries between the stock exchange and the investors.

Derivative

"Includes –

A. a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for difference or any other form if security;

B. a contract which derives its value from the prices, or index of prices, of underlying securities.

C. Commodity derivatives;

D. Such other instruments as may be declared by the Central Government to be derivatives". **[Section 2(ac)]**

To comprehend the definition, let us first understand the domain of derivatives, which is considered as one of the most complex financial instruments.

In layman's term, derivatives are the financial instruments which help you make profits by betting on the future value of the underlying (i.e. the primary) asset. These might be in the form of stocks, indices, commodities, currencies, exchange rates or even rate of interest. The securities in which they are traded is called the underlying asset; and the value of such underlying assets changes frequently.

Example: The market price of a share of a company may increase/ decrease; the foreign currency exchange rate may fluctuate, the indices like Sensex or NIFTY might go up or down, etc. All of these are examples of derivatives.

Derivatives are traded in the market in the form of Futures, Forwards, Options or Swaps –

Forward Contracts

Forward contract is an agreement to sell a currency, commodity or other asset at a specified future date and at a pre-determined price, agreed upon today. Any type of contractual agreement that calls for the future purchase of a good or a service at a price agreed upon today and without the right of cancellation is a forward contract.

Example: If a farmer plans to grow 1000 kilos of rice next year, he could sell his rice for the price prevalent in the market at the time when he harvests it. As an another option, he might opt to lock-in a price today, at which he wishes to sell the harvest, by selling a forward contract to the Industrialist, that obligates him to sell his 1000 kilos of wheat, after harvest for a fixed price. By

locking-in, he can reduce his risk of falling rice prices. However, if the prices rise later, he will get only what his entitles him to.

Future Contract

A futures contract is an agreement between two parties – a buyer and a seller – to buy or sell a security after a future date. The contract trades on a futures exchange and is subject to daily settlement procedure. Future contracts evolved out of forward contracts and possess many of the same characteristics. Futures are different from forwards from the fact that they settle every day, and that the parties to a forward contract tend to bear more credit risk than the parties to futures contracts because there is no clearing house involved that guarantees performance. That is why, forward contracts usually come with premiums for the added credit risk.

Section 30A of the Act deals with special provisions related to **commodity derivatives** and states that nothing in the Act shall apply to non-transferable specific delivery contracts (as explained in the terms below).

Government Security

"Means a security created and issued, whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in Section 2(2) of the Public Debt Act, 1944." [Section 2(b)]

Government securities are the low-risk securities since they are backed by the power of the government. Basically, it acknowledges the government's debt obligation and are short termed and long termed. The short-term government securities come in the form of treasury bills ('T-Bills'); and long term securities in the form of zero-risk government bonds.

Government of India also issues savings instruments like the Savings Bonds, National Savings Certificates, etc., or special securities such as oil bonds, Food Corporation of India bonds, fertiliser bonds, power bonds, etc.

Goods

"Mean every kind of movable property other than actionable claims, money and securities." [Section 2(bb)]

Commodity Derivative

"Commodity derivative" means a contract-

(i) For the delivery of such goods, as may be notified by the Central Government in the Official Gazette, and which is not a ready delivery contract; or

(ii) For differences, which derives its value from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified by the Central Government, in consultation with the Board, but does not include securities as referred to in sub-clauses (A) and (B) of clause (ac). **[Section 2(bc)]**

Member

"Means a member of a recognised stock exchange." **[Section 2(c)]**

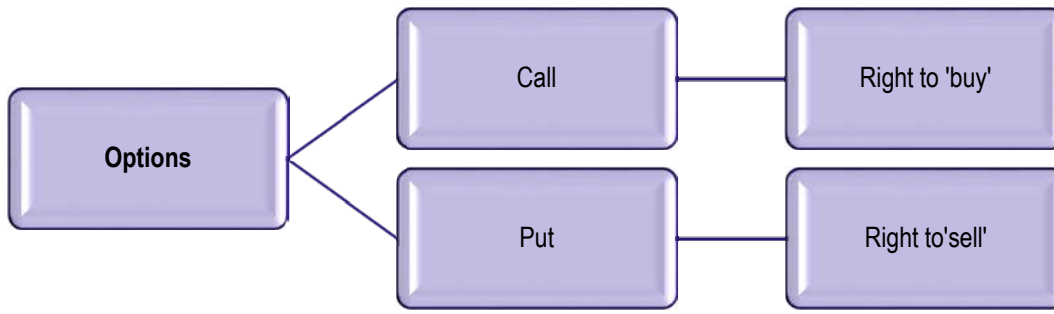
Non-transferable specific delivery contract

"Means a specific delivery contract, the rights or liabilities under which or under any delivery order, railway receipt, bill of lading, warehouse receipt or any other documents of title relating thereto are not transferable." **[Section 2(ca)]**

Option in Securities

"Means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and a call in securities." **[Section 2(d)]**

Options are contracts, through which a seller giver the buyer, a right, but not the obligation, to buy or sell a specified number of shares at a pre-determined price, within a set time period. These contracts are essentially derivatives, since they derive their value from an underlying security on which the option is based. With options, one can tailor his position according to his own situation and stock market outlook.



Example

Mr. Vivaan is having 400 shares of M/s Travel Everywhere Limited and the current price of these shares in the market is INR 100. Vivaan's goal is to sell these shares in 6 months' time. However, he is worried that the price of these shares could fall considerably, by then. At the same time, Vivaan doesn't want to sell off these shares today, as he conjectured that the share price might appreciate in the near future. How should Mr. Vivaan protect his security and reduce the risk of loss on the share price?

In this case, Vivaan may opt for 'Option' derivative contract, which is an agreement to buy or sell a set of assets at a specified time in the future for a specified amount. However, it is not obligatory for him to hold the terms of the agreement, since he has an 'option' to exercise the contract. For example, if the current market price of the share is INR 100 and he buy an option to sell the shares to Mr. Rosesh at INR 200 after three-month, so Vivaan bought a put option.

Now, if after three months, the current price of the shares is INR 210, Mr. Vivaan may opt not to sell the shares to Mr. Rosesh and instead sell them in the market, thus making a profit of INR 110. Had the market price of the shares after three months would have been INR 90, Mr. Vivaan would have obliged the option contract and sold those shares to Rosesh, thus making a profit, even though the current market price was below the contracted price. Thus, here, the shares of Travel Everywhere is the underlying asset and the option contract is a form of derivative.

Prescribed

"Means prescribed by rules made under this Act." **[Section 2(e)]**

Ready Delivery Contract

"Means a contract which provides for the delivery of goods and the payment of a price therefor, either immediately, or within such period not exceeding eleven days after the date of the contract and subject to such conditions as the Central Government may, by notification in the Official Gazette, specify in respect of any goods, the period under such contract not being capable of extension by the mutual consent of the parties thereto or otherwise:

Provided that where any such contract is performed either wholly or in part:

(i) By realisation of any sum of money being the difference between the contract rate and the settlement rate or clearing rate or the rate of any offsetting contract; or

(ii) By any other means whatsoever, and as a result of which the actual tendering of the goods covered by the contract or payment of the full price therefor is dispensed with, then such contract shall not be deemed to be a ready delivery contract." **[Section 2(ea)]**

Ready Delivery Contracts are also known as 'cash trading' or 'cash transactions' which are either settled on the same date or within a short period, upto eleven days. Under this, most of the sale and purchase transactions which the contracting parties is settled by paying for the goods immediately and the delivery of the goods take place instantly.

Recognised Stock Exchange

"Means a stock exchange which is for the time being recognised by the Central Government under section 4." **[Section 2(f)]**

We shall be discussing the provisions of recognition of stock exchanges, later in the chapter.

Rules

"with reference to the rules relating in general to the constitution and management of a stock exchange, includes, in the case of a stock exchange which is an incorporated association, its memorandum and articles of association." **[Section 2(g)]**

Scheme

"Means a scheme for corporatisation or demutualisation of recognised stock exchange which may provide for –

i. The issue of shares for a lawful consideration and provision of trading rights in lieu of membership cards of members of a recognised stock exchange;

ii. The restrictions on voting rights;

iii. The transfer of property, business, assets, rights, liabilities, recognitions, contracts of the recognised stock exchange, whether in the name of the recognised stock exchange or any trustee or otherwise and any permission given to, or by, the recognised stock exchange.

iv. the transfer of employees of a recognised stock exchange to another recognised stock exchange;

v. any other matter required for the purpose of, or in connection with, the corporatisation or demutualisation, as the case may be, of the recognised stock exchange. **[Section 2(ga)]**

Securities Appellate Tribunal

"Means a Securities Appellate Tribunal established under sub-section (1) of section 15K of the Securities and Exchange Board of India Act, 1992." **[Section 2(gb)]**

Securities

"Include –

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

(ii) Derivative

(iii) Units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(iv) Security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(v) Units or any other such instrument issued to the investor under any mutual fund scheme;

Explanation – for the removal of doubts, it is hereby declared that "securities" 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;

(vi) 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 debtor receivable, including mortgage debt, as the case may be;

(vii) Government securities;

(viii) Such other instruments as may be declared by the Central Government to be securities; and

(ix) Rights or interest in securities. **[Section 2(h)]**

Specific Delivery Contract

"Means a commodity derivative which provides for the actual delivery of specific qualities or types of goods during a specified future period at a price fixed thereby or to be fixed in the manner thereby agreed and in which the names of both the buyer and the seller are mentioned." **[Section 2(ha)]**

Spot Delivery Contract

"Means a contract which provides for –

(a) Actual delivery of securities and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;

(b) Transfer of securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository." **[Section 2(i)]**

Stock Exchange

"Means –

(a) Any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under section 4A and 4B, or

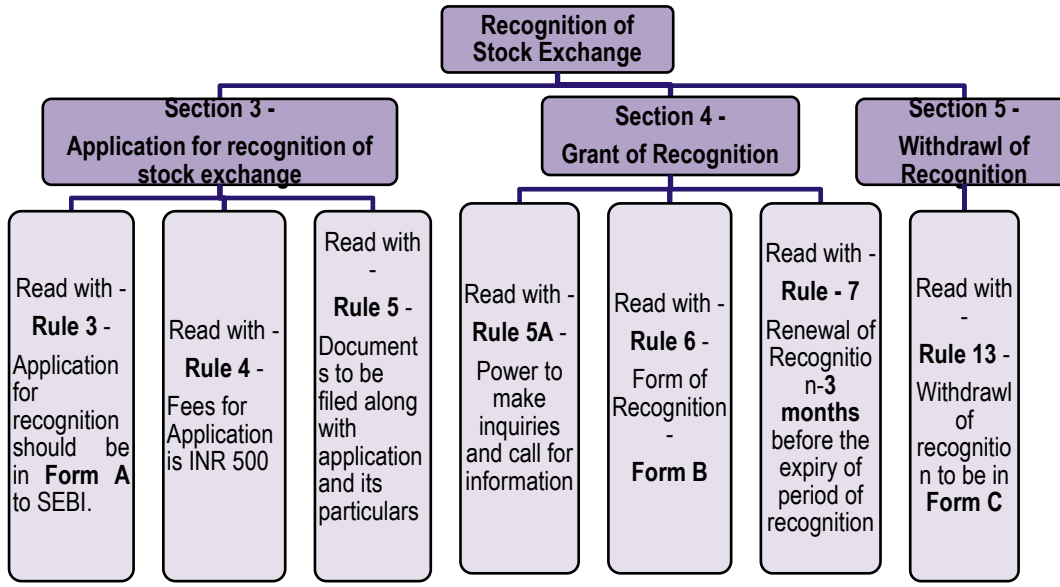
(b) A body corporate incorporated under the Companies Act, 1956 whether under a scheme of corporatisation and demutualisation or otherwise,

For the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. **[Section 2(j)]**

Transferable Specific Delivery Contract

"Means a specific delivery contract which is not a non-transferable specific delivery contract and which subject to such conditions relating to its transferability as the Central Government may by notification in the Official Gazette, specify in this behalf." [Section 2(k)]

3. RECOGNITION OF STOCK EXCHANGE



It is important to note that wherever the powers have been dispensed with the Central Government to exercise any provision in the Act, most of them have been delegated to the SEBI, i.e. they are exercisable by SEBI as well vide S.O. 672(E), dated 13th September 1994, as published in the Gazette of India.

Application for recognition of stock exchanges (Section 3)

- **Filing of an application by Central Government:** As per the provision, any stock exchange, which is desirous of being recognised for the purposes of this Act, may make an application as prescribed in Rule 3 of the Securities Contract (Regulation) Rules, 1957 to the Central Government (powers delegated to SEBI also) [Section 3(1)]. The application for the recognition of the stock exchange shall be made to SEBI in Form A.
- **Deposit of fees:** Rule 4 of the Securities Contract (Regulation) Rules, 1957 describe the fees to be paid for the application shall be INR 500. It further states that the amount of the fee shall be deposited in the nearest Government treasury or the nearest branch of the State Bank of India, except that the fees for the application made in Mumbai, Kolkata, Madras, Delhi and Kanpur shall be deposited in the Reserve Bank of India.

- **Particulars to be stated in application:** Section 3(2) of the Act states that every application made to SEBI shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the rules relating in general to the constitution of the stock exchange and in particular, to –

  (a) The governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted;

  (b) The powers and duties of the office bearers of the stock exchange;

  (c) The admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and re-admission of members therefrom or thereinto;

  (d) The procedure for the registration of partnerships as members of the stock exchange in cases where the rules provide for such membership; and the nomination and appointment of authorised representatives and clerks.

- **Filing of documents with the application:** The prescribed particulars, as stated above, are contained in Rule 5 of the Securities Contract (Regulation) Rules, 1957, which state that every application shall be accompanied by four copies of the rules (including memorandum and articles of association where applicant stock exchange is an incorporated body) and bye-laws of the stock exchange applying for recognition as specified in Section 3 of the Act and the receipt granted by the Government treasury, or as the case may be, the State Bank of India or the Reserve Bank of India, in respect of the amount of the fee deposited and shall contain clear particulars as to the matters specified in the Annexure to Form A.

Grant of recognition to Stock Exchanges (Section 4)

Requirements for the grant of recognition: Section 4(1) stated that if the Central Government (or SEBI) is satisfied, after making such inquiry and after obtaining such further information, if any, as it may require, -

(a) That the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;

(b) That the stock exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government (or SEBI), after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act, and

(c) That it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange;

it may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.

As per the provisions above, SEBI may make inquiries or call for information as per the provisions contained in Rule 5A of the Securities Contract (Regulation) Rules, 1957, which states that before granting recognition to a stock exchange under section 4 of the Act, the Securities Exchange Board of India may make such inquiries and such further information to be furnished, as it may deem necessary, relating to the information furnished by the stock exchange in the Annexure to its application in Form A.

After seeking the required information and making the inquiries, SEBI may grant recognition to the stock exchange as per the provisions contained in Rule 6 of the Rules which discusses that the recognition granted to a stock exchange shall be in Form B and be subject to the following conditions, namely –

(a) That the recognition, unless granted on a permanent basis, shall be for such period not less than one year as may be specified in the recognition;

(b) That the stock exchange shall comply with such conditions as are or may be prescribed or imposed under the provisions of the Act and these rules from time-to-time.

Rule 7 - Renewal of Recognition

Rule 7(1) states that three months before the expiry of the period of recognition, a recognised stock exchange desirous of renewal of such recognition may make an application to the Securities and Exchange Board of India in Form A. The fee payable upon the application of renewal of recognition of stock exchange shall be two hundred rupees.

Who is eligible to be a member of a recognised stock exchange?

Rule 8 details the qualification for membership of a recognised stock exchange –

The below-mentioned persons can be admitted as the members of the recognised stock exchanges, subject to certain conditions, as prescribed in Rule 8 of the Securities Contract (Regulation) Rules, 1957, a snapshot of which is as below –

• Rule 8(1) - No person shall be eligible to be elected as a member if -

- (a) he is **less than 21 years of age**;
- (b) he is **not a citizen of India**; (provided that the governing body may in suitable cases relax this condition upon prior approval of SEBI)
- (c) he has been **adjudged bankrupt** or receiving order in bankruptcy has been made against him or he has proved to be insolvent even though he has obtained his final discharge;
- (d) he has been **compounded** with his creditors unless he has paid sixteen annas in the rupee;
- (e) he has been **convicted** of an offence involving **fraud and dishonesty**;
- (f) he is engaged as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability unless he undertakes on admission to server his connecton with such business
- (h) he has been, at any time **expelled or declared a defaulter** by any other stock exchange;
- (i) he has been previously **refused admission to membership** unless a period of one year has elapsed since the date of such rejection.

• Rule 8(2) - No person eligible for admission as a member under Rule 8(1) shall be admitted as a member unless -

- (a) he has worked for not less than two years as a partner with, or an authorised assistant or authorised clerk or remisier or apprentice to, a member; or
- (b) he agrees to work for a minimum period of two years as a partner or representative member with another member and to enter into bargains on the floor of the stock exchange and not in his own name but in the name of such other member; or
- (c) he suceeds to the established business of a deceased or retiring member who is his father, uncle, brother or any other person who is, in the opinion of the governing body, a close relative:
- Provided that the rules of the stock exchange may authorise the governing body to waive compliance with any of the foregoing conditions if the person seeking admission is in respect of means, position, intergrity, knowledge and experience of business in securities, considered by the governing body to be otherwise qualified for membership.

• Rule 8(3) - No person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if -

- (a) he ceases to be a citizen of India: Provided that nothing herein shall affect those who are not citizens of India but who were members at the time of succh application or were admitted subsequently under the provisions of Rule 8(1)(b), subject to their complying with all other requirements of this rule;
- (b) he is adjudged bankrupt or a receiving order in bankruptcy is made against him or he is proved to be insolvent;
- (c) he is convicted of an offence involving fraud or dishonesty;
- (d) he engages either as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability, provided that -
- (i) the governing body may, for reasons, to be recorded in writing, permit a member to engage himself as principal or employee in any such business, if the member in question ceases to carry on business of the stock exchange either as an individual or as a partner in a firm;
- (ii) in the case of those members who were under the rules in force at the time of such application permitted to engage in any such business and were actually so engaged on the date of such application, a period of 3 years from the date of servering their connection with any such business,
- (iii) nothing herein shall affect the members of a recognised stock exchange, which are corporations, bodies corporate, companies or institutions referred to in item (a) to (n) of the proviso to sub -rule 4.

Rule 8(4) - A company defined in Companies Act, 1956 shall be eligible to be elected as member of a stock exchange if

- (i) such company is formed in compliance with the provisions of section 322 of the said Act; (ii) a majority of the directors of such company are shareholders of such company and also memners of that stock exhange; and (iii) the directors of such company, who are members of that stock exchange, have ultimate liability in such company:
- According to proviso to sub-rule (4), where SEBI makes a recommendation in this regard, the governing body of a stock exchange shall, in relaxation of the requirements of this clause, admit as member the following corporations, bodies corporate, companies or institutions namely -
- (a) the Industrial Finance Corporation, establised under the Industrial Finance Corporation Act, 1948;
- (b) the Industrial Development Bank of India, established under the Industrial Development Bank Act, 1964
- (c) any insurance company registered by the Insurance Regulatory Development Authority under the Insurance ACt, 1938;
- (e) the Unit Trust of India;
- (f)the Industrial Credit and Investment Corporation of India, a company registered under the Companies Act, 1956
- (g) the subsidiaries of any of the corporations or companies specified in above and any subsidiary of the State Bank or any nationalised bank set up for providing merchant banking services, buying and selling securities and other similar activities;
- (h) any bank included in the Second Schedule to the Reserve Bank of India Act, 1934;
- (i) the Export Import Bank of India;
- (j) the National Bank for Agriculture and Rural Development;
- (k) the National Housing Bank;
- (l) Central Board of Trsutees, Employees' Provident Fund;
- (m) any pension fund registered or appointed or regulated by the Pension Fund Regulatory and Development Authority;
- (n) any Standalone Primary Dealers authorised by the Reserve Bank of India.

Rule 4A - A company defined in the Companies Act, 1956 shall also be eligible to be elected as a member of a stock exchange, if -

- (i) such company is formed in compliance with the provisions of section 12 of the said Act;
- (ii) such company undertakes to comply with such financial requirements and norms as may be specified by SEBI for registration of such company under sub-section (1) of ection 12 of SEBI Act, 1992;
- (iv) the directors of the Company are not disqualified from being members of a stock exchange under clause (1) [except sub-clause (b) and sub-clause (f) thereof] or clause (3) [except sub-clause (a) and sub-clause (f) thereof] and the Directors in any Company which had been a member of the stock exchange and had been declared defaulter or expelled by the stock exchange; and
- (v) not less than two directors of the company are persons who possess a minimum two years' experience:
  - (a) dealing in securities; or
  - (b) as portfolio managers; or
  - (c) as investment consultants.

Others -

- Rule 8(5) - Where any member of the Stock Exchange is a **Firm**, the provisions of sub-rules (1), (3) and (4) shall, so far as they can, apply to the admission or continuation of any partner in such firm;
- Rule 8(6) - A **Limited Liability Partnership ('LLP')** as defined in the Limited Liability Partnership Act, 2008 shall also be eligible to be elected as a member of a stock exchange if, -
  - (i) such LLP undertaked to comply with such financial requirements and norms as may be provided by SEBI for registration of such LLP under Section 12(1) of SEBI Act, 1992;
  - (ii) the designated partners of LLP are not disqualified from being members of a stock exchange under sub-rule(1) [except clauses (b) and (f) thereof] or sub-rule (3) [except clause (a) and clause (f) thereof] and the designated partners of LLP had not held the offices of Directors in any company or body corporate or partner in any firm or LLP, which had been a member of a stock exchange and had been declared defaulter or expelled by the stock exchange; and
  - (iii) not less than two designated partners of the LLP are persons who possess a minimum experience of two years in -
  - (a) dealing in securities or
  - (b) as portfolio managers or
  - (c) as investement consultants.
- Rule 8(7) - Any **provident fund represented by its trustees**, of an exempted establishement under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Withdrawal of Recognition (Section 5)

Serving of notice for withdrawal of recognition: Section 5(1) states that if the Central Government/ SEBI is of the opinion that the recognition granted to a stock exchange, should, in the interest of the trade or in the public interest, be withdrawn, the Central Government or SEBI may serve on the governing body of the stock exchange, a written notice that the Central Government is considering the withdrawal of the recognition for the reasons stated in the notice and after giving an opportunity to the governing body to be heard in the matter, the Central Government may withdraw by notification in the Official Gazette, the recognition granted to the stock exchange.

Consequences of withdrawal: Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification similarly published for the due performance of any contracts outstanding on that date.

As per the Rule 13, the written notice for the withdrawal of recognition shall be in Form C.

When recognition granted stand to be withdrawn: Also, the Section 5(2) of the Act states that where the recognised stock has not been corporatized or demutualised or it fails to submit the scheme referred to in section 4B(1) within the specified time therefor or the scheme has been rejected by SEBI under section 4B(5), the recognition granted to such stock exchange under section 4, shall, stand withdrawn and the Central Government shall publish, by notification in the Official Gazette, such withdrawal of recognition.

Thus, it is clear from the above provisions that the SEBI's intent was to mandate that the existing stock exchanges should corporatize themselves for better administration and increased transparency of their working. For this, SEBI issued a circular SMD/POLICY/CIR3 on 30th January 2003, asking all the stock exchanges to submit a scheme within six months to implement the scheme. When the stock exchanges did not pay heed to the SEBI's circular, the Securities Contract (Regulations) Act, 1956 was amended in 2004 to compel the stock exchanges to corporatize and demutualise. Whichever stock exchange did not follow SEBI's directions, were considered to be inactive and ineligible for transactions.

Stock exchanges other than recognised stock exchanged prohibited (Section 19)

As per section 19 of the Act, no person shall organise or assist in organising or be a member of any stock exchange (other than a recognised stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities, except with the approval of Central Government or SEBI.

4. ADMINISTRATION OF STOCK EXCHANGES

Administration of Stock Exchanges		
	Section 6 - Power of CG/ SEBI to call for periodical returns or direct inquiries to be made; read with Rule 12, 14, 15, 16 & 17A	Section 7A - Power of recognised stock exchange to make rules restricting voting rights, etc.
		Section 8 - Power of CG/SEBI to direct rules to be made or to make rules
	Section 7 - Annual Reports to be furnished to CG by stock exchange read with Rule 17	Section 9 -Power of recognised stock exchange to make bye-laws
		Section 10 - Power of SEBI to make or amend bye-laws of recognised stock exchanges
		Section 11 - Power of CG/SEBI to supersede governing body of a recognised stock exchange
	Section 12 - Power to suspend business of recognised stock exchange	Section 12A - Power to issue directions

The recognised stock exchanges are bound to work in a prescribed manner. The Securities Contract (Regulation) Rules, 1957 state that every stock exchange is required to follow the following rules –

- Rule 12 – Audit of account of members –
  - The corresponding rule states that every member shall get his accounts audited by a Chartered Accountant whenever such audit is required by SEBI.
- Rule 14 – Books of Account and other documents to be maintained and preserved by every stock exchange –
  - It states that every recognised stock exchange shall maintain and preserve the following books of account and documents for a period of **5 years** –
    - Minute books of the meetings of –
      - ✓ Members;
      - ✓ Governing body
      - ✓ Any standing committee or committees of the governing body or of the general body of members.
    - Register of members showing their full names and addresses. Where any member of the stock exchange is a firm, full names and addresses of all partners shall be shown.
    - Register of authorised clerks

- Register of remisiers of authorised assistants
- Record of security deposits
- Margin deposits book
- Ledgers
- Journals
- Cash book
- Bank pass-book.

- Rule 15 – Books of Account and other documents to be maintained and preserved by **every member** of the recognised stock exchange –
  - Books of account to be maintained and preserved by the members for **5 years** –
    - Register of transactions (Sauda Book)
    - Clients' ledger
    - General ledger
    - Journals
    - Cash Book
    - Bank pass-book
    - Documents register showing full particulars of shares and securities received and delivered.
  - Books of account to be maintained and preserved for a period of **two years** –
    - Members' contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members;
    - Counterfoils or duplicates of contract notes issued to clients.
    - Written consent of clients in respect of contracts entered into as principals.
    - The provisions of the Act state that the Central Government or SEBI has certain powers which it can exercise on the working of recognised stock exchanges. Let us discuss these provisions in detail –

Periodical Returns and inquiries (Section 6)

- **Furnishing of periodical returns relating to its affairs by every recognised stock exchange:** Section 6 (1) read with Rule 17A states that it is the responsibility of every

recognised stock exchange to furnish periodical return to Central Government or SEBI relating to –

- The official rates for the securities enlisted thereon;
- The number of shares delivered through the clearing house;
- The making-up prices;
- The clearing house programmes;
- The number of securities listed and de-listed during the previous 3 months;
- The number of securities brought on or removed from the forward list during the previous 3 months; and
- Any other matter as may be specified by the Securities and Exchange Board of India.

- **Maintenance and inspection of books of accounts:** The responsibility of the recognised stock exchanges to maintain and preserve the books of accounts, as discussed in Rule 14 & 15 as mentioned above, and that such documents and books of account shall be subject to inspection at all reasonable times by SEBI. [Section 6(2)]
- **Order passed:** Section 6(3) read with Rule 16, positions that the SEBI may, in the interest of trade or public interest, issue an order to –
  - Call upon a recognised stock exchange or any member thereof to furnish in writing such information or explanation relating to the affairs of the stock exchange or of the members in relation to the stock exchanges as SEBI may require; or
  - Appoint one or more persons to make an inquiry in the prescribed manner in Rule 16, in relation to the –
    - affair of the governing body of a stock exchange or
    - the affairs of any of the members of the stock exchange in relation to the stock exchange

    submit a report of the result of such inquiry to SEBI within such time as prescribed in Rule 16 or, in the case of an inquiry in relation to the affairs of any of the members of a stock exchange, direct the governing body to make the inquiry and submit its report to SEBI.
- **Production of the Book of accounts & documents:** The provisions of Section 6(4) also state that where an inquiry in relation to the affairs of the stock exchange or the affairs of any of its members in relation to the stock exchange has been undertaken under sub-section (3) –
  - Every director, manager, secretary, or other officer of such stock exchange;
  - Every member of such stock exchange;

- If the members of the stock exchange is a firm, every partner, manager, secretary or other officer of the firm; and
- Every other person or body of persons who has had dealings in the course of business with any of the persons mentioned in clause (a), (b) and (c), whether directly or indirectly,

Shall be bound to produce before the authority making the inquiry all such books of account, and other documents in his custody or power relating to or having a bearing on the subject-matter of such inquiry and also to furnish the authorities within such time as may be specified with any such statement or information relating thereto as may be required of him.

Annual Reports to be furnished to CG by stock exchanges (Section 7)

The provision states that every recognised stock exchange shall furnish a copy of the annual report to the Central Government which shall contain the particulars as prescribed in Rule 17 of the Securities Contract (Regulation) Rules, 1957. The said rules position that –

Every recognised stock exchange shall before the 31st day of January in each year or within such extended time as the SEBI may from time-to-time allow, furnish an annual report to SEBI about its activities during the preceding calendar year, which shall *inter alia* contain detailed information about the following matters –

- Changes in the rules and bye-laws, if any;
- Changes in the composition of the governing body;
- Any new sub-committees set up and changes in the composition of existing ones;
- Admissions, re-admissions, deaths or resignations of members;
- Disciplinary action against members;
- Arbitration of disputes (nature and number) between members and non-members;
- Defaults
- Action taken to combat any emergency in trade;
- Securities listed and de-listed; and
- Securities brought on or removed from the forward list.

Further, every recognised stock exchange shall within 1 month of the date of the holding of its annual general meeting, furnish the SEBI with a copy of its audited balance-sheet and profit and loss account for its preceding financial year.

Restriction of voting rights by stock exchanges (Section 7A)

The provisions of the Act state that the recognised stock exchange has the power to make rules or amend its rules to provide for –

(a) The restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting;

(b) The regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange;

(c) The restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange;

(d) Such incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified in clause (a), (b) and (c).

In case the recognised stock exchange wishes to amend the rules, in relation to the above clauses, it must take the approval of Central Government.

Powers of Central Government or SEBI

Power of Central Government/SEBI to direct rules to be made or to make rules of the Stock Exchange (Section 8)

- The Central Government may, after consultation with the governing bodies of stock exchanges, form an opinion that it is necessary or expedient so to do, direct any recognised stock exchange by order in writing, to make or amend any rules already made in respect of all or any of the matters specified in Section 3(2) within a period of 2 months from the date of the order.
- If the recognised stock exchange does not comply with the order of the CG/SEBI, the latter may make the rules for, or amend the rules made by the recognised stock exchange, either in the form proposed in the order or with such modifications thereof as may be agreed to between the stock exchange and Central Government.

Clearing Corporation (Section 8A)

Let us first understand the concept of a clearing corporation. It is an organisation associated with a stock exchange to handle the confirmation, settlement and delivery of transactions, fulfilling the main obligation of ensuring transactions are made in a prompt and efficient manner.

Transfer of duties & functions of a clearing house with prior approval of SEBI: Section 8A of the Act states that a recognised stock exchange may, with the prior approval of SEBI, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated

under the Companies Act for the purpose of –

- The periodical settlement of contracts and differences thereunder;
- The delivery of, and payment for, securities;
- Any other matter incidental to, or connected with, such transfer.

Also, the clearing corporation shall transfer the duties of the clearing house to a clearing corporation, make bye- laws and submit the same to SEBI for its approval. SEBI may grant the approval to the bye-laws submitted to it, upon being satisfied that the same is in public interest.

Power of recognised stock exchange to make bye-laws (Section 9)

As per the provisions of this section, a recognised stock exchange may make bye-laws for the regulation and control of contracts, subject to prior approval of SEBI. The bye-laws may provide for–

- The opening and closing of markets and the regulation of the hours of the trade;
- A clearing house for the periodical settlement of contracts and differences thereunder, the delivery of and payment for securities, the passing on of delivery orders and the regulation and maintenance of such clearing house;
- The submission to SEBI by the clearing house as soon as may be after each periodical settlement of all or any of the following particulars as SEBI may from, time-to-time, namely–
    - The total number of each category of security carried over from one settlement period to another;
    - The total number of each category of security, contracts in respect of which have been squared up during the course of each settlement period;
    - The total number of each category of security actually delivered at each clearing;
- The publication by the clearing house of all or any of the particulars submitted to SEBI under the above mentioned clause subject to the directions, if any, issued by SEBI in this behalf;
- The regulation or prohibition of blank transfers;
- The number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house;
- The regulation, or prohibition of budlas or carry-over facilities;
- The fixing, altering or postponing of days for settlements;
- The determination and declaration of market rates, including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing;
- The regulation of the entering into, making, performance, rescission and termination, of contracts, including contracts between members or between a member and his constituent

or between a member and a person who is not a person, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts;

- The regulation of taravani business including the placing of limitations thereon;
- The listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and suspension or withdrawal of any such securities, and the suspension or prohibition of trading in any specified securities;
- The method and procedure for the settlement of claims or disputes, including settlement by arbitration;
- The levy and recovery of fees, fines and penalties;
- The regulation of the course of business between parties to contracts in any capacity;
- The fixing of scale of brokerage and other charges;
- The making, comparing, settling and closing of bargains;
- The emergencies in trade which may arise, whether as a result of pool or syndicated operations or cornering or otherwise, and the exercise of powers in such emergencies, including the power to fix maximum and minimum prices for securities;
- The regulation of dealings by members for their own accounts;
- The separation of the functions of jobbers and brokers;
- The limitations on the volume of trade done by any individual member in exceptional circumstances;
- The obligation of members to supply such information or explanation and to produce such documents relating to the business as the governing body may require.

The stock exchange may specify the bye-laws for which there may be a consequence for contravention which may be –

- Fine;
- Expulsion from membership;
- Suspension from membership for a specified period;
- Any other penalty of a like nature not involving the payment of money.

Power to make or amend bye-laws of recognised stock exchange (Section 10)

The Central Government or SEBI are entrusted with the power to make or amend the bye-laws of the recognised stock exchange, either on its own or on behalf of a request received by it in writing. Such an

amendment in the bye-laws of the stock exchange shall be published in Official Gazette of India and Official Gazette of State in which the principal office of the recognised stock exchange is situated.

In case the governing body of the stock exchange, objects to the amendment of bye-laws, directed by SEBI on its own, then it may apply to SEBI within 2 months of the publication in Gazette of India; and SEBI may make a revision to such an amendment after giving an opportunity to be heard to the governing body of such stock exchange.

The making or the amendment or revision of any bye-laws under this section shall in all cases be subject to the condition of previous publication – provided that if SEBI is satisfied in any case that in the interest of the trade or in the public interest any bye-laws should be made, amended or revised immediately, it may, by order in writing specifying the reasons therefor, dispense with the condition of previous publication.

Power to supersede the governing body of a recognised stock exchange (Section 11)

If the Central Government is of the opinion that the governing body of any recognised stock exchange should be superseded, then CG may serve a notice to the governing body of such stock exchange and may appoint any person or persons to exercise and perform all the powers and duties of the governing body, to act as the Chairman and vice-chairman thereof.

Power to suspend business of recognised stock exchange (Section 12)

If the Central Government opines that an emergency has arisen and for the purpose of meeting the emergency, the Central Government considers it expedient so to do, it may, by notification in the Official Gazette direct a recognised stock exchange to suspend such of its business for a period not exceeding 7 days and subject to the conditions as may be specified in the notification. Central Government may also extend the period of notification, if it is so considered in the interest of trade or public interest.

Power to issue directions (Section 12A)

(1) If, after making or causing to be made an inquiry, SEBI is satisfied that it is necessary in the interest of the investors or orderly development of securities market; or to prevent the affairs of any recognised stock exchange or clearing corporation, or such other agency or person, providing trading or clearing or settlement facility in respect of securities, being conducted in a manner detrimental to the interests of investors or securities market; or to secure the proper management of any such stock exchange or clearing corporation or agency or person; it may issue such directions-

- To any stock exchange or clearing corporation or agency or persons referred to in above; or
- To any company whose securities are listed or proposed to be listed in a recognised stock exchange

as may be appropriate in the interests of investors in securities and the securities market.

[1](2) Without prejudice to the provisions of sub-section (1) and section 23-I, the Securities and Exchange Board of India may, by an order, for reasons to be recorded in writing, levy penalty under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G, 23GA and 23H after holding an inquiry in the prescribed manner.

5. CONTRACTS AND OPTIONS IN SECURITIES

Contracts in notified areas illegal in certain circumstances (Section 13)

If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or States or area that it is necessary so to do, it may, by notification in the Official Gazette, declared this section to apply to such State or States or area, and thereupon every contract in such state or States or area which is entered into after the date of the notification otherwise than between members of a recognised stock exchange or recognised stock exchanges in such State or States or area or through or with such member shall be illegal.

However, where any contract entered into between members of two or more recognised stock exchanges in such State or States or area, shall—

(i) be subject to such terms and conditions as may be stipulated by the respective stock exchanges with prior approval of Securities and Exchange Board of India;

(ii) require prior permission from the respective stock exchanges if so stipulated by the stock exchanges with prior approval of Securities and Exchange Board of India.

Additional Trading Floor (Section 13A)

In simple terms, a trading floor is an area on exchange where trading occurs. Trading floors can be found in the various buildings of Bombay Stock Exchange, National Stock Exchange, etc. However with the advent of electronic trading platforms, many of the trading floors that once dominated the market exchanges, have started to disappear since trading has become more electronically based. Additional trading floor means a trading ring or a trading facility offered by a recognised stock exchange outside its area of operating to enable the investors to buy and sell securities through such trading floor under the regulatory framework of that stock exchange. Therefore now, the trading floors can also be found in brokerages, investment banks and other companies involved in trading activities.

According to section, a stock exchange may establish additional trading floor with the prior approval of the SEBI in accordance with the terms and conditions stipulated by the said Board.

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[1] Sub-section (2) inserted by the Finance Act, 2018, w.e.f. **8-3-2019**

Contracts in notified areas to be void in certain circumstances [Section 14]

(1) Any contract entered into in any State or area specified in the notification under section 13 which is in contravention of any of the bye-laws specified under section 9(3)(a) shall be void :

(i) **as respects the rights of any member of the recognised stock exchange** who has entered into such contract in contravention of any such bye-law, and also

(ii) **as respects the rights of any other person** who has knowingly participated in the transaction entailing such contravention.

(2) The right of any person other than a member of the recognised stock exchange shall not be effected, to enforce any such contract or to recover any sum under or in respect of such contract if such person had no knowledge that the transaction was in contravention of any of the bye-laws specified in section 9(3)(a).

Members may not act as principals in certain circumstances (Section 15)

- **Restrictions on the members on entering into contract:** According to section 15 of the Act, no member of a recognised stock exchange shall enter into any contract as a principal with any person, other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses the same in the note, memorandum or agreement of sale or purchase that he is acting as a principal.
- However, where the member has secured the consent or authority of such person, otherwise than in writing, he shall secure written confirmation by such person or such consent or authority ***within 3 days*** from the date of contract.
- **When no written consent/authority is necessary:** Also, no such written consent or authority of such person shall be necessary for closing out any outstanding contract entered into by such persons in accordance with the bye-laws, if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as a principal.

Contracts in Derivatives [(Section 18A)]

The provisions of the Act state that contracts in derivative shall be legal and valid if such contracts are–

- Traded on a recognised stock exchange;
- Settled on the clearing house of the recognised stock exchange in accordance with the rules and bye-laws of such stock exchange;
- Between such parties and on such terms as the CG may, by notification in the Official Gazette, specify.

Power to prohibit contracts in certain cases (Section 16)

In case the Central Government or SEBI opines that it is necessary to prevent undesirable speculation in specified securities in any State or area, it may, by notification in the Official Gazette, declare that no person in the State or area, may enter into a contract for the sale or purchase of any security specified in the notification, except with the permission of Central Government or SEBI. All the contracts entered into, in contravention of the provisions of this section shall be illegal after the date of notification.

Licensing of dealers in securities in certain areas (Section 17)

The provisions of this section state that no person shall carry on or purport to carry on, whether on his own or on behalf of any other person, the business of dealing in securities, except under the authority of a licence granted by SEBI in this behalf.

Public issue and listing of securities referred to in Section 2(h)(ie) (Section 17A)

- No securities of the nature referred to in Section 2(h)(ie) shall be offered to the public or listed on any recognised stock exchange unless the issuer fulfils such eligibility criteria and complies with such other requirements as may be specified by regulations made by SEBI.
- Every issuer referred to in Section 2(h)(ie), who is intending to offer the certificates or instruments referred therein to the public shall make an application to one or more recognised stock exchange, for permission for such certificates or instruments to be listed on the stock exchange or each such stock exchange, before issuing the offer document to public.
- Where the issuer does not get the required permission by the recognised stock exchange, he shall repay all the money received from the applicants in pursuance of the offer document, and if such money is not repaid within 8 days after the issuer becomes liable to repay it, then the issuer and every director or trustee thereof, who is in default shall be jointly and severally liable to repay that money with interest at the rate of 15 per cent per annum, on and after the expiry of 8th day.

6. INVESTORS' RIGHTS RELATING TO DIVIDEND, INCOME FROM COLLECTIVE INVESTMENT SCHEME & MUTUAL FUNDS

Title to Dividends (Section 27)

It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with

the company for being registered in his name within fifteen days of the date on which the dividend became due.

The said period shall be extended –

- In case of death of the transferee, by the actual period taken by his legal representative to establish his claim to dividend;
- In case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
- In case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

Nothing shall affect –

- The right of the company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the Company as the holder of security in respect of which the dividend has become due; or
- The right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

Right to receive income from Collective Investment Scheme (Section 27A)

It shall be lawful for the holder of any securities, being units or other instruments issued by the collective investment scheme, whose name appears on the books of the collective investment scheme issuing the said security to receive and retain any income in respect of units or other instruments issued by the collective investment scheme declared by the collective investment scheme in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the collective investment scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the collective investment scheme from the transfer or has lodged the security and all other documents relating to the transfer which may be required by the collective investment scheme with the collective investment scheme for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the collective investment scheme became due. **[Sub-section (1)]**

Explanation: The period specified in this section shall be extended—

(i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income respect of units or other instrument issued by collective investment scheme;

(ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and

(iii) in case of delay in the lodging of any security, being units or other instruments issued by the collective investment scheme and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

Nothing contained in sub-section (1) shall affect—

(a) the right of a collective investment scheme to pay any income from units or other instruments issued by collective investment scheme which has become due to any person whose name is for the time being registered in the books of the collective investment scheme as the holder of the security being units or other instruments issued by collective investment scheme in respect of which the income in respect of units or other instruments issued by collective scheme has become due; or

(b) the right of transferee of any security, being units or other instruments issued by collective investment scheme, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security being units or other instruments issued by the collective investment scheme in the name of the transferee.

Right to receive income from Mutual Fund (Section 27B)

It shall be lawful for the holder of any securities, being units or other instruments issued by any mutual fund, whose name appears on the books of the mutual fund issuing the said security to receive and retain any income in respect of units or other instruments issued by the mutual fund declared by the mutual fund in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the mutual fund, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the mutual fund from the transferor has lodged the security and all other documents relating to the transfer which may be required by the mutual fund with the mutual fund for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the mutual fund became due. **[Sub-section (1)]**

Explanation. The period specified in this section shall be extended –

(i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instrument issued by the mutual fund;

(ii) in case of loss of the transfer deed by theft or any other cause beyond the control of transferee, by the actual period taken for the replacement thereof; and

(iii) in case of delay in the lodging of any security, being units or other instruments issued by the mutual fund, and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

Nothing contained in sub-section (1) shall affect-

(a) the right of a mutual fund to pay any income from units or other instruments issued by the mutual fund which has become due to any person whose name is for the time being registered in the books of the mutual fund as the holder of the security being units or other instruments issued by the mutual fund in respect of which the income in respect of units or other instruments issued by mutual fund has become due; or

(b) the right of transferee of any security, being units or other instruments issued by the mutual fund, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the mutual fund has refused to register the transfer of the security being units or other instruments issued by the mutual fund in the name of the transferee."

7. LISTING OF SECURITIES

The Act details the provisions relating to listing of securities with the recognised stock exchanges. Before we get into the depth of the provisions, let us first understand as to what is meant by Listing of Securities.

Listing means taking into admission the securities of any company to dealings on a recognised stock exchange. The Supreme Court held in the matter of *Raymond Synthetic Limited v. Union of India* that the principal objectives of listing are to provide ready marketability and impart liquidity and free negotiability to stocks and shares and protect the interest of shareholders and of the general investing public.

The Supreme Court in the said case held that the public limited company has no obligation to have its shares listed on a recognised stock exchange; however, if the company intends to offer its shares or debentures to the public for subscription by the issue of a prospectus, it must before issuing such prospectus, apply to one or more recognised stock exchanges for permission to have the shares or debentures intended to be so offered to the public to be dealt with each such stock exchange in terms of provisions of the Companies Act. The same has also been held in the case of *Union of India vs. Allied International Products Limited (1971).*

Conditions for listing of securities:

Comply with the listing agreement of the stock exchange

Read with Rule 20

Appeal to CG/SEBI: within 15 days of refusal to list the securities by the stock exchange

Appeal to Securities Appellate Tribunal:

within 15 days to one month of refusal by the stock exchange to list the securities

Conditions for listing (Section 21)

Where the securities are listed on the application of any person in any recognised stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange.

Requirements regarding initial listing/ listing of public issues of securities

A public limited company which is proposing to get its securities listed on a stock exchange, shall do so, by applying to the recognised stock exchange in the prescribed form of the concerned stock exchange and the listing application form shall be duly filled and signed with enclosures. The same should be sent to the stock exchange along with the following –

- Listing agreement duly executed and stamped on a non-judicial stamp paper of requisite value;
- Initial listing fees as prescribed.

The Securities Contract (Regulation) Rules, 1957 provide for the requirements which have to be satisfied by companies for the purpose of getting their securities listed on any stock exchange. A dispersed shareholding structure is essential for the sustenance of a continuous market for listed securities to provide liquidity to the investors and to discover the fair prices. Moreover, larger the number of shareholders, the less is the scope for price manipulation.

Rule 19(1) of the Securities Contracts (Regulations) Rules, 1957 prescribes the documents and particulars to be furnished by a public company while applying for listing its securities.

Delisting of securities (Section 21A)

A recognised stock exchange may delist the securities, after recording the reasons therefore, from any recognised stock exchange on any of the ground or grounds as may be prescribed under this Act. The securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard. A listed company or an aggrieved investor may file an appeal before the Securities Appellate Tribunal against the decision of the recognised stock exchange within fifteen days from the date of the decision.

The alleged grounds have been detailed in Rule 21 which are stated as follows –

(i) the company has incurred losses during the preceding 3 consecutive years and it has negative net-worth;

(ii) trading in securities of the company has remained suspended for a period of more than 6 months;

(iii) the securities of the company have remained infrequently traded during the preceding 3 years;

(iv) the company or any of its promoters or any of its director has been convicted for failure to comply with any of the provisions of the Act or SEBI Act, 1992, or Depositories Act, 1996 or

rules, regulations, agreements made thereunder, as the case may be and awarded a penalty of not less than one crore rupees or imprisonment of not less than 3 years;

(v) the addresses of the company or any of its promoter or any of its directors, are not known or false addresses have been furnished or the company has changed its registered office in contravention of the provisions of Companies Act; or

(vi) shareholding of the company held by the public has come below the minimum level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognised stock exchange.

Right of appeal against refusal of stock exchange to list securities of public companies (Section 22)

Where a recognised stock exchange acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any public company or collective investment scheme, the company or scheme shall be entitled to be furnished with reasons for refusal, and may –

(i) within 15 days from the date on which the reasons for such refusal are furnished to it, or

(ii) where the stock exchange has omitted or failed to dispose of, within the time specified in corresponding provisions of Companies Act, the application for permission for the shares or debentures to be dealt with on the stock exchange, within 15 days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Central Government may on sufficient cause being shown, allow,

appeal to Central Government against such refusal, omission or failure, as the case may be, and thereupon Central Government may, after giving the stock exchange an opportunity of being heard -

(i) vary or set aside the decision of the stock exchange, or

(ii) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission

and where the Central Government sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of Central Government.

Right of Securities Appellate Tribunal against refusal of stock exchange to list securities of public companies (Section 22A)

Furnishing of reasons for refusal: Where a recognised stock exchange, acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal, and may,—

(a) within **fifteen days** from the date on which the reasons for such refusal are furnished to it, or

(b) where the stock exchange has **omitted or failed to dispose of, within the time specified**, the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow, appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure. Thereupon the Securities Appellate Tribunal may, after giving the stock exchange, an opportunity of being heard,—

(i) vary or set aside the decision of the stock exchange; or

(ii) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission, and where the Securities Appellate Tribunal sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Securities Appellate Tribunal.

Sending of copy of order to the concerned parties: Every appeal shall be in such form and be accompanied by such fee as may be prescribed. The Securities Appellate Tribunal shall send a copy of every order made by it to the Board and parties to the appeal. The appeal filed before the Securities Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Procedures and Powers of Securities Appellate Tribunal (SAT) (Section 22B)

- SAT shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, SAT shall have the powers to regulate their own procedure including the places at which they shall have their sittings.
- SAT shall 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 –
  - Summoning and enforcing the attendance of any person and examining him on oath;
  - Requiring the discovery and production of documents;
  - Receiving evidence on affidavits;
  - Issuing commissions for the examination of witnesses or documents;
  - Reviewing its decisions;
  - dismissing an application for default or deciding it ex parte;
  - Setting aside any order of dismissal of any application for default or any order passed by it ex parte; and
  - Any other matter which may be prescribed.

Civil court not to have jurisdiction (Section 22E)

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Securities Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to Supreme Court (Section 22F)

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order. However, the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

8. PENALTIES & OFFENCES

Grounds for imposing penalties (Section 23)

Any person who—

(a) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or

(b) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or

(c) contravenes the provisions contained in section 17, or section 19; or

(d) enters into any contract in derivative in contravention of section 18A or the rules made under section 30;

(e) owns or keeps a place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or

(f) manages, controls, or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or

(g) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 wilfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or

(h) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other persons for any business connected with contracts in contravention of any of the provisions of this Act; or

(i) joins, gathers or assists in gathering at any place other than the place of business specified in the bye-laws of a recognised stock exchange any person or persons for making bids or offers or for entering into or performing any contracts in contravention of any of the provisions of this Act;

shall, without prejudice to any award of penalty by the Adjudicating [2]Officer or the Securities and Exchange Board of India under this Act, on conviction, be punishable with **imprisonment** for a term which may extend to **ten years** or with **fine**, which may extend to **twenty-five crore rupees**, or with both.

Any person who enters into any contract in contravention of the provisions contained in section 15 or who fails to comply with the provisions of section 21 or section 21A or with the orders of or section 22 or with the orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

Other Grounds for Imposing Penalties –

Section	Contravention	Penalty
23A(a)	Any person who fails to furnish any information, document, books, returns or report to a recognised stock exchange within the time specified in the listing agreement or conditions or bye-laws of the stock exchange [3]or who furnishes false, incorrect or incomplete information, document, books, return or report	Fine of at least INR 1,00,000 but may extend to INR 1,00,000 per day during which such failure continues, subject to a maximum of INR 1 crore.
23A(b)	Any person who fails to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange	Fine of at least INR 1,00,000 but may extend to INR 1,00,000 per day during which such failure continues, subject to a maximum of INR 1 crore

[2] Inserted by the Finance Act, 2018, w.e.f. **8-3-2019**.
[3] Inserted by the Finance Act, 2018, w.e.f. **8-3-2019**.

23B	Any person who fails to enter into an agreement with clients	Fine of at least INR 1,00,000 but may extend to INR 1,00,000 per day during which such failure continues, subject to a maximum of INR 1 crore
23C	Failure by a stock broker or sub-broker or a listed company or proposed listed company to redress investors' grievances within the time stipulated by SEBI or recognised stock exchange	Fine of at least INR 1,00,000 but may extend to INR 1,00,000 per day during which such failure continues, subject to a maximum of INR 1 crore
23D	Failure to segregate securities or money of client or clients or using the securities or money of client for self-use or for any other client	At least INR 1,00,000 but may extend to INR 1 crore
23E	Failure to comply with the provisions of listing conditions or delisting conditions or grounds or breach thereof is committed, by a company or a person managing collective investment scheme or mutual fund or [4]real estate investment trust or infrastructure investment trust or alternative investment fund,	Liable for at least INR 5,00,000 which may extend to INR 25 crores
23F	If any issuer make an excess dematerialisation or delivery of unlisted securities	At least INR 5,00,000 which may extend to INR 25 crores
23G	Failure by recognised stock exchange to furnish periodical returns [5][or furnishes false, incorrect or incomplete periodical returns] to SEBI or fails or neglects to make or amend its rules or bye-laws as directed by SEBI or fails to comply with the directions of SEBI	At least INR 5,00,000 which may extend to INR 25 crores
[6]23GA	Where a stock exchange /a clearing corporation fails to conduct its business with its members / any issuer / its agent /any person associated with the securities markets	Penalty at least INR 5 crore which may extend to INR 25 crore rupees /three times the amount of gains made out of such failure,

[4] Inserted by the Finance Act, 2018, w.e.f. **8-3-2019**.
[5] Inserted by the Finance Act, 2018, w.e.f. **8-3-2019**
[6] Section 23GA inserted by the Finance Act, 2018, w.e.f. **8-3-2019**.

	in a manner not in accordance with the rules /regulations made by the SEBI and the directions issued by it under this Act, there such stock exchange / the clearing corporations, as the case may be, shall be liable.	whichever is higher.
23H	Whoever fails to comply with any provision of this Act, the rules or articles or bye-laws or the regulations of recognised stock exchange or directions issued by SEBI for which no separate penalty has been provided	At least INR 1,00,000 which may extend to INR 1 crores

Further, Section 23K states that all sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Procedure for imposing penalties –

Power to adjudicate (Section 23I)

- **Appointment of officer for adjudication:** For the purpose of adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G and 23H, the SEBI may[7] appoint any officer not below the rank of a Division Chief of the Securities and Exchange Board of India to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
- **Power of adjudicating officer:** While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.
- **Board powers to examine the records any proceedings:** The Board may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify. However, no such order shall be passed unless an opportunity of being heard has been given to the concerned person.

[7] Substituted for "shall" by the Finance Act, 2018, w.e.f. **8-3-2019**.

- **Limitation period to act under this section:** Also, nothing contained in this sub-section shall be applicable after an expiry of a period of 3 months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 23L, whichever is earlier.

[8]Factors to be taken into account by adjudging quantum of penalty (Section 23J)

While adjudging the quantum of penalty under [9][section 12A or section 23-I], [10] [the Securities and Exchange Board of India or the adjudicating officer] shall have due regard to the following factors, namely :—

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

Explanation.—For the removal of doubts, it is clarified that the power of an adjudicating officer to adjudge the quantum of penalty under sections 23A to 23C shall be and shall always be deemed to have exercised under the provisions of this section.

Settlement of administrative and civil proceedings (Section 23JA)

- Any person against whom any proceedings have been initiated or may be initiated under section 12A or section 23-I, may file an application in writing to SEBI proposing for settlement of the proceedings initiated for the alleged defaults.
- SEBI may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by SEBI.
- For the purposes of settlement under this section, the procedure as specified by the Board under the Securities and Exchange Board of India Act, 1992 (15 of 1992) shall apply.
- No appeal shall lie under section 23L against any order passed by the Board or the adjudicating officer, as the case may be, under this section.
- [11]All settlement amounts, excluding the disgorgement amount and legal costs, realised under this Act shall be credited to the Consolidated Fund of India

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[8] Substituted for "Factors to be taken into account by the adjudicating officer" by the Finance Act, 2018, w.e.f. **8-3-2019**.
[9] Substituted for "section 23-I" by the adjudicating officer" by the Finance Act, 2018, w.e.f. **8-3-2019**
[10] Substituted for "the adjudicating officer" by the adjudicating officer" by the Finance Act, 2018, w.e.f. **8-3-2019**.
[11] Sub-section (5) inserted by the Finance Act, 2018, w.e.f. **8-3-2019**

Recovery of amounts (Section 23JB)

- If a person fails to pay the penalty imposed [12]under this Act / fails to comply with a direction of disgorgement order issued under section 12A / fails to pay any fees due to the Board- the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more modes.

Modes of recovery				
attachment & sale of movable property;	attachment of the bank accounts;	attachment and sale of immovable property;	arrest & detention of the person in prison;	appointing a receiver for the management of the movable and immovable properties,

For the purposes of this sub-section, the person's movable or immovable property or monies held in bank accounts shall include any property or monies held in bank accounts which has been transferred, directly or indirectly on or after the date when the amount specified in certificate had become due, by the person to his spouse or minor child or son's wife or son's minor child, otherwise than for adequate consideration, and which is held by, or stands in the name of, any of the persons aforesaid; and so far as the movable or immovable property or monies held in bank accounts so transferred to his minor child or his son's minor child is concerned, it shall, even after the date of attainment of majority by such minor child or son's minor child, as the case may be, continue to be included in the person's movable or immovable property or monies held in bank accounts for recovering any amount due from the person under this Act.

- Shall be empowered to seek the assistance of the local district administration while exercising the above powers.
- The recovery of amounts by a Recovery Officer pursuant to non-compliance with any direction issued by the Board under section 12A, shall have precedence over any other claim against such person.
- The expression "Recovery Officer" here means any officer of the Board who may be authorised, by general or special order in writing to exercise the powers of a Recovery Officer.

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[12] Substituted for "by the adjudicating officer" by the Finance Act, 2018, w.e.f. **8-3-2019**.

[13]Continuance of proceedings (Section 23JC)

When Legal representative is liable: Where a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable to pay, if he had not died, in the like manner and to the same extent as the deceased:

Provided that, in case of any penalty payable under this Act, a legal representative shall be liable only in case the penalty has been imposed before the death of the deceased person.

(a) any proceeding **for disgorgement, refund or an action for recovery before the Recovery Officer under this Act**, except a proceeding for levy of penalty, initiated against the deceased before his death shall be deemed to have been initiated against the legal representative, and may be continued against the legal representative from the stage at which it stood on the date of the death of the deceased and all the provisions of this Act shall apply accordingly;

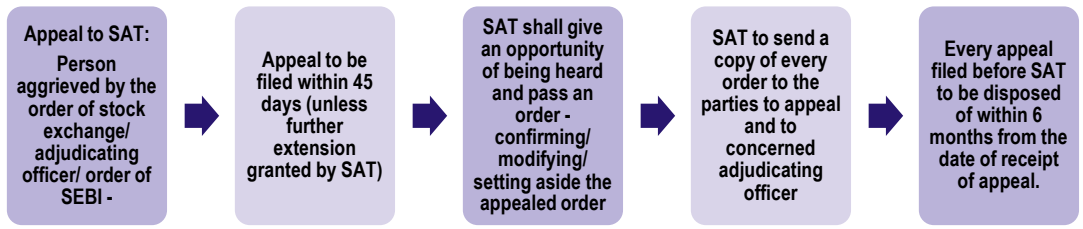
(b) any **proceeding for disgorgement, refund or an action for recovery before the Recovery Officer** under this Act, except a proceeding for levy of penalty, which could have been initiated against the deceased if he had survived, may be initiated against the legal representative and all the provisions of this Act shall apply accordingly.

Quantum of liability of Legal representative: Every legal representative shall be personally liable for any sum payable by him in his capacity as legal representative if, while his liability for such sum remains undischarged, he creates a charge on or disposes of or parts with any assets of the estate of the deceased, which are in, or may come into, his possession, but such liability shall be limited to the value of the asset so charged, disposed of or parted with.

The liability of a legal representative under this section shall, be limited to the extent to which the estate of the deceased is capable of meeting the liability.

Explanation.—For the purposes of this section "Legal representative" means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased and where a party sues or issued in a representative character, the person on whom the estate devolves on the death of the party so suing or sued.

Appeal to Securities Appellate Tribunal (Section 23L)



[13] Section 23JC inserted by the Finance Act, 2018, w.e.f. **8-3-2019**.

Establishment of Special Courts (Section 26A)

- The section has been inserted by the Securities Laws (Amendment) Act, 2014, with retrospective effect from 18th July 2013, and states that the for the purpose of providing speedy trial of offences under this Act, by notification establish or designate as many Special Courts as may be necessary.
- A Special Court shall consist of a single judge who shall be appointed by Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.
- A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.
- All the offences under this Act, committed prior to the date of commencement of the Securities Laws (Amendment) Act, 2014 or on or after the date of such commencement, shall be taken cognizance of and tried by the Special Court.
- The provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and the person conducting prosecution before the Special Court shall be deemed to be a Public Prosecutor within the meaning of Section 2(u) of the Code of Criminal Procedure, 1973.

Appeal and Revision (Section 26C)

- The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

Offences (Section 23M)

- If any person **contravenes**, or attempts to contravene, or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws, for which **no punishment is provided elsewhere in this Act**, he shall be punishable with imprisonment for a term which may extend to **10 years** or with fine, which may extend to INR **25 crores**, or with both.
- If any person **fails to pay the penalty** imposed by the adjudicating officer [14]or the Securities and Exchange Board of India or fails to comply with [15]the direction or order, he shall be punishable with imprisonment for a term which shall not be less than **1 month but which may extend to 10 years,** or **with fine which may extend to INR 25 crores**, or with both.

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[14] Inserted by the Finance Act, 2018, w.e.f. **8-3-2019**.
[15] Substituted for "any of his direction or orders" by the Finance Act, 2018, w.e.f. **8-3-2019**.

Composition of certain offences (Section 23N)

- Any offence punishable under this Act, not being an offence punishable 'with imprisonment' only, or 'with imprisonment and also with fine' may either before or after the institution of any proceeding, be compounded by SAT or a court before which such proceedings are pending.

[16]Contravention by companies (Section 24)

(1) Where a contravention of any of the provisions of this Act or any rule, regulation, direction or order made thereunder has been committed by a company-

- **every person** who, at the time when the contravention was committed, was in charge of, and was 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 contravention,

shall be liable to be proceeded against and punished accordingly .

Exception: No above person shall be liable to any punishment provided in this Act, if he proves that the contravention was committed without his knowledge or that he exercised all due diligence to prevent the commission of such contravention

(2) Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or any rule, regulation, direction or order made thereunder has been committed by a company and it is proved that the contravention has been committed with the consent or connivance of, or is attributable to any gross negligence on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer of the company, shall also be deemed to be guilty of that contravention and shall be liable to be proceeded against and punished accordingly.

Explanation.—For the purpose of this section,—

(a) "company" means any body corporate and includes a firm or other association of individuals, and

(b) "director", in relation to—

(i) firm, means a partner in the firm;

(ii) any association of persons or a body of individuals, means any member controlling the affairs thereof.

(3) The provisions of this section shall be in addition to, and not in derogation of, the provisions of section 22A.

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[16] Substituted for "Offences by companies" by the Finance Act, 2018, w.e.f. **8-3-2019**.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. P Ltd. was holding 35% of the paid up equity capital of X Stock Exchange. The company appoints M Ltd. as its proxy who is not a member of the X Stock Exchange, to attend and vote at the meeting of the stock exchange. State the correct statement as to the appointment of M Ltd. as a proxy for P Ltd. and on the voting rights of P Ltd. in the X Stock Exchange:

   (a) X Stock Exchange can restrict the appointment of M Ltd., as proxy, and voting rights of P Ltd. in the Stock Exchange.

   (b) Central Government can restrict appointment of proxies and voting rights of P Ltd. in the X Stock Exchange.

   (c) Both (a) & (b)

   (d) X Stock Exchange can also restrict the voting rights of P Ltd. if rules of the exchange so provides. Otherwise can restrict the voting rights of P Ltd. & appointment of proxies through amendment in rules.

2. Which of the contracts in derivative are not legal:

   (a) Contracts which are traded on a recognised stock exchange

   (b) Contracts which are Settled on the clearing house of the recognised stock exchange in accordance with the rules and bye-laws of such stock exchange;

   (c) Contracts which are recognized as per the notification issued by the Central Government

   (d) Contracts which are between such parties and on such terms as the CG may, by notification in the Official Gazette, specify.

3. SEBI ordered DSE, to produce their books of accounts and audited financial statements for the period 1st April 2016 to 31st March 2018 within 30 days of the receipt of the communication by the stock exchange. The communication was received by the company on 30th April 2018 and no documents were furnished to SEBI in reply to the notice till 15th May 2018. State the consequences of not supplying the said documents to SEBI:

   (a) Period of submission of said documents may be condoned on reasonable grounds.

   (b) Show cause notice may be served why DSE not be penalized for not submitting of the documents within the time limit.

   (c) DSE shall be punishable with a fine.

   (d) DSE shall be punishable with fine and imprisonment.

Descriptive Questions

Question 1

Ms. Ashmita D'Souza recently graduated from National Law School, Bangalore and made her parents proud. While working on one of her assignments, she got really interested in knowing about the securities and gained expertise in the day-to-day working of financial markets. Meanwhile, her father got a wonderful opportunity at work to move to Germany and the whole family is very excited to make the move and settle there. Ashmita, along with her family applied for residence there and also gained the citizenship of Germany. She got married to a German, named Vincent, and they both came to India to start a career. After working with Ashmita on a couple of assignments, Vincent got interested to become a member of the Madras Stock Exchange, Chennai. Discuss, whether Vincent or Ashmita can become a member of the stock exchange, stating the provisions of Securities Contract Regulations in India.

Question 2

Shitiza has recently started her articleship with a reputed CA firm. Her first assignment involves understanding the working of stock exchange and the transactions related thereto. Since she is a part of your team, your manager has assigned you with the responsibility to make sure that Shubhangi is aware of the basic terms relating to securities market. In view of the Securities Contract (Regulation) Act, 1956, brief your teammate about the following terms -

a. *Option in securities*

b. *Spot delivery contracts*

c. *Ready delivery contract*

d. *Derivative*

Question 3

Upon complaints been received by SEBI, regarding the listed securities of Blue Rock Limited at the Guwahati Stock Exchange, SEBI has passed an order to delist the securities of the company from the said stock exchange. Blue Rock Limited is aggrieved by the order of the SEBI. Advise the company on the further step that the company can take against the order of SEBI to delist the securities.

Question 4

What is the right of any person to receive the income from collective investment scheme?

Question 5

SEBI has asked Jaipur Stock Exchange to furnish their books of accounts and audited financial statements for the period 1st April 2015 to 31st March 2017 within 30 days of the receipt of the communication by the stock exchange. The communication was received by the company on 30th

April 2017 and no documents were furnished to SEBI in reply to the notice till 15th May 2017. Can the stock exchange be penalised for this inaction?

ANSWERS/SOLUTION

Answers to MCQ

1. **(d)** **Hint:** Section 7(A) of the Securities (Contracts) Regulation Act, 1956 provides that a recognised stock exchange is empowered to amend rules to provide for all or any of the following matters:

(i) Restriction of voting right to members only.

(ii) Regulation of voting rights by specifying that each member is entitled to one vote only irrespective of number of shares held.

(iii) Restriction on right of members to appoint proxy.

As such X Stock Exchange can restrict the appointment of M Ltd., as proxy, if rules of the exchange so provide. If it is not so provided, rules may be amended and after getting approval of the Central Government regarding amendment, it can restrict appointment of proxies.

X Stock Exchange can also restrict the voting rights of P Ltd. if rules of the exchange so provide. If it is not so provided, rules maybe amended and after getting approval of Central Government regarding amendment, it can restrict the voting rights of P Ltd. and appointment of proxies.

2. **(c)** **Hint:** Contracts in Derivatives (Section 18A of SCRA, 1956)

3. **(c)** **Hint:** As per section 23A(a) of the Securities Contract (Regulation) Act, 1956, if any person fails to furnish any information, document, books, returns or report to a recognised stock exchange within the time specified in the listing agreement or conditions or bye-laws of the stock exchange, he shall punishable with a fine of at least one lakh rupees which may extend to one lakh rupees per day during which such failure continues, subject to a maximum of one crore rupees. Thus, DSE shall be liable to the afore-mentioned penalty under section 23A(a) of the Act.

Answers to Descriptive Questions

1. Rule 8 of the Securities Contract (Regulations) Rules, 1957 details the qualifications for becoming the member of a recognised stock exchange. In this regard, Rule 8(3) prescribes the persons that can be admitted as the members of the recognised stock exchange and mentions that no person who is a member at the time of application for recognition or subsequently admitted as a member if he ceases to be a citizen of India. Thus, Ashmita

cannot become the member of the Chennai Stock Exchange since she ceased to be a citizen of India, as she has gained the citizenship of Germany.

In view of the facts given in the case study above, it is clear that Vincent is not a citizen of India. Therefore, as per Rule 8(1) of the Securities Contracts (Regulations) Rules, 2014, he cannot be elected as the member of the recognised stock exchange since he is not a citizen of India. However, the governing body of the Chennai Stock Exchange may take the prior approval of SEBI, in case they are interested in electing Vincent as a member of the stock exchange.

2. **(a)** **Option in securities**: As per section 2(d) of the Securities Contract (Regulation) Act, 1956, option means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a *teji, a mandi, a teji mandi, a galli*, a put, a call or a put and a call in securities. Options are contracts, through which a seller giver the buyer, a right, but not the obligation, to buy or sell a specified number of shares at a pre-determined price, within a set time period. These contracts are essentially derivatives, since they derive their value from an underlying security on which the option is based. With options, one can tailor his position according to his own situation and stock market outlook.

(b) **Spot delivery contracts:** Section 2(i) of the Securities Contract (Regulations) Act, 1956 describe spot delivery contracts to mean a contract which provides for –

(i) Actual delivery of securities and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;

(ii) Transfer of securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository."

(c) **Ready delivery contract:** Section 2(ea) of the Securities Contract (Regulation) Act, 1956 state the meaning of ready delivery contracts to mean a contract which provides for the delivery of goods and the payment of a price therefor, either immediately, or within such period not exceeding eleven days after the date of the contract and subject to such conditions as the Central Government may, by notification in the Official Gazette, specify in respect of any goods, the period under such contract not being capable of extension by the mutual consent of the parties thereto or otherwise:

Provided that where any such contract is performed either wholly or in part:

(i) By realisation of any sum of money being the difference between the contract rate and the settlement rate or clearing rate or the rate of any offsetting contract; or

(ii) By any other means whatsoever, and as a result of which the actual tendering of the goods covered by the contract or payment of the full price therefor is dispensed with, then such contract shall not be deemed to be a ready delivery contract.

Ready Delivery Contracts are also known as 'cash trading' or 'cash transactions' which are either settled on the same date or within a short period, upto eleven days. Under this, most of the sale and purchase transactions which the contracting parties is settled by paying for the goods immediately and the delivery of the goods take place instantly.

(d) **Derivative:** As per Section 2(ac) of the Securities Contract (Regulation) Act, 1956, derivatives include –

(i) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for difference or any other form if security;

(ii) a contract which derives its value from the prices, or index of prices, of underlying securities.

(iii) Commodity derivatives;

(iv) Such other instruments as may be declared by the Central Government to be derivatives"

3. As per the facts of the case given in the question above, the aggrieved company, i.e. Blue Rock Limited may appeal to the Securities Appellate Tribunal ('SAT') against the decision of SEBI within 45 days of date from which the order has been passed, unless further extension has been granted by SAT on reasonable grounds.

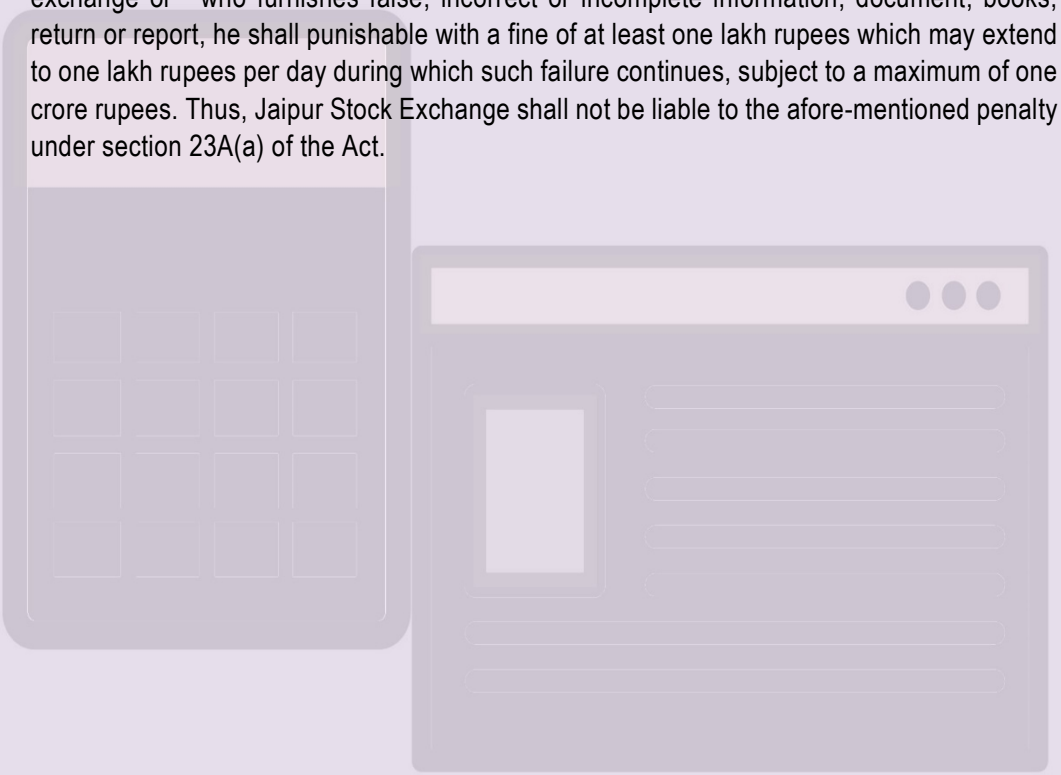
As per Section 23L, the Tribunal shall give an opportunity of being heard to the respondent and may pass the order confirming, modifying or setting aside the decision of SEBI.

SAT shall also send a copy of its order to every party to appeal and to the concerned adjudicating officer. Also, the company, Blue Rock Limited should be assured that a speedy decision shall be taken, since the Tribunal is required to dispose of every 6 months from the date of receipt of appeal.

4. Section 27A of the Securities Contract (Regulation) Act, 1956 sets out that It shall be lawful for the holder of any securities, being units or other instruments issued by the collective investment scheme, whose name appears on the books of the collective investment scheme

issuing the said security to receive and retain any income in respect of units or other instruments issued by the collective investment scheme declared by the collective investment scheme in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the collective investment scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the collective investment scheme from the transfer or has lodged the security and all other documents relating to the transfer which may be required by the collective investment scheme with the collective investment scheme for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the collective investment scheme became due.

5. As per section 23A(a) of the Securities Contract (Regulation) Act, 1956, if any person fails to furnish any information, document, books, returns or report to a recognised stock exchange within the time specified in the listing agreement or conditions or bye-laws of the stock exchange or [17]who furnishes false, incorrect or incomplete information, document, books, return or report, he shall punishable with a fine of at least one lakh rupees which may extend to one lakh rupees per day during which such failure continues, subject to a maximum of one crore rupees. Thus, Jaipur Stock Exchange shall not be liable to the afore-mentioned penalty under section 23A(a) of the Act.



[17] Inserted by the Finance Act, 2018, w.e.f. **8-3-2019**

CHAPTER 2

THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992

SEBI (LODR) REGULATIONS, 2015

LEARNING OUTCOMES

By the end of this chapter, students will be able to-

- Explain the role, powers and functions of the Securities and Exchange Board of India
- Identify how the SEBI regulates the capital markets in India under a resolution of the Government of India.
- Understand the prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control
- Know the penalties and adjudication and identify the establishment, jurisdiction, authority and procedure of Appellate Tribunal.
- Know about the significant regulations governed by the SEBI (LODR), Regulations, 2015.

1. INTRODUCTION

The Securities and Exchange Board of India was established in 1988. It got legal character in 1992. SEBI was primarily set up to regulate the activities of the merchant banks, to control the operations of mutual funds, to work as a regulator of the stock exchange activities and to act as a regulatory authority of new issue activities of companies. The reason the SEBI was constituted was because before the SEBI the law relating to the securities market in India was contained in different enactments like Companies Act, 1956, Securities Contract (Regulation) Act, 1956, and the Capital Issues (Control) Act, 1947. Then, at times when the capital market witnessed tremendous growth, it was found, that the legislation was scattered in different laws and administrative agencies did not have proper manpower or expertise to deal with the investors. Even there was no monitoring or prosecuting machinery to check malpractices, insider trading, etc. Then, Government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI). It was constituted on 12th April 1988 as an interim administrative body under the Finance Ministry. In April, 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India.

In the year of 1995, the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992.

The prime objective of the SEBI Act,1992 are:

1. Protecting the interests of the investors in securities;
2. Promoting the development of, and;
3. Regulating, the securities market and for matters connected therewith or incidental thereto.

SEBI as the watchdog of the industry has an important and crucial role in the market participants and crucial role in the market participants perform three duties in accordance with the regulatory norms. The preamble of the SEBI describes the basic functions of the SEBI as*'…to protect the interest of investors in the securities and to promote the development of, and to regulate the securities market and for matters connected therewith'.*

This SEBI Act deemed to have come into force on the 30th day of January, 1992 and extended to whole of India as per section 1 of the SEBI Act, 1992.

2. IMPORTANT DEFINITIONS

According to section 2 of the SEBI Act, 1992, following are some of the important definitions of terms used in the Act-

Board means the Securities and Exchange Board of India established under section 3; [Section 2(1) (a)]

Collective investment scheme means any scheme or arrangement which satisfies the conditions specified in section 11AA [Section 2(1)(ba)]

[1]**Judicial Member** means a Member of the Securities Appellate Tribunal appointed under sub-section (1) of section 15MA and includes the Presiding Officer; [Section 2(1)(db)]

Member means a member of the Board and includes the Chairman; [Section 2(1)(e)]

Regulations means the regulations made by the Board under this Act; [Section 2(1)(h)]

Reserve Bank means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934 [Section 2(1)(ha)]

Securities has the meaning assigned to it in section 2 of the Securities Contracts (Regulation) Act, 1956 [Section 2(1)(i)]

[2]**Technical Member** means a Technical Member appointed under sub-section (1) of section 15MB. [Section 2(1)(j)]

(2) Words and expressions used and not defined in this Act but defined in the Securities Contracts (Regulation) Act, 1956 or the Depositories Act, 1996, shall have the meanings respectively assigned to them in that Act.

3. ESTABLISHMENT OF THE SECURITIES AND EXCHANGE BOARD OF INDIA

Establishment and incorporation of Board [Section 3]

SEBI (hereinafter called 'the Board') has been established as-

- a body corporate
- having perpetual succession and a common seal,
- with powers to acquire, hold and dispose of property, both movable and immovable, and
- to contract as also to sue or be sued by the name of SEBI.
- The head office of the Board shall be at Mumbai.
- Further the Board may establish offices at other places in India.

Management of the Board [Section 4]

The SEBI board is managed by its members (appointed by the Central Government), consists of following:

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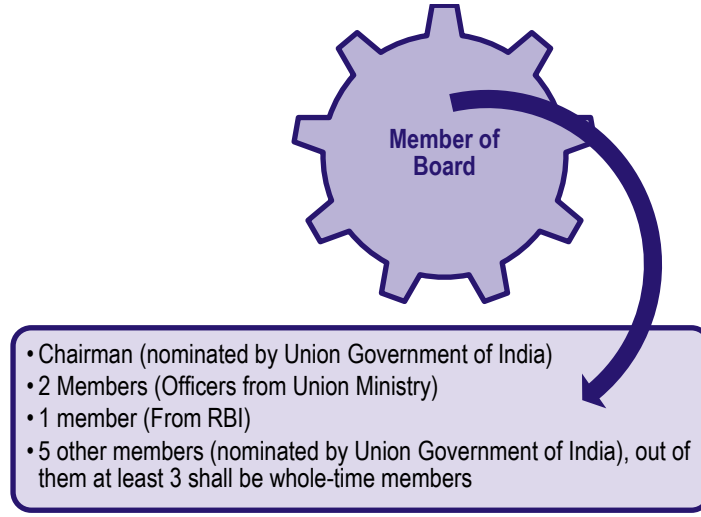
1 Inserted by Part VIII of Chapter VI of the Finance Act, 2017 vide Gazette Notification No. 7, Extraordinary Prt II Section 1 dated March 31, 2017. This shall come into force from April 26, 2017.

2 Inserted by Part VIII of Chapter VI of the Finance Act, 2017 vide Gazette Notification No. 7, Extraordinary Prt II Section 1 dated March 31, 2017. This shall come into force from April 26, 2017.



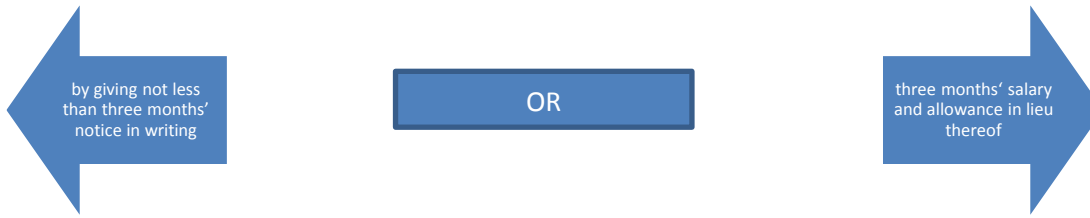
The Chairman and the five other members as referred in the section, shall be persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance; economics, accountancy, administration or in any other discipline which, in the opinion of the Central Government, shall be useful to the Board [Section 4(5)].

The general superintendence, direction and management of the affairs of the Board shall vest in a Board of Members, which may exercise all powers and do all acts and things, which may be exercised or done by the Board. [Section 4(2)]

Term of office and conditions of service of Chairman and members of the Board [Section 5]

The term of office and other conditions of service of Chairman and other Members of the Board as appointed in section 4(1)(d) shall be such as may be prescribed by rules made under the Act.

Right to termination: The Central Government will have the right to terminate the services of the Chairman or other members appointed to the Board (other than its own officials or of the Reserve Bank on the Board) at any time before the expiry of their tenure-

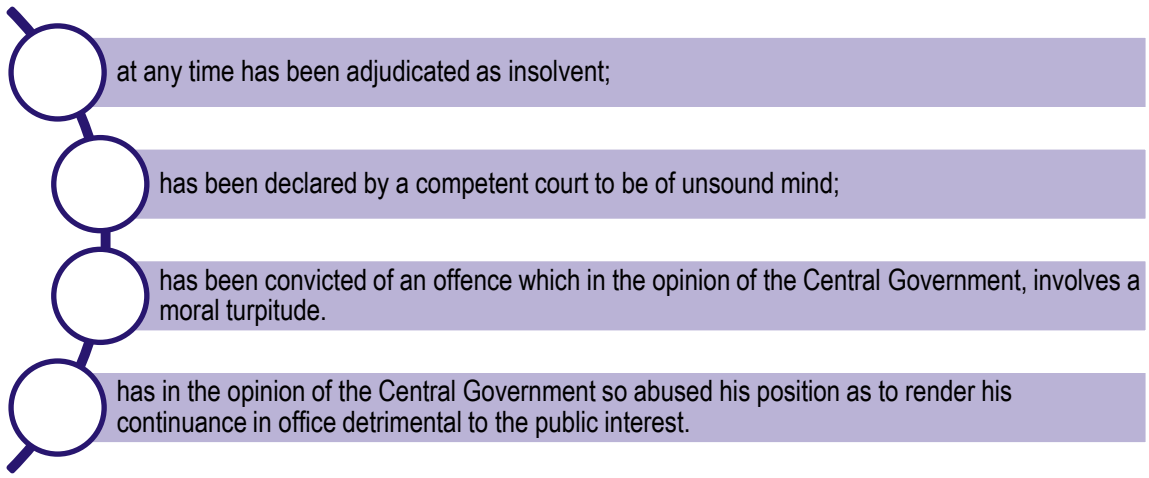


The Chairman and other members shall have the right to relinquish office at any time before the expiry of their tenure by giving a notice of three months in writing to the Central Government.

Term of office: As per the rules framed in this regard, the Chairman and Whole time Members may hold office for a period of five years subject to the maximum age limit of 65 years and can be re-appointed by the Central Government.

Removal of Members of the Board [Section 6]

The Central Government shall have the power to remove a **member or the Chairman** appointed to the Board, if he:



Before removing a member or the Chairman, he will be given a reasonable opportunity of being heard in the matter.

Meetings of the Board [Section 7]

The Board shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings (including quorum at such meetings) as may be provided by regulations made under Section 30 of the Act.

In the absence of the Chairman: If for any reason, Chairman is unable to attend a meeting, any member chosen by the members present from amongst themselves shall preside over the meeting.

Decision by majority vote: All questions which come up before any meeting shall be decided by majority vote of the members present and the Chairman or the presiding member will have a second or casting vote, in the event of equality of votes.

Member not to participate in meetings in certain cases [Section 7A]

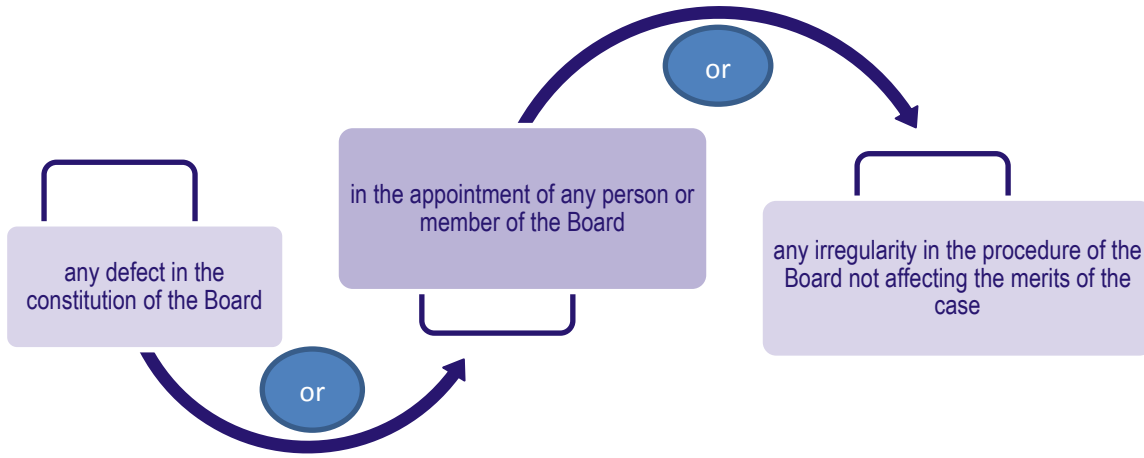
Any member-

- who is a director of a company, and
- who as such director has any indirect pecuniary interest in any matter coming up for consideration at a meeting of the Board,

-shall, disclose (as soon as possible after relevant circumstances have come to his knowledge) the nature of his interest at such meeting and such disclosure shall be recorded in the proceedings of the Board, and the member shall not take any part in any deliberation or decision of the Board with respect to that matter.

Vacancies, etc., not to invalidate proceedings of the Board [Section 8]

- Any vacancy in the Board shall not invalidate any of the acts or proceeding of the Board. Similarly, the following reason shall not invalidate any act or proceeding of the Board-



4. POWERS AND FUNCTIONS OF SEBI [SECTION 11]

Subject to the provisions of this Act, it shall be the duty of the Board to protect the interest of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

The measures may provide for:

(a) regulating the business in stock exchanges and any other securities markets;

(b) registering and regulating the working of stock brokers, sub - brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be; associated with securities markets in any manner;

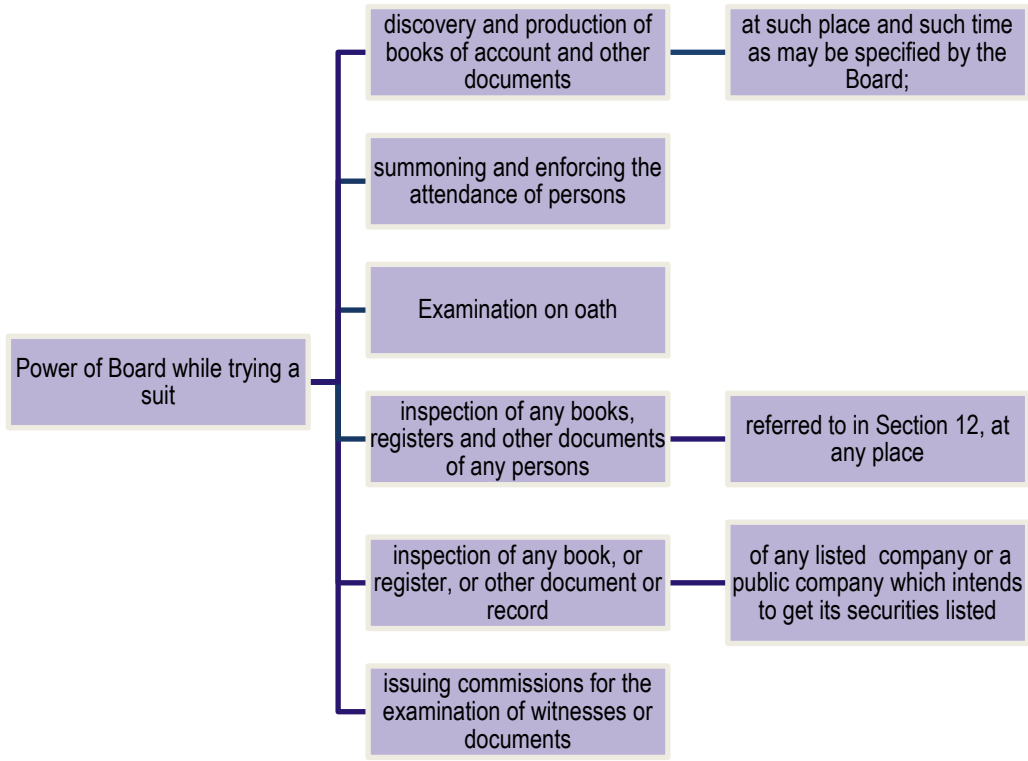
(ba) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf.

(c) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;

(d)	promoting and regulating self-regulatory organisations;
(e)	prohibiting fraudulent and unfair trade practices relating to securities markets;
(f)	promoting investors' education and training of intermediaries' of securities markets;
(g)	prohibiting insider trading in securities;
(h)	regulating substantial acquisition of shares and take-over of companies;
(i)	calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with securities market, intermediaries and self-regulatory organizations in the securities market
(ia)	calling for information and records from any person including any bank or any other authority or board or corporation established or constituted by or under any Central or State Act which, in the opinion of the Board, shall be relevant to any investigation or inquiry by the Board in respect of any transaction in securities;
(ib)	calling for information from, or furnishing information to, other authorities, whether in India or outside India, having functions similar to those of the Board, in the matters relating to the prevention or detection of violations in respect of securities laws, subject to the provisions of other laws for the time being in force in this regard: Provided that the Board, for the purpose of furnishing any information to any authority outside India, may enter into an arrangement or agreement or understanding with such authority with the prior approval of the Central Government;
(j)	performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government.
(k)	levying fees or other charges for carrying out the purposes of this section.
(l)	conducting research for the above purposes;
(la)	calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions.
(m)	performing such other functions as may be prescribed.

Power with respect to inspection of books and Documents: Further, the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company which intends to get its securities listed on any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

Board are vested with same power as that of civil court: The Board shall 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:



Passing of an order by an Board: The Board may, by an order, for reasons to be recorded in writing, in the interests of investors or securities market, take any of the following measures, either pending investigation or inquiry or on completion of such investigation or inquiry, namely:—

(a) suspend the trading of any security in a recognised stock exchange;

(b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities;

(c) suspend any office-bearer of any stock exchange or self-regulatory organization from holding such position;

(d) impound and retain the proceeds or securities in respect of any transaction which is under investigation;

[3](e) attach, for a period not exceeding ninety days, bank accounts or other property of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder:

[3] Clause (e) of sub-section (4) substituted by Banning of Unregulated Deposit Schemes Ordinance, 2019, w.e.f. **21-2-2019**.

Provided that the Board shall, within ninety days of the said attachment, obtain confirmation of the said attachment from the Special Court, established under section 26A, having jurisdiction and on such confirmation, such attachment shall continue during the pendency of the aforesaid proceedings and on conclusion of the said proceedings, the provisions of section 28A shall apply:

Provided further that only property, bank account or accounts or any transaction entered therein, so far as it relates to the proceeds actually involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder shall be allowed to be attached.

(f) direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation.

The amount disgorged, pursuant to a direction issued, under the SEBI Act or the Securities Contracts (Regulation) Act, 1956 or the Depositories Act, 1996, as the case may be-

- shall be credited to the Investor Protection and Education Fund (IPEF) established by the Board, and
- such amount shall be utilised by the Board in accordance with the regulations made under this Act.''.

Additional functions of SEBI under the Securities Contracts (Regulation) Act, 1956: The Securities Contracts (Regulation) Act, 1956 which was enacted to prevent undesirable transactions in securities and to regulate the business of securities had given certain powers to the Central Government, under the provisions of that Act. The functions of the Central Government under that Act have been granted to SEBI. These functions are:

(a) Power to call for periodical returns or direct enquiries to be made (Section 6 of SCRA): SEBI will receive from every recognised Stock Exchange such periodical returns relating to its affairs as may be prescribed by SCRA rules.

Description of Powers	Powers of SEBI
Power to inspect	It shall be open to SEBI to inspect at all reasonable times books of accounts and other documents to be maintained by the Stock Exchanges **for periods not exceeding five years** as may be prescribed in the public interest and in the interest of trade by the Central Government.
Power of SEBI to call for information/ explanation relating to affairs of the stock exchange	It shall also be open to SEBI to call upon recognised stock exchanges or any member thereof to furnish in writing such information or explanation relating to the

	affairs of the Stock Exchange or of the member in relation to the stock exchange as may be required by SEBI in the interest of trade or in the public interest.
SEBI to appoint persons to make an inquiry	It shall also be open to SEBI to appoint, by order in writing, one or more persons to make an inquiry in the prescribed manner in relation to the affairs of the governing body of stock exchange or the affairs of any of the members of the stock exchange in relation to the stock exchange and submit a report of the result of such enquiry to SEBI within the time as, specified in the order. In the case of affairs of any of the members/ of a stock exchange, SEBI can direct the governing body of such stock exchange to make an inquiry and submit its report.
SEBI will bound the concerned persons to produce documents before himself /other enquiry officer	Every director, manager, secretary or other officer of such stock exchange, every member of such stock exchange and every constituent or agent of such member if it is a firm and every other person or body of persons having dealings with any of these persons whether directly or indirectly shall be bound to produce before SEBI or other enquiry officer, all books of accounts and other documents in his custody or power relating to the subject matter of the enquiry. This has to be done within the time specified and as may be required by the enquiry authority.

(b) **Power to approve the bye-laws of stock exchanges:** Section 9 of SCRA provides that any recognised stock exchange may make bye-laws for the regulation and control of contracts with the previous approval of SEBI. Such bye- laws may provide for submission of periodical settlements carried out by clearing houses to SEBI or publication of such particulars by clearing houses subject to SEBI's directions. Such bye-laws have to be published for public comments and after approval by SEBI shall have to be published in the Gazette of India and also in the Official Gazette of the State unless SEBI, by written order with reasons dispense with the condition of previous publication.

(c) **Power of SEBI to make or amend bye-laws of recognised stock exchanges (Section 10, SCRA):** SEBI may either on a request in writing received by it in this behalf from the governing body of a recognised stock exchange or on its own motion make bye-laws on matters specified in Section 9 of SCRA or amend any bye-laws made by such stock exchange. SEBI will have to be satisfied, after consultation with the governing body of the stock exchange, that it is necessary or expedient to make or amend the bye-laws and record its reasons also.

(d) **Licensing of dealers in securities in certain areas (Section 17 SCRA):** SEBI has been empowered to grant a license to any person for the business of dealing in securities in any State or area to which Section 13 of SCRA has not been declared to apply. Section 13 of SCRA deals with contracts in notified areas to be illegal in certain circumstances.

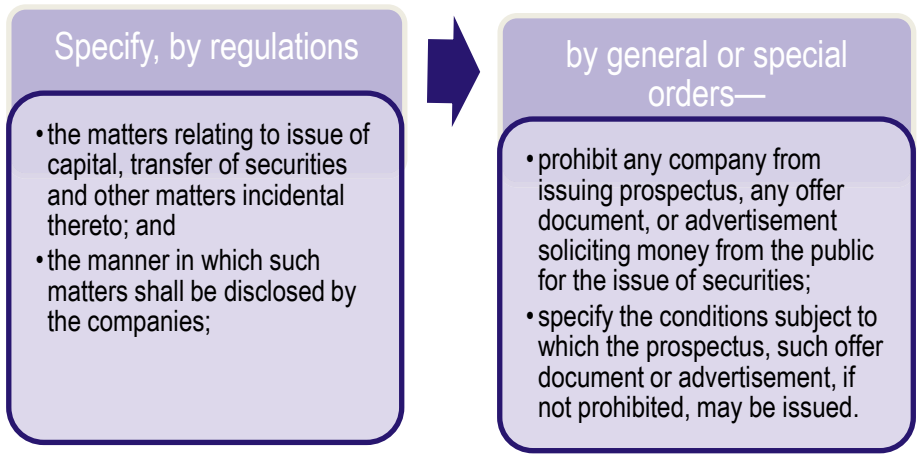
(e) **Public Issue and listing of securities referred to in section 2 (h) (ie) of SCRA:** As per section 17A, securities of the nature referred to in section 2 (h) (ie) shall be offered to the public or listed on any stock exchange unless the issuer fulfills eligibility criteria and complies with other requirements as may be specified by SEBI by regulations.

(f) **Power to delegate:** Section 29A of SCRA provides that the Central Government may, by order published in the Official Gazette, direct that the powers exercisable by it under any provision of the SCRA shall, in relation to such matters and subject to such conditions, if any as may be specified in the order, be exercisable also by SEBI or the Reserve Bank of India.

More Powers for SEBI: Certain additional powers with regard to certain provisions under the Companies Act, 2013, related to issue and transfer of securities and non-payment of dividend, in the case of listed public companies intending to get their securities listed on any recognised stock exchange, shall be administered by SEBI.

5. BOARD TO REGULATE OR PROHIBIT ISSUE OF PROSPECTUS, OFFER DOCUMENT OR ADVERTISEMENT SOLICITING MONEY FOR ISSUE OF SECURITIES [SECTION 11A]

(1) As per the section, the Board may, for the protection of investors,—



(2) The Board may specify the requirements for listing and transfer of securities and other matters incidental thereto.

6. COLLECTIVE INVESTMENT SCHEME [SECTION 11AA]

Any scheme or arrangement which satisfies the conditions referred to in sub-section (2) or sub-section (2A) shall be a collective investment scheme.

Provided that any pooling of funds under any scheme or arrangement, which is not registered with the Board or is not covered under sub-section (3), involving a corpus amount of one hundred crore rupees or more shall be deemed to be a collective investment scheme.

Requisite conditions: Any scheme or arrangement made or offered by any person under which, -

(i) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized for the purposes of the scheme or arrangement;

(ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable, from such scheme or arrangement;

(iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;

(iv) the investors do not have day-to-day control over the management and operation of the scheme or arrangement. [Sub-section 2]

(v) Any scheme or arrangement made or offered by any person satisfying the conditions as may be specified in accordance with the regulations made under this Act [sub-section (2A)].

Exceptions: Following scheme or arrangement shall not be a collective investment scheme -

(i) made or offered by a co-operative society registered under the Co-operative Societies Act, 1912 or a society being a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any State;

(ii) under which deposits are accepted by non-banking financial companies as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934;

(iii) being a contract of insurance to which the Insurance Act, 1938 applies;

(iv) providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952;

(v) under which deposits are accepted under the Companies Act, 2013

(vi) under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under the Companies Act, 2013;

(vii) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982;

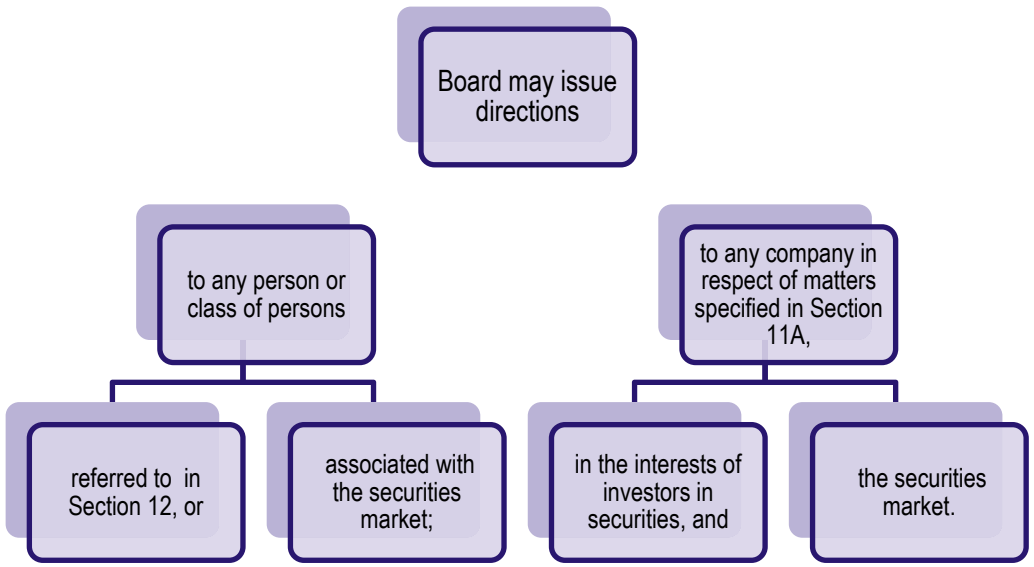
(viii) under which contributions made are in the nature of subscription to a mutual fund;

(ix) such other scheme or arrangement which the Central Government may, in consultation with the Board, notify,

7. POWER TO ISSUE DIRECTIONS [SECTION 11B]

Save as otherwise provided in Section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary:

- in the interest of investors, or orderly development of securities market; or
- to prevent the affairs of any intermediary or other persons referred to in Section 12 being conducted in a manner detrimental to interest of investors or securities market; or
- to secure the proper management of any such intermediary or persons,



Explanation.—For the removal of doubts, it is hereby declared that the power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.

8. INVESTIGATION [SECTION 11C]

(1) **Grounds for issue of an order of investigation:** Where the Board has reasonable ground to believe that—

(a) the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or

(b) any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board there under.

It may, at any time by order in writing, direct any person (hereafter in this section referred to as the Investigating Authority) specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board.

(2) **Furnishing of relevant documents to the investigating authority:** It shall be the duty of-

- every manager, managing director, officer and other employee of the company and every intermediary referred to in section 12, or
- every person associated with the securities market to preserve, and
- to produce to the Investigating Authority or any person authorised by it in this behalf,

-all the books, registers, other documents and record of, or relating to, the company or, as the case may be, of or relating to, the intermediary or such person, which are in their custody or power.

(3) **Period of custody:** The Investigating Authority may keep in its custody any books, registers, other documents and record produced for six months and thereafter shall return the same to any intermediary or any person associated with securities market by whom or on whose behalf the books, registers, other documents and record are produced:

The Investigating Authority may call for any book, register, other document and record if they are needed again.

If the person on whose behalf the books, registers, other documents and record are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, it shall give certified copies of such books, registers, other

documents and record to such person or on whose behalf the books, registers, other documents and record were produced.

(4) **Examination on oath:** Any person, directed to make an investigation, may examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before it personally.

(5) **On failure:** If any person fails without reasonable cause or refuses—

Failure in compliance	Punishment
(a) to produce to the Investigating Authority or any person authorised by it in this behalf any book, register, other document and record which is his duty to produce; or (b) to furnish any information which is his duty to furnish; or (c) to appear before the Investigating Authority personally or to answer any question which is put to him by the Investigating Authority in pursuance of that sub-section; or (d) to sign the notes of any examination,	Person shall be punishable with- • imprisonment for a term which may extend to one year, or • with fine, which may extend to one crore rupees, or • with both, and • also with a further fine which may extend to five lakh rupees for every day after the first during which the failure or refusal continues.

(6) **Notes of examination to be used as examination:** Notes of any examination shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

(7) **Impounding of documents :** Where in the course of investigation, the Investigating Authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to, any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an application to the Magistrate or Judge of such designated court in Mumbai, as may be notified by the Central Government for an order for the seizure of such books, registers, other documents and record.

(8) **Demand of services of other officers:** The authorized officer may requisition the services of any police officer or any officer of the Central Government, or of both, to assist him for all or any of the purposes as specified above with respect to impounding of documents and it

shall be the duty of every such officer to comply with such requisition.

(9) **Order of court:** After considering the application and hearing the Investigating Authority, if necessary, the Magistrate or Judge of the Designated Court may, by order, authorise the Investigating Authority –

- to enter, with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept;
- to search that place or those places in the manner specified in the order; and
- to seize books, registers, other documents and record, it considers necessary for the purposes of the investigation:

Exemptions: Provided that the Magistrate or Judge of the Designated Court shall not authorise seizure of books, registers, other documents and record, of any listed public company or a public company (not being the intermediaries specified under section 12) which intends to get its securities listed on any recognised stock exchange unless such company indulges in insider trading or market manipulation.

(10) **Impounded documents will remain in the custody of investigating authority:** The Investigating Authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized and inform the Magistrate or Judge of the Designated Court of such return:

Provided that the Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof.

(11) Every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 (2 of 1974) relating to searches or seizures made under that Code.

9. CEASE AND DESIST PROCEEDINGS [SECTION 11D]

If the Board finds, after causing an inquiry to be made, that any person has violated, or is likely to violate, any provisions of this Act, or any rules or regulations made thereunder, it may pass an order requiring such person to cease and desist from committing or causing such violation:

Provided that the Board shall not pass such order in respect of any listed public company or a public company (other than the intermediaries specified under section 12) which intends to get its securities listed on any recognised stock exchange unless the Board has reasonable grounds to believe that such company has indulged in insider trading or market manipulation."

10. REGISTRATION CERTIFICATE [SECTION 12]

Provision related to	provides
Persons who are authorized to buy, sell or deal in securities	Stock broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act
Board may by notification specify the persons who shall buy or sell or deal in securities	Depository, participant, custodian of securities, foreign institutional investor, credit rating agency, or any other intermediary associated with the securities market as the Board may by notification in this behalf specify, shall buy or sell or deal in securities in accordance with the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act;
Person who shall sponsor or cause to be sponsored or carry on or caused to be carried on any venture capital funds and collective investment scheme including mutual funds	Shall be, who obtains certificate of registration from the Board in accordance with the regulations.

Manner of application for registration: Every application for registration shall be in such manner and on payment of such fees as may be determined by regulations.

Suspension /cancellation of a certificate of registration: The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations; Provided that no order under this sub-section shall be made unless the person concerned has been -given a reasonable opportunity of being heard.

11. PROHIBITION OF MANIPULATIVE AND DECEPTIVE DEVICES, INSIDER TRADING AND SUBSTANTIAL ACQUISITION OF SECURITIES OR CONTROL [SECTION 12A]

Prohibition on person	From performing following activities
No person shall directly or indirectly	use or employ in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, • any manipulative or deceptive device or • contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;
	employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;
	engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;
	engage in insider trading;
	• deal in securities while in possession of material or non-public information or • communicate such material or non-public information to any other person, -in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;
	• acquire control of any company or securities more than the percentage of equity share capital of a company

	-whose securities are listed or proposed to be listed on a recognised stock exchange in contravention of the regulations made under this Act.

12. FINANCE, ACCOUNTS AND AUDIT

Grants by the Central Government [Section 13]

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Board grants of such sums of money as that Government may think fit for being utilized for the purposes of this Act.

Fund [Section 14]

(1) There shall be constituted a Fund to be called the Securities and Exchange Board of India General Fund and there shall be credited thereto-

- all grants, fees and charges received by the Board under this Act;
- all sums received by the Board from such other sources as may be decided upon by the Central Government.

(2) The Fund shall be applied for meeting—

- the salaries, allowances and other remuneration of the members, officers and other employees of the Board;
- the expenses of the Board in the discharge of its functions under section 11;
- the expenses on objects and for purposes authorised by this Act.

Accounts and audit [Section15]

(1) **Preparation of annual financial statement of Board in consultation with CAG of India:** The Board shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.

(2) **Audit of accounts of Board:** The accounts of the Board shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Board to the Comptroller and Auditor-General of India.

(3) **Right and Privileges:** The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Board shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and,

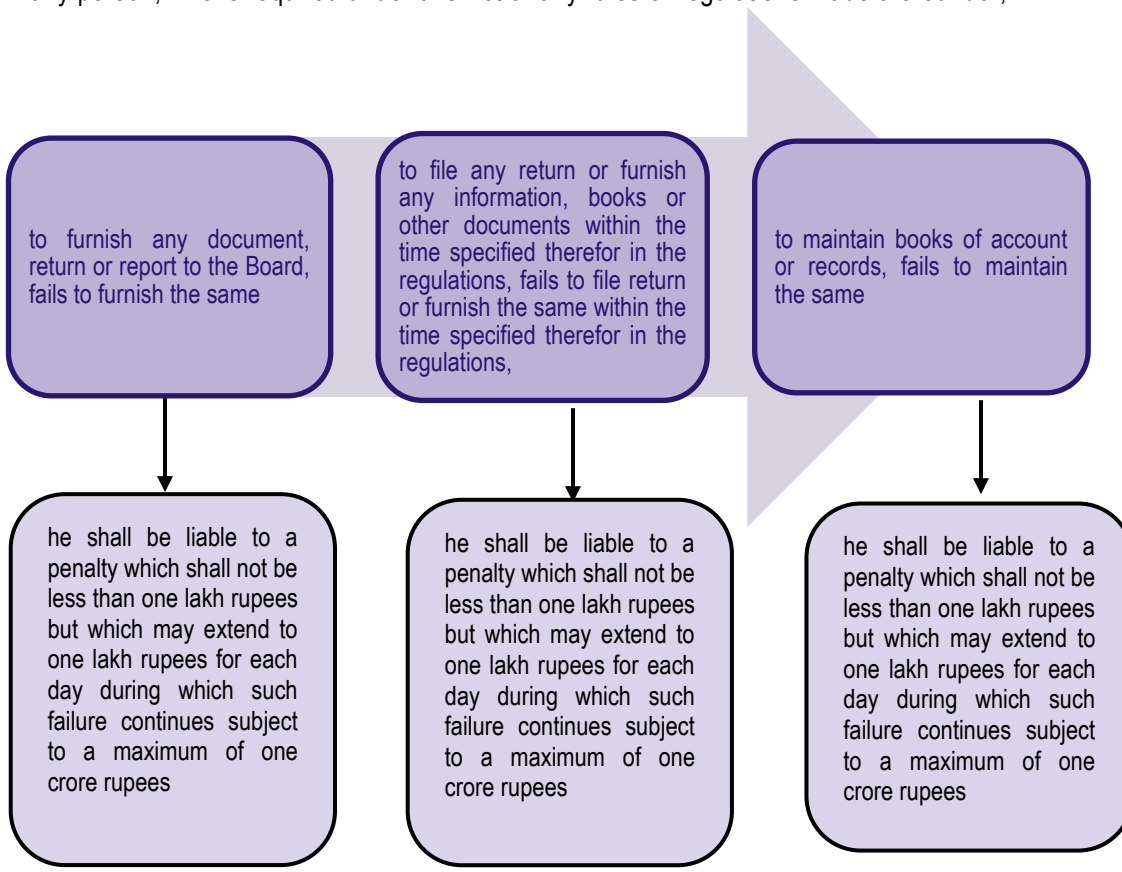
in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Board.

(4) **Certified Accounts and Audit reports to be forwarded to the Central Government:** The accounts of the Board as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

13. PENALTIES AND ADJUDICATION

Penalty for failure to furnish information, return, etc. [Section 15A]

If any person, who is required under this Act or any rules or regulations made thereunder,—



Penalty for failure by any person to enter into agreement with clients [Section 15B]

If any person, who is registered as an intermediary and is required under this Act or any rules or regulations made thereunder to enter into an agreement with his client, fails to enter into such agreement,

- he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for failure to redress investors' grievances [Section 15C]

If any listed company or any person who is registered as an intermediary, after having been called upon by the Board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board,

- such company or intermediary shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for certain defaults in case of mutual funds [Section 15D]

Person liable	For defaults	Punishments levied
If any person, who is—	required under this Act or any rules or regulations made thereunder to obtain a certificate of registration from the Board for sponsoring or carrying on any collective investment scheme, including mutual funds, sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration	he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds subject to a maximum of one crore rupees;
	registered with the Board as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration	he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
	registered with the Board as a collective investment scheme, including mutual funds, fails to	he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh

	make an application for listing of its schemes as provided for in the regulations governing such listing	rupees for each day during which such failure continues subject to a maximum of one crore rupees;
	registered as a collective investment scheme, including mutual funds, fails to dispatch unit certificates of any scheme in the manner provided in the regulation governing such dispatch	he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
	registered as a collective investment scheme, including mutual funds, fails to refund the application monies paid by the investors within the period specified in the regulations	he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees
	registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations	he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Penalty for failure to observe rules and regulations by an asset management company [Section 15E]

Where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies,

- such asset management company shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees

Penalty for default in case of stock brokers [Section 15 F]

Person, registered as a stock broker	fails to issue	contract notes in the form and manner specified by the stock exchange of which such broker is a member,	he shall be liable to a penalty of more than 1 lakh but which may extend to for which the contract note was required to be issued by that broker
	fails to deliver	any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations	he shall be liable to a penalty of more than 1 lakh but which may extend to one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds subject to a maximum of one crore rupees
	charges	an amount of brokerage which is in excess of the brokerage specified in the regulations	he shall be liable for more than 1 lakh but which may extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher

Penalty for insider trading [Section 15G]

Any insider shall be liable to a penalty of more than ten lakh rupees extending upto twenty-five crore rupees / three times the amount of profits made out of insider trading, whichever is higher, who-

- either on his own behalf or on behalf of any other person
- communicates any unpublished price-sensitive information to any person, with or without his request for such information
- counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information
- deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or
- except as required in the ordinary course of business or under any law, or

Penalty for non-disclosure of acquisition of shares and takeovers [Section 15 H]

If any person, who is required under this Act or any rules or regulations made thereunder, fails to,—

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disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or

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make a public announcement to acquire shares at a minimum price; or

↓

make a public offer by sending letter of offer to the shareholders of the concerned company; or

↓

make payment of consideration to the shareholders who sold their shares pursuant to letter of offer,

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he shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher.

Penalty for fraudulent and unfair trade practices [Section 15HA]

If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall –

- not be less than five lakh rupees but
- which may extend to twenty-five crore rupees or
- three times the amount of profits made out of such practices,.

} Which ever is higher

Penalty for contravention where no separate penalty has been provided [Section 15HB]

Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

Power to adjudicate [Section 15-I]

On the matters related to	Power to adjudicate
For the purpose of adjudging under sections 15A, 15B, 15C, 15D, 15E, 15F, 15G ,15H, 15HA and 15HB	Board shall appoint any officer not below the rank of a Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
On holding of an inquiry	The adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in subsection (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.
Order passed by adjudicating officer is not justified	The Board may call for and examine the record of any proceedings and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify: Provided that no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter: **Limitation period:** Provided further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 15T, whichever is earlier.

Factors to be taken into account by the adjudicating officer [Section 15J]

While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely:—

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

It is clarified here that the power of an adjudicating officer to adjudge the quantum of penalty under sections 15A to 15E, clauses (b) and (c) of sections 15F, 15G, 15H and 15HA shall be and shall always be deemed to have been exercised under the provisions of this section.

Crediting sums realised by way of penalties to Consolidated Fund of India [Section15JA]

All sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Settlement of administrative and civil proceedings [Section 15 JB]

(1) **Filing of an application:** Any person, against whom any proceedings have been initiated or may be initiated under section 11, section 11B, section 11D, sub-section (3) of section 12 or section 15-I, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

(2) **Board may consider for settlement of defaults:** The Board may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under this Act.

(3) **Mode of settlement proceedings:** The settlement proceedings under this section shall be conducted in accordance with the procedure specified in the regulations made under this Act.

(4) **No appeal preferred:** No appeal shall lie under section 15T against any order passed by the Board or adjudicating officer, as the case may be, under this section.]

14. ESTABLISHMENT, JURISDICTION, AUTHORITY AND PROCEDURE OF SECURITIES APPELLATE TRIBUNAL (SAT)

Establishment of Securities Appellate Tribunals [Section 15K]

(1) The Central Government shall, by notification, establish a Tribunal to be known as the Securities Appellate Tribunal to exercise the jurisdiction, powers and authority conferred on it by or under this Act or any other law for the time being in force.

(2) The Central Government shall also specify in the notification referred to in sub-section (1), the matters and places in relation to which the Securities Appellate Tribunal may exercise jurisdiction.

Composition of Securities Appellate Tribunal [Section 15L]

(1) The Securities Appellate Tribunal shall consist of a Presiding Officer and such number of Judicial Members and Technical Members as the Central Government may determine, by notification, to exercise the powers and discharge the functions conferred on the Securities Appellate Tribunal under this Act or any other law for the time being in force.

(2) Subject to the provisions of this Act,—

(a) the jurisdiction of the Securities Appellate Tribunal may be exercised by Benches thereof;

(b) a Bench may be constituted by the Presiding Officer of the Securities Appellate Tribunal with two or more Judicial or Technical Members as he may deem fit:

Provided that every Bench constituted shall include at least one Judicial Member and one Technical Member;

(c) the Benches of the Securities Appellate Tribunal shall ordinarily sit at Mumbai and may also sit at such other places as the Central Government may, in consultation with the Presiding Officer, notify.

(3) The Presiding Officer may transfer a Judicial Member or a Technical Member of the Securities Appellate Tribunal from one Bench to another Bench.

Qualification for appointment as Presiding Officer or Member of Securities Appellate Tribunal [Section 15M]

A person shall not be qualified for appointment as the Presiding Officer or a Judicial Member or a Technical Member of the Securities Appellate Tribunal, unless he—

(a) is, or has been, a Judge of the Supreme Court or a Chief Justice of a High Court or a Judge of High Court for at least seven years, in the case of the Presiding Officer; and

(b) is, or has been, a Judge of High Court for at least five years, in the case of a Judicial Member; or

(c) in the case of a Technical Member—

(i) is, or has been, a Secretary or an Additional Secretary in the Ministry or Department of the Central Government or any equivalent post in the Central Government or a State Government; or

(ii) is a person of proven ability, integrity and standing having special knowledge and professional experience, of not less than fifteen years, in financial sector including securities market or pension funds or commodity derivatives or insurance.

Appointment of judicial member [Section 15MA]

The Presiding Officer and Judicial Members of the Securities Appellate Tribunal shall be appointed by the Central Government in consultation with the Chief Justice of India or his nominee.

Appointment of technical member [Section 15MB]

(1) The Technical Members of the Securities Appellate Tribunal shall be appointed by the Central Government on the recommendation of a Search-cum-Selection Committee consisting of the following, namely:—

(a) Presiding Officer, Securities Appellate Tribunal—Chairperson;

(b) Secretary, Department of Economic Affairs—Member;

(c) Secretary, Department of Financial Services—Member; and

(d) Secretary, Legislative Department or Secretary, Department of Legal Affairs—Member.

(2) The Secretary, Department of Economic Affairs shall be the Convener of the Search-cum Selection Committee.

(3) The Search-cum-Selection Committee shall determine its procedure for recommending the names of persons to be appointed under sub-section (1).

Validity of appointment of Presiding officer and members of SAT [Section 15MC]

(1) No appointment of the Presiding Officer, a Judicial Member or a Technical Member of the Securities Appellate Tribunal shall be invalid merely by reason of any vacancy or any defect in the constitution of the Search cum- Selection Committee.

(2) **Disqualification of members:** A member or part time member of the Board or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, or any person at senior management level equivalent to the Executive Director in the Board or in such Authorities, shall not be appointed as Presiding Officer or Member of the Securities Appellate Tribunal, during his service or tenure as such with the Board or with such Authorities, as the case may be, or within two years from the date on which he ceases to hold office as such in the Board or in such Authorities.

(3) **Effect of holding of office by officer or members on commencement of Finance Act, 2017:** The Presiding Officer or such other member of the Securities Appellate Tribunal, holding office on the date of commencement of Part VIII of Chapter VI of the Finance Act, 2017 shall continue to hold office for such term as he was appointed and the other provisions

of this Act shall apply to such Presiding Officer or such other member, as if Part VIII of Chapter VI of the Finance Act, 2017 had not been enacted.

Tenure of office of Presiding Officer and other Members of Securities Appellate Tribunal [Section 15N]

The Presiding Officer or every Judicial or Technical Member of the Securities Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office, and shall be eligible for reappointment for another term of maximum five years:

Provided that no Presiding Officer or the Judicial or Technical Member shall hold office after he has attained the age of seventy years.

Salary and allowances and other terms and conditions of service of Presiding Officers [Section 15-O]

The salary and allowances payable to and the other terms and conditions of service including pension, gratuity and other retirement benefits of the Presiding Officer and other Members of a Securities Appellate Tribunal shall be such as may be prescribed.

Provided that neither the salary and allowances nor the other terms and conditions of service of the Presiding Officer and other Members of a Securities Appellate Tribunal shall be varied to their disadvantage after appointment.

Filling up of vacancies [Section 15P]

If, for reason other than temporary absence, any vacancy occurs in the office of the Presiding Officer or any other Member of a Securities Appellate Tribunal-

- then the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy, and
- the proceedings may be continued before the Securities Appellate Tribunal from the stage at which the vacancy is filled.

In the event of occurrence of any vacancy in the office of the Presiding Officer of the Securities Appellate Tribunal by reason of his death, resignation or otherwise, the senior-most Judicial Member of the Securities Appellate Tribunal shall act as the Presiding Officer until the date on which a new Presiding Officer is appointed in accordance with the provisions of this Act. **[Section 15PA]**

Resignation and removal [section 15Q]

(1) **Resignation by notice in writing:** The Presiding Officer or any other Member of a Securities Appellate Tribunal may, by notice in writing under his hand addressed to the Central Government, resign his office.

Provided that the Presiding Officer or any other Member shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office-

- until the expiry of three months from the date of receipt of such notice or
- until a person duly appointed as his successor enters upon his office or ⇨ Whichever is the earliest
- until the expiry of his term of office,

(2) Removal of Presiding officer/Judicial member/ Technical member: The Central Government may, after an inquiry made by the Judge of the Supreme Court, remove the Presiding Officer or Judicial Member or Technical Member of the Securities Appellate Tribunal, if he—

(a) is, or at any time has been adjudged as an insolvent;

(b) has become physically or mentally incapable of acting as the Presiding Officer, Judicial or Technical Member;

(c) has been convicted of any offence which, in the opinion of the Central Government, involves moral turpitude;

(d) has, in the opinion of the Central Government, so abused his position as to render his continuation in office detrimental to the public interest; or

(e) has acquired such financial interest or other interest as is likely to affect prejudicially his functions as the Presiding Officer or Judicial or Technical Member:

Provided that he shall not be removed from office under clauses (d) and (e), unless he has been given a reasonable opportunity of being heard in the matter.

(3) Central Government authorized to regulate the procedure of investigation: The Central Government may, by rules, regulate the procedure for the investigation of misbehavior or incapacity of the Presiding Officer or any other Member.

Appointment, qualification and the other terms and conditions of service of the Presiding Officer and other Members of the Appellate Tribunal to be governed by Finance Act, 2017 [Section 15QA]

(i) Where the qualification, appointment etc. is after the commencement of Finance Act, 2017: Notwithstanding anything contained in this Act, the qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Presiding Officer and other Members of the Appellate Tribunal appointed after the commencement of Part XIV of Chapter VI of the Finance Act, 2017, shall be governed by the provisions of section 184 of that Act.

(ii) Where the qualification, appointment etc. is before the commencement of Finance Act, 2017: Provided that the Presiding Officer and Member appointed before the commencement of Part XIV of Chapter VI of the Finance Act, 2017, shall continue to be governed by the

provisions of this Act and the rules made thereunder as if the provisions of section 184 of the Finance Act, 2017 had not come into force.

Orders constituting Appellate Tribunal to be final and not to invalidate its proceedings [Section 15R]

No order of the Central Government appointing any person as the Presiding Officer or a Member of a Securities Appellate Tribunal shall be called in question in any manner, and no act or proceeding before a Securities Appellate Tribunal shall be called in question in any manner on the ground merely of any defect in the constitution of a Securities Appellate Tribunal.

Staff of the Securities Appellate Tribunal [Section 15S]

(1) The Central Government shall provide the Securities Appellate Tribunal with such officers and employees as that Government may think fit.

(2) The officers and employees of the Securities Appellate Tribunal shall discharge their functions under general superintendence of the Presiding Officer.

(3) The salaries and allowances and other conditions of service of the officers and employees of the Securities Appellate Tribunal shall be such as may be prescribed.

Appeal to the Securities Appellate Tribunal [Section 15T]

(1) Any person aggrieved, —

(a) by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the rules or regulations made thereunder; or

(b) by an order made by an adjudicating officer under this Act; or

(c) by an order of the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

(2) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Board or the Adjudicating Officer or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be, is received by him and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

(3) On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(4) The Securities Appellate Tribunal shall send a copy of every order made by it to the Board, or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be the parties to the appeal and to the concerned Adjudicating Officer.

(5) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Procedure and powers of the Securities Appellate Tribunal [Section 15U]

(1) The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.

(2) The Securities Appellate Tribunal shall have, for the purposes of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely:—

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) issuing commissions for the examination of witnesses or documents;

(e) reviewing its decisions;

(f) dismissing an application for default or deciding it *ex parte*;

(g) setting aside any order of dismissal of any application for default or any order passed by it *ex parte*;

(h) any other matter which may be prescribed.

(3) Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code (45 of 1860), and the Securities Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974).

(4) Where Benches are constituted, the Presiding Officer of the Securities Appellate Tribunal may, from time to time make provisions as to the distribution of the business of the Securities Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with, by each Bench.

(5) On the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Presiding Officer of the Securities Appellate Tribunal may transfer any case pending before one Bench, for disposal, to any other Bench.

(6) If a Bench of the Securities Appellate Tribunal consisting of two members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Presiding Officer of the Securities Appellate Tribunal who shall either hear the point or points himself or refer the case for hearing only on such point or points by one or more of the other members of the Securities Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the members of the Securities Appellate Tribunal who have heard the case, including those who first heard it.

Right to legal representation [Section 15V]

The appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

Limitation [Section15W]

The provisions of the Limitation Act, 1963 shall, as far as may be, apply to an appeal made to a Securities Appellate Tribunal.

Presiding Officer, Members and staff of Securities Appellate Tribunals to be public servants [Section15X]

The Presiding Officer, Members and other officers and employees of a Securities Appellate Tribunal shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code.

Civil Court not to have jurisdiction [Section 15Y]

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an adjudicating officer appointed under this Act or a Securities Appellate Tribunal constituted under this Act is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to Supreme Court [Section 15Z]

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may-

- file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

15. MISCELLANEOUS

Power of Central Government to issue directions [Section 16]

(1) Without prejudice to the foregoing provisions of this Act or the Depositories Act, 1996, the Board shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy as the Central Government may give in writing to it from time to time.

Provided that the Board shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

(2) The decision of the Central Government whether a question is one of policy or not shall be final.

Power of Central Government to supersede the Board [Section 17]

If at any time the Central Government is of opinion that Board unable to perform its functions, it may by notification, supersede the Board for such period, not exceeding six months.

Reasons to supersede the Board-

Central government may supersede the Board-

- on account of grave emergency, the Board is unable to discharge the functions and duties under the provisions of this Act; or
- that the Board has persistently made default in complying with any direction issued by the Central Government under this Act or
- default in the discharge of the functions and duties imposed under the provisions of this Act and as a result of such default the financial position of the Board or the administration of the Board has deteriorated; or
- that circumstances exist which render it necessary in the public interest so to do

Effect of publication of notification of superseding the Board:

Upon the publication of a notification of superseding the Board,—

(a) all the members shall, as from the date of supersession, vacate their offices as such;

(b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Board, shall until the Board is reconstituted, be exercised and discharged by such person or persons as the Central Government may direct; and

(c) all property owned or controlled by the Board shall, until the Board is reconstituted vest in the Central Government.

Reconstitution of Board on the expiration of the period of supersession:

On the expiration of the period of supersession specified in the notification, the Central Government may reconstitute the Board by a fresh appointment and in such case any person or persons who vacated their offices, shall not be deemed disqualified for appointment:

Provided that the Central Government may, at any time, before the expiration of the period of supersession, take action.

Complete reports and action taken to be laid before the Parliament: The Central Government shall cause a notification issued and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Returns and reports [Section 18]

(1) **Furnishing of returns and reports by the Board to the Central Government:** The Board shall furnish to the Central Government at such time and in such form and manner as may be prescribed or as the Central Government may direct, such returns and statements and such particulars in regard to any proposed or existing programme for the promotion and development of the securities market, as the Central Government may, from time to time, require.

(2) **Report of previous financial year by the Board:** the Board shall, within ninety days after the end of each financial year, submit to the Central Government a report in such form, as may be prescribed, giving a true and full account of its activities, policy and programmes during the previous financial year.

(3) **Report to be presented before Parliament:** A copy of the report received under sub-section (2) shall be laid, as soon as may be after it is received, before each House of Parliament.

Appeals [Section 19]

(1) **Appeal to Central Government:** Any person aggrieved by an order of the Board made, before the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the rules or regulations made thereunder may prefer an appeal to the Central Government within such time as may be prescribed.

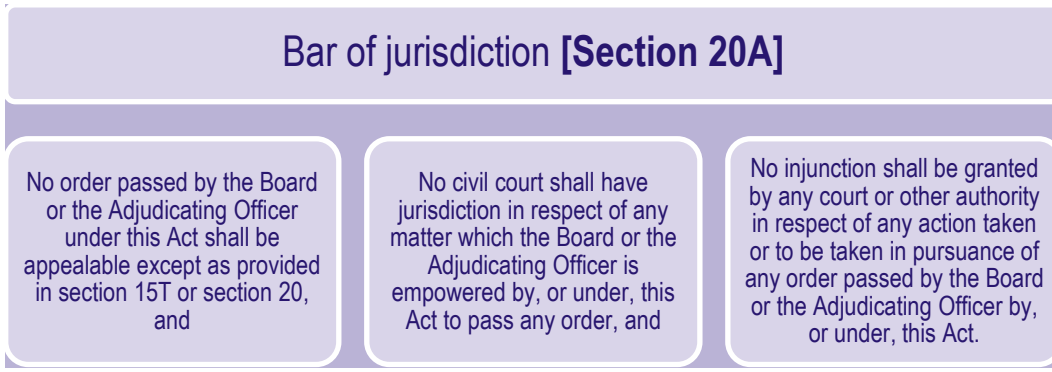
(2) **No appeal after expiry of limitation:** No appeal shall be admitted if it is preferred after the expiry of the period prescribed therefor.

However, it is admitted after the expiry of the period prescribed if the appellant satisfies the Central Government that he had sufficient cause for not preferring the appeal within the prescribed period.

(3) **Appeal shall be made in prescribed form with a copy of an order:** Every appeal made

under this section shall be made in such form and shall be accompanied by a copy of the order appealed against and by such fees as may be prescribed.

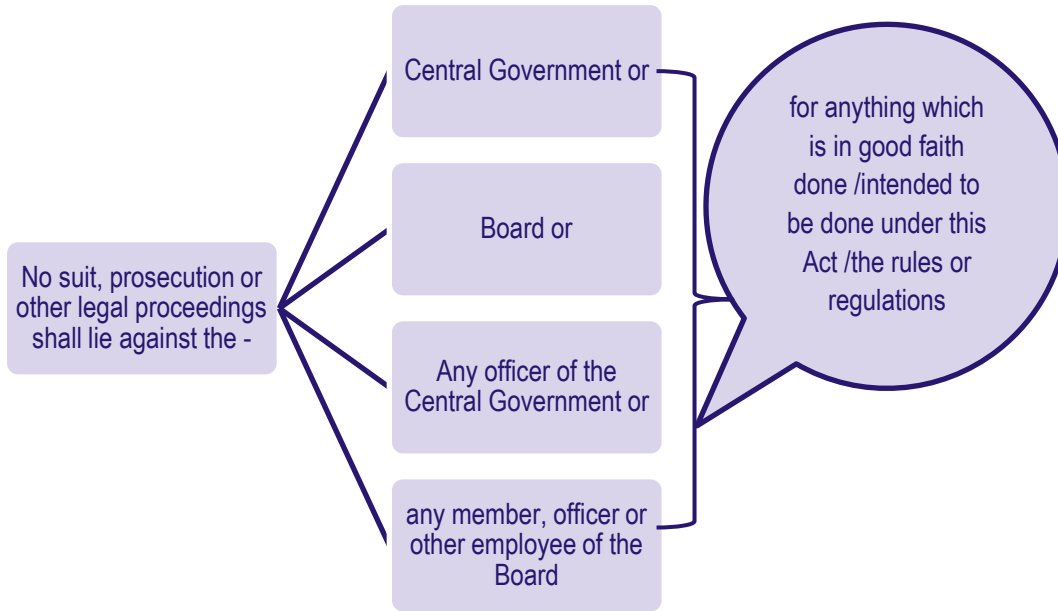
(4) The procedure for disposing of an appeal shall be such as may be prescribed. Provided that before disposing of an appeal, the appellant shall be given a reasonable opportunity of being heard.



Members, officers and employees of the Board to be public servants [Section 22]

All members, officers and other employees of the Board shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code.

Protection of action taken in good faith [Section 23]



Offences [Section 24]

(1) Without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

(2) If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

Composition of certain offences [Section 24A]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Power to grant immunity [Section 24B]

(1) The Central Government may, on recommendation by the Board, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation,

- grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation.

Exception: Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity.

Provided further that recommendation of the Board under this sub-section shall not be binding upon the Central Government.

(2) **Withdrawal of granted immunity by the Central Government:** An immunity granted to a person above may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also

become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Cognizance of offences by courts [Section 26]

(1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations made thereunder, save on a complaint made by the Board.

Special Courts [Section 26A]

Establishment of Special Courts [Section 26A]	Offences triable by Special Courts [Section 26 B]
(1) Establishment of Special Court: The Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts as may be necessary. **(2) Composition:** A Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working. **(3) Qualification for appointment:** A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.	All offences under this Act committed prior to the date of commencement of the Securities Laws (Amendment) Act, 2014 or on or after the date of such commencement, shall be taken cognizance of and tried by- • the Special Court established for the area in which the offence is committed or where there are more Special Courts than one for such area, by • such one of them as may be specified in this behalf by the High Court concerned.

Appeal and revision [Section 26C]

The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

Application of Code to proceedings before Special Court [Section 26D]

(1) Save as otherwise provided in this Act, the provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session and the person

conducting prosecution before a Special Court shall be deemed to be a Public Prosecutor within the meaning of clause (u) of section 2 of the Code of Criminal Procedure, 1973.

(2) The person conducting prosecution referred to in sub-section (1) should have been in practice as an advocate for not less than seven years or should have held a post, for a period of not less than seven years, under the Union or a State, requiring special knowledge of law.

Transitional provisions [Section 26E]

Any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be taken cognizance of and tried by a Court of Session exercising jurisdiction over the area, notwithstanding anything contained in the Code of Criminal Procedure, 1973:

Provided that nothing contained in this section shall affect the powers of the High Court under section 407 of the Code of Criminal Procedure, 1973 to transfer any case or class of cases taken cognizance by a Court of Session under this section.

Offences by companies [Section 27]

(1) **Where an offence under this Act has been committed by a company** -every person who at the time the offence was committed was in charge of, and was 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:

Exemption: This sub-section shall not render any such person liable to any punishment provided in this Act, 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.

(2) Notwithstanding anything contained in sub-section (1), where an 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 the offence and shall be liable to be proceeded against and punished accordingly.

Explanation: For the purposes of this section,—

(a) company means any body corporate and includes a firm or other association of individuals; and

(b) director, in relation to a firm, means a partner in the firm.

Recovery of amounts [Section 28A]

(1) If a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any direction of the Board for refund of monies or fails to comply with a direction of disgorgement order or fails to pay any fees due to the Board, the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the

person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely:—

(a) attachment and sale of the person's movable property;

(b) attachment of the person's bank accounts;

(c) attachment and sale of the person's immovable property;

(d) arrest of the person and his detention in prison;

(e) appointing a receiver for the management of the person's movable and immovable properties,

and for this purpose, the provisions of sections 220 to 227, 228A, 229, 232, the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time, in so far as may be, apply with necessary modifications as if the said provisions and the rules made thereunder were the provisions of this Act and referred to the amount due under this Act instead of to income-tax under the Income-tax Act, 1961.

Explanation 1— For the purposes of this sub-section, the person's movable or immovable property or monies held in bank accounts shall include any property or monies held in bank accounts which has been transferred directly or indirectly on or after the date when the amount specified in certificate had become due, by the person to his spouse or minor child or son's wife or son's minor child, otherwise than for adequate consideration, and which is held by, or stands in the name of, any of the persons aforesaid; and so far as the movable or immovable property or monies held in bank accounts so transferred to his minor child or his son's minor child is concerned, it shall, even after the date of attainment of majority by such minor child or son's minor child, as the case may be, continue to be included in the person's movable or immovable property or monies held in bank accounts for recovering any amount due from the person under this Act.

Explanation 2.— Any reference under the provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962 to the assesses shall be construed as a reference to the person specified in the certificate.

Explanation 3.— Any reference to appeal in Chapter XVIID and the Second Schedule to the Income-tax Act, 1961, shall be construed as a reference to appeal before the Securities Appellate Tribunal under section 15T of this Act.

(2) The Recovery Officer shall be empowered to seek the assistance of the local district administration while exercising the powers under sub-section (1).

(3) Notwithstanding anything contained in any other law for the time being in force, the recovery of amounts by a Recovery Officer under sub-section (1), pursuant to non-compliance with

any direction issued by the Board under section 11B, shall have precedence over any other claim against such person.

(4) For the purposes of sub-sections (1), (2) and (3), the expression "Recovery Officer" means any officer of the Board who may be authorised, by general or special order in writing, to exercise the powers of a Recovery Officer.

Power to make rules [Section 29]

(1) The Central Government may, by notification, make rules for carrying out the purposes of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:—

(a) the term of office and other conditions of service of the Chairman and the members under sub-section (1) of section 5;

(b) the additional functions that may be performed by the Board under section 11;

(c) Omitted

(d) the manner in which the accounts of the Board shall be maintained under section 15;

(da) the manner of inquiry under sub-section (1) of section 15-I;

(db) the salaries and allowances and other terms and conditions of service of the Presiding Officers, Members and other officers and employees of the Securities Appellate Tribunal under section 15-O and sub-section (3) of section 15S;

(dc) the procedure for the investigation of misbehaviour or incapacity of the Presiding Officers, or other Members of the Securities Appellate Tribunal under sub-section (3) of section 15Q;

(dd) the form in which an appeal may be filed before the Securities Appellate Tribunal under section 15T and the fees payable in respect of such appeal;

(e) the form and the manner in which returns and report to be made to the Central Government under section 18;

(f) any other matter which is to be, or may be, prescribed, or in respect of which provision is to be, or may be, made by rules.

Power to make regulations [Section 30]

(1) The Board may, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely:—

(a) the times and places of meetings of the Board and the procedure to be followed at such meetings under sub-section (1) of section 7 including quorum necessary for the transaction of business;

(b) the terms and other conditions of service of officers and employees of the Board under sub-section (2) of section 9;

(*c*) the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies under section 11A;

(ca) the utilisation of the amount credited under sub-section (5) of section 11;

(cb) the fulfilment of other conditions relating to collective investment scheme under subsection (2A) of section 11AA;]

(d) the conditions subject to which certificate of registration is to be issued, the amount of fee to be paid for certificate of registration and the manner of suspension or cancellation of certificate of registration under section 12.

(da) the terms determined by the Board for settlement of proceedings under sub-section (2) and the procedure for conducting of settlement proceedings under sub-section (3) of section 15JB;

(db) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be made by regulations.

Rules and regulations to be laid before Parliament [Section 31]

Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

Application of other laws not barred [Section 32]

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

Power to remove difficulties [Section 34]

(1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order, published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:

Provided that no order shall be made under this section after the expiry of five years from the commencement of this Act.

(2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Validation of certain acts [Section 34A]

34A. Any act or thing done or purporting to have been done under the principal Act, in respect of calling for information from, or furnishing information to, other authorities, whether in India or outside India, having functions similar to those of the Board and in respect of settlement of administrative and civil proceedings, shall, for all purposes, be deemed to be valid and effective as if the amendments made to the principal Act had been in force at all material times.

SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

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SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

1. SCOPE

On September 2, 2015, SEBI notified the Listing Obligations and Disclosure Requirements Regulations, 2015 to be called as the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 with objectives:-

To align clauses of the listing agreement with Companies Act and secondly, to consolidate the conditions under different securities' listing agreements in one single regulation. The 2015 Regulations are applicable to any entity (whether a company or not) accessing the stock exchange, for listing equity shares (on main board, SME exchange, institutional trading platforms), debt securities, preference shares, depository receipts, securitized debt instruments, mutual fund units, and other securities as may be specified by SEBI.

2. INTRODUCTION

Securities and Exchange Board of India (SEBI), on September 2, 2015, issued SEBI (Listing and Disclosure) Regulations, 2015 on listing of different segments of the capital market and disclosure norms in relation thereto.

These regulations have been structured into single document with the aim to consolidate and streamline the provision of existing listing agreements for different segments of capital markets, such as equity shares (including convertibles), non-convertible debt securities, etc. for ensuring better enforceability.

The latest set of norms provides broad principles for periodic disclosures by listed entities, apart from incorporating corporate governance principles. These regulations shall apply to the listed entity who has listed any of the following designated securities on recognized stock exchange(s):

- Specified securities listed on main board or SME Exchange or Institutional trading platform;
- Non-convertible debt securities, non-convertible redeemable preference Shares, perpetual debt instrument, perpetual non-cumulative preference Shares;
- Indian depository receipts;
- Securitized debt instruments;
- [4]security receipts;
- Units issued by mutual funds;
- Any other securities as may be specified by the Board.

Key features of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 -

1. Composition of Board: Regulation 17(1) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 states that company should have optimum combination of executive and non-executive directors, with not less than 50% of directors comprising of non-executive directors. Minimum age of director should be 21 years.

[4] Clause (da) inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2018, w.e.f. **6-9-2018.**

Independent directors – Regulation 17 specifies that where **the chairperson of the board of directors is a non-executive director**, at least one-third of the board of directors shall comprise of independent directors.

Where the listed entity **does not have a regular non-executive chairperson**, at least half of the board of directors (i.e., 50%) shall comprise of independent directors.

Provided that where the **regular non-executive chairperson is a promoter** of the listed entity or **is related to any promoter or person occupying management positions** at the level of board of director or at one level below the board of directors- at least half of the board of directors of the listed entity shall consist of independent directors.

If the promoter is a company (and not individual), "related to any promoter" means –

(a) If the **promoter is a listed entity**, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it,

(b) If the **promoter is an unlisted entity**, its directors, its employees or its nominees shall be deemed to be related to it.

[Explanation to proviso to regulation 17(1) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015].

Provisions relating to independent directors are not applicable to section 8 (licensed i.e. non-profit) companies [MCA Notification dated 5-6-2015 issued under section 462 of Companies Act, 2013]

Disclosure about relationships between directors - Disclosure about relationship between directors inter-se shall be made in the Annual Report, notice of appointment of director, prospectus and letter of offer for issuance and related filings made to stock exchange, where the company is listed.

Vacancy in post of independent director - Vacancy in post of independent director should be filled within three months - Schedule IV of Companies Act, 2013.

2. Board meetings and information to be given to Board: Regulation 17(2) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides of conduct of Board meetings. It shall be held at least four times in a year, with maximum time gap of 120 days between the meetings.

Review of compliance report – As per Regulation 17(3) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 201, Board will periodically review compliance reports of all laws applicable to company, prepared by company and steps taken by company to rectify instances of non-compliance.

3. Restrictions on Committee membership

Nature of holding of office by a person	Maximum Ceiling
A person shall be a member of committees of Board	10
A person shall be a chairperson of committees	5 (across all companies in which he is director)

For purpose of considering the limit of committees on which a director can serve, all listed and unlisted public companies will be included, but other companies (private companies, foreign companies, section 8 companies) will be excluded.

Further, only two committees i.e. Audit committee and Stockholders' Relationship Committee shall be considered for purpose of the limit, i.e. membership of other committees will not be considered [Regulation 26(1) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015]

4. Qualified and independent Audit Committee: Company will form a qualified and independent audit committee. The requirements are contained in Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

5. Corporate governance requirements with respect to Subsidiary Companies of listed company Regulation 24 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 also apply to listed subsidiary, if it has subsidiaries.

At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of the subsidiary company. The Audit Committee of the holding company shall also review the financial statements, in particular the investments made by the subsidiary company. The minutes of the Board meetings of the subsidiary company shall be placed for review at the Board meeting of the holding company. The Management should bring to notice of Board of holding company all significant transactions and arrangements entered into by unlisted subsidiary company.

Listed entity shall not dispose of shares in its material subsidiary without special resolution in general meeting.

6. Disclosures of events or information: All material disclosures should be made. Following are the disclosures given in Regulation 30 of

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Following disclosures shall be made -

Basis of related party transactions - A statement of all transactions with related parties including their basis shall be placed before the Audit Committee. Material transactions which are not in normal course of business shall be placed before audit committee. If any transaction is not on an arm's length basis, management shall provide an explanation to the Audit Committee justifying the same.

Disclosure of Accounting Treatment – In case of non-compliance of accounting standards, the fact should be disclosed in financial statement, together with management's explanation why the alternate treatment is giving better view.

Disclosure of risks and risk management - Company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

Proceeds from Initial Public Offerings (IPOs) - When money is raised through an Initial Public Offering (IPO) it shall disclose to the Audit Committee, the uses/applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus. This statement shall be certified by the statutory auditors of the company. Where company has appointed monitoring agency to monitor utilisation of proceeds of public or rights issue, the report of monitoring committee will be placed before audit committee. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

Remuneration of Directors - All pecuniary relationship or transactions of the non-executive director's vis-à-vis the company shall be disclosed in the Annual Report. Disclosure about remuneration giving prescribed details should be made in section on Corporate Governance.

Management discussion and analysis report of Board - A management discussion and analysis report of Board shall form part of annual report to shareholders. The report should include following matters within the limits set by the company's competitive position - (a) Industry structure and development (b) Opportunities and threats (c) Segment-wise or product wise performance (d) Outlook (e) Risks and concerns (f) Internal control systems and their adequacy (g) Discussion on financial performance with respect to operational performance (h) Material developments in human resources/industrial relations.

Business Responsibility Statement - Companies are expected to make public disclosure regarding steps taken from Environment, Social and Governance (ESG) perspective. Companies should submit BR Report as part of Annual Report. [Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015]

Disclosure when director is to be appointed/re-appointed - In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information - (a) A brief resume of the director; (b) Nature of his expertise in specific functional areas (c) Names of companies in which the person also holds the directorship and the membership of Committees of the Board and (d) Shareholding of non-executive directors in the company either own or as beneficiary

Information about company on web - Quarterly results and presentation made by companies to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.

7. CEO/CFO certification: CEO (either the Managing Director or Manager appointed under Companies Act) and the CFO (whole-time Finance Director or other person discharging this function) of the company shall certify to Board that, they have reviewed the financial statements and the cash flow statements and to the best of their knowledge and belief these statements are true.

The certificate should be submitted to Board annually before or at the time when the annual accounts are presented to Board.

Appointment of CFO shall be approved by Audit Committee before finalisation of appointment of CFO by management.

8. Report on Corporate Governance to Members: Annual Report of Company shall include a separate section on report on corporate governance.

Board of Directors - (i) Composition and category of directors, for example, promoter, executive, non-executive, independent non-executive, nominee director, which institution represented as lender or as equity investor (ii) Attendance of each director at the Board of Directors (BoD) meetings and the last AGM (iii) Number of other BoDs or Board Committees in which he/she is a member or Chairperson (iv) Number of BoD meetings held, dates on which held.

Audit Committee - (i) Brief description of terms of reference (ii) Composition, name of members and Chairperson (iii) Meetings and attendance during the year.

Remuneration Committee - (i) Brief description of terms of reference (ii) Composition, name of members and Chairperson (iii) Attendance during the year (iv) Remuneration policy (v) Details of remuneration to all the directors, as per format in main report.

Shareholders Grievance Committee - (i) Name of non-executive director heading the committee (ii) Name and designation of compliance officer (iii) Number of shareholders' complaints received so far (iv) Number not solved to the satisfaction of shareholders (v) Number of pending complaints

General Body meetings - (i) Location and time, where last three AGMs held (ii) Whether any special resolutions passed in the previous 3 AGMs (iii) Whether any special resolution passed last year through postal ballot - details of voting pattern (iv) Person who conducted the postal ballot exercise (v) Whether any special resolution is proposed to be conducted through postal ballot (vi) Procedure for postal ballot

Disclosures - (i) Disclosures on materially significant related party transactions that may have potential conflict with the interests of company at large (ii) Details of non-compliance by the company, penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years (iii) Whistle Blower policy and

affirmation that no personnel has been denied access to the audit committee (iv) Details of compliance with mandatory requirements and adoption of non-mandatory requirements of clause 49.

9. Transparency and disclosures: SEBI has provided for many disclosures to bring transparency and ensure adequate disclosures to members and public. Some important measures are (a) Publication of quarterly unaudited reports with segment reporting within one month (b) Quarterly limited review by auditors (c) Disclosures about important events in the company (d) Disclosures in Directors' Report.

10. SEBI guidelines on evaluation: Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 make provisions relating to Board evaluation of performance of (i) Board (ii) Individual directors and Chairperson and (iii) Committees of Board (specially Nomination and Remuneration Committee).

(a) Section 134(3) of Companies Act, 2013 requires statement of annual evaluation by Board of its own performance and of committees

(b) section 178(2) of Companies Act, 2013 requires Nomination and Remuneration Committee to identify persons to be directors

(c) Schedule IV - Performance evaluation of independent directors

(d) SEBI (LODR) Regulations covering provisions relating to functions of Board, performance evaluation of directors, role of Nomination and Remuneration Committee and Corporate Governance Report.

Further, the Listing Regulations have been sub-divided into two parts viz,:

(a) **Substantive** provisions incorporated in the main body of Regulations,

(b) **Procedural** requirements in the form of schedules to the Regulations

3. COMMON OBLIGATIONS OF LISTED ENTITIES

This part deals with the obligations and responsibilities upon all the listed entities. A responsibility has been cast upon Key Managerial Personnel (KMP'S), Directors, and Promoters that they shall comply with responsibilities or obligations assigned to them under the regulations. [Regulation 5]

The following are the common obligations on Listed entities:-

(1) Regulation 6: Compliance Officer And his Obligations: A listed entity shall appoint a qualified Company Secretary as the Compliance Officer. The Compliance officer so appointed shall be responsible for ensuring conformity with regulatory compliance, co-ordination and reporting to the Board, ensuring that correct procedures have been followed that would result in correctness of information filed by listed entity under the regulations and monitoring email address of grievance redressal division.

(2) **Regulation 7: Share Transfer Agent:** The listed entity shall appoint a share transfer agent or manage the share transfer facility in house.

4. REGULATION 24: CORPORATE GOVERNANCE REQUIREMENTS WITH RESPECT TO SUBSIDIARY OF LISTED ENTITY.

The Board: [5](1) At least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

Explanation.— the term "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds twenty per cent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than fifty per cent or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting except in cases where such divestment is made under a scheme of arrangement duly approved by a Court/Tribunal or under a resolution plan duly approved under section 31 of the Insolvency Code and such an event is disclosed to the recognized stock exchanges within one day of the resolution plan being approved.

Selling, disposing and leasing of assets amounting to more than 20% of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal or under a resolution plan duly approved under section 31 of the Insolvency Code and such an event is disclosed to the recognized stock exchanges within one day of the resolution plan being approved.

5. QUARTERLY COMPLIANCES– Listed Entity

A. Regulation 13(3):- Grievance Redressal Mechanism

The listed entity shall file with the recognized stock exchange(s) on a quarterly basis, within **21 days** from the end of each quarter, a statement giving the number of investor complaints pending at the beginning of the quarter, those received during the quarter, disposed of during the quarter and those remaining unresolved at the end of the quarter.

[5] Substituted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, with effect from the half year ending March 31, 2019, w.e.f. **1-4-2019.**

B. Regulation 27(2):- Other Corporate Governance Requirements

A listed entity shall submit quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognized stock exchange(s), Within **15 days** from close of quarter.

C. Regulation 31(1): Holding of Specified Securities and Shareholding Pattern.

A listed entity shall submit a statement showing holding of securities and shareholding pattern separately for each class of securities:-

(a) **One day** prior to listing of its securities on the stock exchange(s);

(b) On a quarterly basis, **within 21 days** from the end of each quarter; and,

(c) Within **10**days of any capital restructuring of the listed entity resulting in a change exceeding **2 % per cent** of the total paid-up share capital.

D. Regulation 33(3): Financial Results

The listed entity shall submit quarterly and year-to-date standalone financial results to the stock exchange **within 45 days** of end of each quarter, other than the last quarter.

E. Regulation 32(1): Statement of Deviation(S) Or Variation(S)

A listed entity shall submit to the stock exchange the following statement(s) on a quarterly basis for public issue, rights issue, preferential issue etc.,-

(a) **indicating deviations**, if any, in the use of proceeds from the objects stated in the offer document or explanatory statement to the notice for the general meeting, as applicable;

(b) **indicating category wise variation** (capital expenditure, sales and marketing, working capital etc.) between projected utilization of funds made by it in its offer document or explanatory statement to the notice for the general meeting, as applicable and the actual utilization of funds.

6. PRIOR INTIMATION OF BOARD MEETING

A. Regulation 29(1): Financial Results

At least **5 days** in advance (excluding date of meeting and date of intimation).

B. Other Matters Regulation 29(2)

For following purposes Intimation shall be required to be made at least **2 working days** in advance, excluding the date of the intimation and date of the meeting:-

- Proposal for **Voluntary Delisting** by the listed entity from the stock exchange(s);
- Fund raising by way of further public offer, rights issue, American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds, qualified institutions placement, debt issue, preferential issue or any other method and for determination of issue price.

- Declaration/recommendation of dividend, issue of convertible securities including convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend
- The proposal for declaration of bonus securities where such proposal is communicated to the board of directors of the listed entity as part of the agenda papers;
- Proposal for Buyback of Securities.

C. Regulation 29(3): Prior Intimation

The listed entity shall give intimation to the stock exchange(s) at least **11 working days** before any of the following proposal is placed before the board of directors -

- Any alteration in the **form or nature** of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof.
- Any alteration in the **date** on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

D. Regulation 42(2): Record Date or Date of Closure of Transfer Books

A listed entity shall give notice in to stock exchange(s) of record date specifying the **purpose** of the record date, at least **7 working days** (excluding the date of intimation and the record date).

E. Regulation 42(3): Dividend

A listed entity shall recommend or declare all dividend and/or cash bonuses At least **5 working** days (excluding the date of intimation and the record date) before the record date.

F. Regulation 46(3):- Website

A listed entity shall update any change in the content of its website **Within 2 working days** from the date of such change in content.

7. ANNUAL / YEARLY COMPLIANCES

The annual/yearly compliances that have to be followed are as follows:

A. Regulation 33(3): Financial Results: Listed entity shall submit audited standalone financial results for the financial year, along with the audit report and either **Form A** (for audit report with unmodified opinion) or **Form B** (for audit report with modified opinion) **within 60 days** from end of Financial Year.

B. Regulation 34: Annual Report: [6]The listed entity shall submit to the stock exchange and publish on its website—

[6] Substituted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018. The amendment shall be applicable in respect of the Annual report filed for the year ended March 31, 2019 and thereafter.

(a) a copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders;

(b) in the event of any changes to the annual report, the revised copy along with the details of and explanation for the changes shall be sent not later than 48 hours after the annual general meeting.

C. **Regulation 36(2): Documents & Information to Shareholders:** A listed entity shall send annual report to the holders of securities not less than **21 days before** the Annual General Meeting.

8. ROLE OF COMPLIANCE OFFICER

The role of a Compliance Officer is as follows:

- Listed Company shall ensure KMP, Directors, Promoters complies with obligations
- Compliance Officer ensure listed Company confirms with regulatory provisions in letter and spirit.
- Co-ordination with – Board and Stock Exchange
- Report to – Board and Stock Exchange.
- Ensure – Correct, Authentic, Comprehensive info is filed.
- Monitor email id for grievance redressal.
- Determining materiality of information to be reported to stock exchange.
- Report to Board about compliance.
- Ensure compliance with SS 1(Board Meeting) and SS 2(General Meeting)
  - To provide guidance to director about their Duties.
  - To assist board in conduct of affairs of the Company.
  - Assist and Advice board in complying with CG and best practices.
  - Facilitate meeting / represent company etc.

9. CORPORATE GOVERNANCE

- **Approval for related party transactions** through a resolution [As per Clause 49 of Listing Agreement, it was Special Resolution]
- All existing material related party contracts / arrangements, prior to the date of notification of these Regulations, and which may continue beyond, to be placed for approval of the shareholders in first General Meeting subsequent to notification of these Regulations.

Compliance Report on Corporate Governance

The following reports are submitted to Stock Exchange:-

- **Quarterly Compliance Report** – to be submitted within **15 days** from end of quarter
- **Compliance Report** to be submitted **within 6 months** from the end of financial year – may be submitted along with second quarter report.
- **Annual Compliance Report**.

10. TYPES OF COMMITTEES UNDER LODR REGULATIONS

A. Audit Committee:

Every listed entity shall constitute a qualified and independent audit committee which shall have:

(a) The audit committee shall have minimum **three** directors as members.

(b) **Two-thirds** of the members of audit committee shall be independent directors.

(c) **All** members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

(d) The chairperson of the audit committee shall be an **Independent Director** and he shall be present at Annual general meeting to answer shareholder queries.

(e) The Company Secretary shall act as the secretary to the audit committee.

(f) The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee.

Meetings of Audit Committee:

(a) The audit committee shall meet at least **four** times in a year and not more than **120** days shall elapse between two meetings.

(b) The **Quorum** for audit committee meeting shall either be **two** members or **one third** of the members of the audit committee, whichever is greater, with at least **2** Independent directors.

(c) The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

B. Nomination and Remuneration Committee:

The Board of directors shall constitute the nomination and remuneration committee as follows:

- The committee shall comprise of at least **3** directors;
- All directors of the committee shall be **Non-Executive Directors**; and

- At least **50 percent** of the directors shall be independent directors.

The **Chairperson** of the nomination and remuneration committee shall be an independent director: **Provided** that the chairperson of the listed entity, whether executive or non-executive, may be appointed as a member of the Nomination and Remuneration Committee and shall not chair such Committee. [7]The nomination and remuneration committee shall meet at least once in a year.

C. Stakeholders Relationship Committee:

The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into [8]various aspects of interest of shareholders, debenture holders and other security holders.

- The Chairperson of this committee shall be a Non-Executive director.
- The Board of Directors shall decide other members of this committee.
- 9At least three directors, with at least one being an independent director, shall be members of the Committee.

D. Risk Management Committee

- The Board of directors shall constitute a Risk Management Committee.
- The majority of members of Risk Management Committee shall consist of members of the board of directors.
- The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.
- The Board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem [10]fit such function shall specifically cover cyber security.
- The provisions of this regulation regarding risk management committee shall be applicable to top [11]500 listed entities, determined on the basis of market capitalization, as at the end of the immediate previous financial year.

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[7] Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. **1-4-2019.**

[8] Substituted for "the mechanism of redressal of grievances" the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. **1-4-2019.**

[9] Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. **1-4-2019.**

[10] Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. **1-4-2019.**

[11] Substituted for "100" the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, w.e.f. **1-4-2019.**

TEST YOUR KNOWLEDGE

Multiple Choice Question

1. Mr. KG filed a complaint against Mr. P alleging that Mr. P has communicated unpublished price sensitive information to Mr. X. Mr. P took a plea that Mr. X requested him for such information and it was done bonafidely. State the correct statement as to the liability of Mr. P in the given situation-

   (a) Mr. P will not be liable as he communicated about unpublished price sensitive information on the request of Mr. X

   (b) Mr. P will not be liable as he communicated about unpublished price sensitive information to Mr. X, in the ordinary cause of business

   (c) Mr. P will not be liable as he communicated about unpublished price sensitive information to Mr. X as it was done without any malafide intention.

   (d) Mr. P will be liable as he communicated about unpublished price sensitive information to Mr. X, whether with or without his request for such information.

2. Number of independent directors in Audit committee-

   (a) one-third of the members of audit committee.

   (b) Two-thirds of the members of audit committee shall be independent directors.

   (c) minimum 2

   (d) minimum 3

3. For how much capital restructuring, the listed entitiy shall submit a statement showing holding of securities and shareholding pattern with the stock exchange:

   (a) resulting in a change exceeding 1% of the total paid-up share capital

   (b) resulting in a change exceeding 2% of the total paid-up share capital

   (c) resulting in a change exceeding 2.5% of the total paid-up share capital

   (d) resulting in a change exceeding 2% of the total issued share capital

4. SEBI has imposed a penalty on Hotel Leel Ventures Ltd. for violation of Takeover Code. The directors of Management is seeking your advice to apprise them with the time period for filling an appeal with SAT and Supreme Court? Suggest what will be the time period for filing appeal with SAT and Supreme Court?

   (a) In case of filing appeal with SAT: Within 45 days from the date of order of the copy made by SEBI or adjudicating officer and in case of filing appeal with Supreme Court: Within 60 days from the date of communication of the decision or order of SAT.

(b) In case of filing appeal with SAT: Within 60 days from the date of order of the copy made by SEBI or adjudicating officer and in case of filing appeal with Supreme Court: Within 60 days from the date of communication of the decision or order of SAT.

(c) In case of filing appeal with SAT: Within 30 days from the date of order of the copy made by SEBI or adjudicating officer and in case of filing appeal with Supreme Court: Within 60 days from the date of communication of the decision or order of SAT.

(d) In case of filing appeal with SAT: Within 60 days from the date of order of the copy made by SEBI or adjudicating officer and in case of filing appeal with Supreme Court: Within 45 days from the date of communication of the decision or order of SAT.

5. Suppose SEBI has constituted its board as per requirements of section 4 of SEBI Act, 1992 with 3 whole time members under Section 4(1)(d) of the SEBI Act, 1992, but one of them resigned and to refill his post, it took 1 month. Examine acts done in between the vacancy period, as per SEBI Act 1992.

(a) All acts become void ab-initio as per section 8 of the SEBI Act, 1992.

(b) Only financial acts are void ab initio as per section 8 of the SEBI Act, 1992.

(c) All acts are valid as per section 8 of the SEBI Act, 1992.

(d) All acts should be rectified after composition of proper board as per section 8 of the SEBI Act, 1992.

6. ABC & Co., Chartered Accountants, is a partnership firm, who is auditor of one of the listed company Z ltd. for the financial year 2018-19. Mr. B is engaging partner of that audit with a team of 15 members. While doing audit of the financial statement of the company, two members of the team, who are chartered accountant, passed the information to their friends and relatives that this year company's profit is increasing by 25% as compared to last audited financial year, before this information came in to public domain through the company. They made profit from this information by purchase at low price and after financial statements came in public domain and share prices raised, they sold shares at enhanced price. Please state whether it is a case of insider trading. If yes, then how much penalty for this act, under SEBI Act, 1992.

(a) No, it is not insider trading, because that these persons are not restricted to use the information to benefit themselves.

(b) No, it is not insider trading, because it is not price sensitive information.

(c) Yes, it is insider trading and penalty u/s 15G would be minimum Rs. 10 lacs which may extend upto Rs. 25 cr. or 3 times of profit derived, whichever is higher.

(d) Yes, it is insider trading and penalty u/s 12A would be Rs. 25 cr. or 3 times of profit derived, whichever is lower.

7. A ltd., a listed company, wants to revise the rate of interest of its existing 12% bond by 1% i.e. 13% bond from 14th August 2019, the said proposal is to be laid before board meeting to be held on 14th July 2019. Upto which of the following date, A Ltd. has to intimate to stock exchange as per regulation 29 of SEBI (LODR), 2015:

   (a) 3rd July 2019.

   (b) 3rd August 2019.

   (c) 5th July 2019.

   (d) 5th August 2019.

Descriptive Questions

Question 1

A group of complainants have alleged that Mr. Z, a Member of the Securities and Exchange Board of India (SEBI) has pecuniary interest in some of the cases that came up before the Board and that he misused his position and therefore, he should be removed from his office. The complainants seek your advice. Advise.

Question 2

SEBI received complaints from some investors alleging that ABC Ltd. and some brokers are indulging in price manipulation in the shares of ABC Ltd. Explain the powers that can be exercised by SEBI under the Securities and Exchange Board of India Act, 1992 in case the allegations are found to be correct.

Question 3

Clever who is registered as an Intermediary fails to enter into an agreement with his client and hence penalised by SEBI under section 15B of the SEBI Act. Advise Mr. Clever as to what remedies are available to him against the order of SEBI.

Question 4

A group of investors are upset with the functioning of two leading stock brokers of Calcutta Stock Exchange and want to make a complaint to SEBI for intervention and redressal of their grievances. Explain briefly the purpose of establishing SEBI and what type of defaults by the stock brokers come within the purview of SEBI Act, 1992.

Question 5

Mr. Raman, an investor is not satisfied with the dealings of his stock broker who is registered with Delhi Stock Exchange. Mr. Raman approaches you to guide him regarding the avenues available to him for making a complaint against the stock broker under Securities and Exchange Board of India Act, 1992 and also the grounds on which such complaint can be made. You are required to briefly explain the answer to his queries.

Question 6

On the complaint of Mr. Kamlesh Gupta, after enquiry SEBI finds that Mr. P. Mehta a Chief Executive Officer of the Company, on the basis of unpublished price sensitive information, has indulged in the trading of the securities of that company. Explain, on the basis of the said finding, what action SEBI can take against Mr. P. Mehra under the Securities and Exchange Board of India Act, 1992.

Question 7

Securities and Exchange Board of India (SEBI) has undertaken inspection of books of accounts and records of LR Ltd., a listed public company. Specify the measures which may be taken by SEBI under the Securities and Exchange Board of India Act, 1992 to protect the interest of investors and securities market, on completion of such inquiry.

Question 8

Mr. S, a member of MN Ltd., obtained an order from the Securities and Exchange Board of India (SEBI) against the company. But the company failed to redress the grievance of Mr. S within the time fixed. Consequently, SEBI imposed penalty on the company. The company, however, did not pay the penalty also. State how the penalty can be recovered from the company?

ANSWERS/SOLUTION

Answers to MCQ

1. **(d)** **Hint:** Section 15G of the Securities and Exchange Board of India (SEBI) Act, 1992.

2. **(b)** **Hint:** As per SEBI (LODR) Regulations, two-thirds of the members of audit committee shall be independent directors.

3. **(b)** **Hint:** As per SEBI (LODR) Regulations, a listed entity shall submit a statement showing holding of securities and shareholding pattern separately for each class of securities:-

(a) **One day** prior to listing of its securities on the stock exchange(s);

(b) On a quarterly basis, **within 21 days** from the end of each quarter; and,

(c) Within **10** days of any capital restructuring of the listed entity resulting in a change exceeding **2 % per cent** of the total paid-up share capital.

4. **(a)** **Hint:** Section 15T and 15Z of SEBI Act, 1992

5. **(c)** **Hint:** Section 8 of SEBI Act, 1992

6. **(c)** **Hint:** Section 15G of the SEBI Act, 1992

7. **(a)** **Hint:** Regulation 29

Answers to Descriptive Questions

1. Removal of Member of the SEBI (Section 6 of the Securities and Exchange Board of India Act, 1992)

According to section 6 of the Securities and Exchange Board of India Act, 1992, the Central Government shall have the power to remove a member appointed to the Board, if he:

(i) is, or at any time has been adjudicated as insolvent;

(ii) is of unsound mind and stands so declared by a competent court;

(iii) has been convicted of an offence which, in the opinion of the Central Government, involves a moral turpitude.

(iv) has, in the opinion of the Central Government so abused his position as to render his continuance in office detrimental to the public interest.

Before removing a member, he will be given a reasonable opportunity of being heard in the matter.

In the present case, a group of complainants have alleged that Mr. Z, a member of the SEBI has pecuniary interest in some of the cases that came up before the Board and he misused his position and therefore, he should be removed from his office.

Here, above complainants may approach the Central Government for removal of Mr. Z, a member of the SEBI and if the Central Government is of the opinion that Mr. Z has so abused his position as to render his continuation in office detrimental to the public interest, the Central Government may remove Mr. Z from his office after giving him a reasonable opportunity of being heard in the matter.

2 Price manipulation in the shares of ABC Ltd. can be considered as fraudulent and unfair trade practices relating to securities market. In this case SEBI may exercise the following powers under section 11(4) of securities and Exchange Board of India Act, 1992.

(i) Suspend the trading of any security (in this case the securities of ABC Ltd.) in a recognized stock exchange.

(ii) Restrain persons (in this case ABC Ltd.) from accessing the securities market. It can also prohibit any person associated with securities market (i.e. brokers who have indulged in price manipulation) to buy, sell or deal in securities market.

SEBI may issue the above orders for reasons to be recorded in writing. SEBI shall, either before or after passing such orders give an opportunity of hearing to company and brokers concerned (proviso 2 to Section 11(4)) SEBI may also appoint an adjudicating officer who may levy penalty under section 15 HA after holding an enquiry in the prescribed manner. According to section 15HA if any person indulges in fraudulent and unfair trade practices

relating to securities, he shall be leviable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

Prohibition on manipulation and deceptive practices: Further according to section 12A, no person shall directly or indirectly indulge in following (i.e.) (a) using in manipulative or deceptive device in connection with purchase, sale or securities listed (b) Employ any scheme or device to defraud in connection with dealing in securities which are listed (c) engage in an act which would operate as fraud or deceit upon any person in connection with dealing in securities which are listed. SEBI may impose penalty which shall not be less than one lakh rupees but which may extend to one crore rupees. (Section 15 HB).

3. **Remedies against SEBI order:** Section 15B of the Securities and Exchange Board of India Act, 1992 lays down that if any person, who is registered as an intermediary and is required under this Act or any rules or regulations made there under, to enterr into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less. Mr. Clever has been penalised under the above mentioned provision. Two remedies are available to Mr. Clever in this matter:-

(i) **Appeal to the Securities Appellate Tribunal:** Section 15T of the SEBI Act, (1) any person aggrieved,—

(a) by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the rules or regulations made thereunder; or

(b) by an order made by an adjudicating officer under this Act; or

(c) by an order of the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Board or the Adjudicating Officer or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be, is received by him and it shall be in such form and be accompanied by such fee as may be prescribed :

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders

thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

The Securities Appellate Tribunal shall send a copy of every order made by it to the Board, or the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority, as the case may be the parties to the appeal and to the concerned Adjudicating Officer.

The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

(ii) **Appeal to the Supreme Court:** Section 15Z of the SEBI Act, 1992 provides that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order to him on any question of fact or law arising out of such order. The Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

4. The Securities and Exchange Board of India (SEBI) was established primarily for the purpose of

1. to protect the interests of investors in securities
2. to promote the development of securities market
3. to regulate the securities market and
4. For matters connected therewith and incidental thereto.

The following defaults by stock brokers come within the purview of SEBI Act:

(a) Any failure on the part of the stock broker to issue contract notes in the form and in the manner specified by the Stock Exchange.

(b) Any failure on the part of the broker to deliver any security or to make payment of the amount due to the investor in the manner or within the period specified in the regulations.

(c) Any collection of charges by way of brokerage in excess of the brokerage as specified in the regulations. (Section 15 F, SEBI Act, 1992)

5. Securities and Exchange Board of India (SEBI) was established for regulating the various aspects of stock market. One of its functions is to register and regulate the stock brokers. In the light of this, Mr. Raman is advised that the complaint against the erring stock broker may be submitted to SEBI.

The grounds on which or the defaults for which complaints may be made to SEBI are as

follows:

(a) Any failure on the part of the stock broker to issue contract notes in the form and manner specified by the stock exchange of which the stock broker is a member.

(b) Any failure to deliver any security or any failure to make payment of the amount due to the investor in the manner within the period specified in the regulations.

(c) Any collection of charges by way of brokerage which is in excess of the brokerage specified in the regulations.

6. Section 15G of the Securities and Exchange Board of India (SEBI) Act, 1992 deals with penalty for Insider Trading. According to this, if any insider

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary cause of business or under any law, or

(iii) counsels or procures for, any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information,

shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher. As such SEBI can, after following the prescribed procedure, impose a penalty on Mr. P. Mehra. The maximum penalty that SEBI can impose is Rupees twenty-five crores or three times the amount of profits made out of insider trading, whichever is higher.

7. As per section 11 (4) of the Securities and Exchange Board of India Act, 1992, the Board may, by an order, for reasons to be recorded in writing, in the interest of investors or securities market, take any of the following measures, either pending investigation or inquiry or on completion of such investigation or inquiry, namely:—

1. suspend the trading of any security in a recognised stock exchange;
2. restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities;
3. suspend any office-bearer of any stock exchange or self-regulatory organization from holding such position;
4. impound and retain the proceeds or securities in respect of any transaction which is under investigation;
5. attach, after passing of an order on an application made for approval by the Judicial Magistrate of the first class having jurisdiction, for a period not exceeding one month,

one or more bank account or accounts of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder:

However only the bank account or accounts or any transaction entered therein, so far as it relates to the proceeds actually involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder shall be allowed to be attached;

6. direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation.

8. According to Section 28A of the Securities and Exchange Board of India Act, 1992, if a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any direction of the Board for refund of monies or fails to comply with a direction of disgorgement order issued under section 11B or fails to pay any fees due to the Board, the Recovery Officer may draw up under his signature a statement /certificate in the specified form specifying the amount due from the person and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely:

(a) attachment and sale of the person's movable property;

(b) attachment of the person's bank accounts;

(c) attachment and sale of the person's immovable property;

(d) arrest of the person and his detention in prison;

(e) appointing a receiver for the management of the person's movable and immovable properties.

The expression 'Recovery Officer' means any officer of the Board who may be authorized by general or special order in writing, to exercise the powers of a Recovery Officer. The Recovery Officer shall be empowered to seek the assistance of the local district administration while exercising the powers.

Final Course

(Revised Scheme of Education and Training)

Study Material

(Modules 1 to 3)

Paper 4

Corporate and Economic Laws

Part – II : Economic Laws

Module – 3

BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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PART II: ECONOMIC LAWS

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CHAPTER 1

THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999

LEARNING OUTCOMES

After reading this chapter, you will be able to understand:

- The position of person resident in India for the purposes of the Foreign Exchange Management Act, 1999
- The regulations in relations to Current and Capital Account Transactions
- Regulations governing direct investment outside India
- Regulations governing the transactions in relations to import and export of goods and services
- Process of loans in India made by non-resident lenders in foreign currency to Indian borrowers
- The penalties imposed and the process of adjudication.

1. INTRODUCTION

Need for the Act

The change in the economic scenario, globalisation of capital, free trade across the globe, necessitated the need for managing foreign exchange in the country in an orderly manner. To facilitate cross border trade and cross border capital flows, exchange control law was required. Foreign exchange control led to introduction of exchange control law through Defense of India rules by the Britishers in 1939. Subsequently, Foreign Exchange Regulation Act (FERA) was enacted in 1947 which was later replaced with 'the Foreign Exchange Regulation Act, 1973' (FERA).

Government through the introduction of process of liberalisation of Indian economy in 1991, permitted Foreign Investment in various sectors. This increased flow of foreign exchange to India and foreign exchange reserves increased substantially. As of today, FERA has been repealed and FEMA (Foreign Exchange Management Act) has been passed. The Act has been made effective from 1st June, 2000. This Act enables management of foreign exchange reserves for the country.

Salient Features of the Act: It provides for-

- Regulation of transactions between residents and non-residents
- Investments in India by non-residents and overseas investments by Indian residents
- Freely permissible transactions on current account subject to reasonable restrictions that may be imposed
- RBI control over capital account transactions
- Requirement for realisation of export proceeds and repatriation to India
- Dealing in foreign exchange through 'Authorised Persons' like Authorised Dealer/Money Changer/Off-shore banking unit
- Adjudication and Compounding of Offences
- Investigation of offences by Directorate of Enforcement
- Appeal provisions including Special Director (Appeals) and Appellate Tribunal.

Enforcement of FEMA - Though RBI exercises overall control over foreign exchange transactions, enforcement of FEMA has been entrusted to a separate 'Directorate of Enforcement' formed for this purpose. [Section 36].

Broad Structure of FEMA

Now let us have a glance at the broad structure the Act. The Act consists of 7 Chapters dealing with following areas:

Chapters	Matters	Sections
I	Preliminary	1 – 2
II	Regulation and Management of Foreign Exchange	3 – 9
III	Authorised Person	10 – 12
IV	Contravention and Penalties	13 – 15
V	Adjudication and Appeal	16 – 35
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2. PREAMBLE, EXTENT, APPLICATION AND COMMENCEMENT OF FEMA, 1999

(A) Preamble: This Act aims to consolidate and amend the law relating to foreign exchange with the objective of —

(i) facilitating external trade and payments and

(ii) for promoting the orderly development and maintenance of foreign exchange market in India.

(B) Extent and Application [Sections 1]: FEMA, 1999 extends to the whole of India. In addition, it shall also apply to all branches, offices and agencies outside India owned or controlled by a person resident in India and also to any contravention thereunder committed outside India by any person to whom this Act applies.

Accordingly, FEMA does not apply to citizens of India who are outside India unless they are resident of India. The scope of the Act has been further extended to include branches, offices and agencies outside India. The scope is thus wide enough because the emphasis is on the words "Owned or Controlled". Even contravention of the FEMA committed outside India by a person to whom this Act applies will also be covered by FEMA.

(C) Commencement: The Act, 1999 came into force with effect from 1st June, 2000 vide Notification *G.S.R. 371(E), dated 1.5.2000*.

3. DEFINITIONS [SECTION 2]

In this Act, unless the context otherwise requires:

(a) *"Adjudicating Authority"* means an officer authorised under sub-section (1) of section 16(1); [Section 2(a)]

(b) *"Appellate Tribunal"* means the Appellate Tribunal for Foreign Exchange established under section 18; [Section 2(b)]

(c) *"Authorised person"* means an authorised dealer, money changer, off-shore banking unit or any other person for the time being authorised under section 10(1) to deal in foreign exchange or foreign securities; [Section 2(c)]

(d) *"Capital Account Transaction"* means a transaction, which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liability in India of persons resident outside India, and includes transactions referred to in Section 6(3); [Section 2(e)]

(e) *"Currency"* includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank. [Section 2(h)]

(f) "Currency Notes" means and includes cash in the form of coins and bank notes; [Section 2(i)]

(g) "Current Account Transaction" means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes,

  (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business.

  (ii) payments due as interest on loans and as net income from investments.

  (iii) remittances for living expenses of parents, spouse and children residing abroad, and

  (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children; [Section 2(j)]

(h) *"Export"*, with its grammatical variations and cognate expressions means;

  (i) the taking out of India to a place outside India any goods.

  (ii) provision of services from India to any person outside India; [Section 2(l)]

(i) *"Foreign Currency"* means any currency other than Indian currency; [Section 2(m)]

(j) *"Foreign Exchange"* means foreign currency and includes:

  (i) deposits, credits and balances payable in any foreign currency,

  (ii) drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency,

  (iii) drafts, travellers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency; [Section 2(n)]

(k) *"Foreign Security"* means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency; [Section 2(o)]

(l) *"Import"*, with its grammatical variations and cognate expressions, means bringing into India any goods or services; [Section 2(p)]

(m) *"Person"* includes:

(i) an individual,

(ii) a Hindu undivided family,

(iii) a company,

(iv) a firm,

(v) an association of persons or a body of individuals, whether incorporated or not,

(vi) every artificial juridical person, not falling within any of the preceding sub-clauses, and;

(vii) any agency, office or branch owned or controlled by such person; [Section 2(u)]

(n) *"Person resident in India"* means:

(i) a person residing in India for more than 182 days during the course of the preceding financial year but does not include—

(A) a person who has gone out of India or who stays outside India, in either case—

(a) for or on taking up employment outside India, or

(b) for carrying on outside India a business or vocation outside India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

(B) a person who has come to or stays in India, in either case, otherwise than:

(a) for or on taking up employment in India, or

(b) for carrying on in India a business or vocation in India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

(ii) any person or body corporate registered or incorporated in India,

(iii) an office, branch or agency in India owned or controlled by a person resident outside India,

(iv) an office, branch or agency outside India owned or controlled by a person resident in India; [Section 2(v)]

(o) *"Person Resident Outside India"* means a person who is not resident in India; [Section 2(w)]

(p) *"Repatriate to India"* means bringing into India the realised foreign exchange and

(i) the selling of such foreign exchange to an authorised person in India in exchange for rupees, or

(ii) the holding of realised amount in an account with an authorised person in India to the extent notified by the Reserve Bank.

It includes use of the realised amount for discharge of a debt or liability denominated in foreign exchange and the expression "repatriation" shall be construed accordingly; [Section 2(y)]

(q) *"Security"* means shares, stocks, bonds and debentures, Government securities as defined in the Public Debt Act, 1944 , savings certificates to which the Government Saving Certificates Act, 1959 applies, deposit receipts in respect of deposit of securities and units of the Unit Trust of India established under sub-section (1) of section 3 of the Unit Trust of India Act, 1963 or of any mutual fund and includes certificates of title to securities, but does not include bills of exchange or promissory notes other than Government promissory notes or any other instruments which may be notified by the Reserve Bank as security for the purposes of this Act; [Section 2(za)]

(r) *"Service"* means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, medical assistance, legal assistance, chit fund, real estate, transport, processing, supply of electrical or other energy, boarding or lodging or both, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service; [Section 2(zb)]

(s) *"Transfer"* includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien. [Section 2(ze)]

4. ANALYSIS OF IMPORTANT DEFINITIONS

(A) Authorised Person: Earlier there were two separate categories of persons namely authorised dealers and money changers who were licensed to deal in foreign exchange. Under FEMA, 1999 these terms have been clubbed together under the definition of the authorised person, which shall also include off-shore banking unit. An offshore banking unit can be appointed as 'Authorised Agent'. Offshore banking units can be set up in Special Economic Zones (SEZ), as per Foreign Exchange Management (Offshore Banking Unit) Regulations, 2002. The OBU would be virtually foreign branches of Indian Banks but located in India.

(B) Capital and Current account transactions: The definitions of "Capital Account Transactions" and its counterpart "current account transactions are contained in clauses (e) and (j) of Section 2. The regulations under FEMA regulate a transaction based on whether the transaction is "Capital Account Transaction" or a "Current Account Transaction".

Capital Account Transactions means "A transaction which alters the assets or liabilities including contingent liabilities outside India of persons resident in India or assets or liabilities in India of persons resident outside India would be a capital account transaction." Capital Accounts Transaction in India can be carried out only to the extent permitted because Indian Rupee is not yet fully convertible. Capital and current account transactions are intended to be mutually exclusive. Also the concept of capital account transaction means differently for residents and non-residents. A transaction which alters the asset or liabilities in India of non-residents fall under the category of capital account. However, as far as residents are concerned transactions which alter the contingent liabilities outside India are also capital transactions. The Reserve Bank of India may by regulations place restrictions on various specified transactions for transactions deemed to be considered as capital in nature. In simple terms, cross border transactions pertaining to investments, loans, immovable property, transfer of assets across borders are Capital Account Transactions.

Current Account Transaction means a transaction other than a capital account transaction. In other words, the current account transactions are the counterpart of capital account transactions and those transactions that are capital account in nature are not current account transactions and vice-versa. All transactions undertaken by a resident that do not alter his / her assets or liabilities, including contingent liabilities, outside India are current account transactions. In simple terms, cross border transactions pertaining to business, personal transactions such as travel, education, maintenance of family members, are Current Account Transactions.

Therefore, Capital account transactions are deemed to be prohibited unless permitted while current account transactions are deemed to be permitted unless prohibited.

The meaning of these terms is different from the meaning of terms such as "capital expenditure", "capital receipt" or "capital assets" in accounts, company law or income-tax act. These are explained below.

Examples:

(1) An Indian resident imports machinery from a vendor in UK for installing in his factory. As per accounts and income-tax law, machinery is a "capital expenditure". However, under FEMA, it does not alter (create) an asset in India for the UK vendor. It does not create any liability to a UK vendor for the Indian importer. Once the payment is made, the Indian resident or the UK vendor neither owns nor owes anything in the other country. Hence it is a Current Account Transaction.

(2) An Indian resident imports machinery from a vendor in UK for installing in his factory on a credit period of 3 months. As per accounts and income-tax law, for the credit period of 3 months, there is a liability of the Indian importer to the UK vendor. Technically under FEMA also, it is a liability outside India. However, under definition of Current Account Transaction [S. 2(j)(i)], "short-term

banking and credit facilities in the ordinary course of business" are considered as a Current Account Transaction. Hence import of machinery on credit terms is Current Account Transaction.

What if the credit period is 12 months? Under Master Directions for imports, payment has to be made within 6 months. If the credit period is in excess of 6 months, then it is a loan. There are separate rules for loan. If the transactions falls within the loan rules, then it is permitted. Short term loan by and large means 6 months. For exports, the period for realisation of proceeds, is 9 months.

(3) An Indian resident transfers US$ 1,000 to his NRI brother in New York as "gift". The funds are sent from resident's Indian bank account to the NRI brother's bank account in New York. Under accounts and income-tax law, gift is a "capital receipt". However, under FEMA, once the gift is accepted by the NRI, no one owns or owes anything to anyone in India or USA. The transactions is over. Hence it is a Current Account Transaction.

If gift is a current account transaction, why is there a restriction under Current Account regulations? It is because while there is no restriction on Current Account transactions, some reasonable restrictions can be imposed. Otherwise people may transfer funds abroad under the garb of current account transactions.

If however the resident gives him a gift in India in Indian currency, for the NRI it is funds lying in India (alteration of Indian asset). For Indian resident, there is no asset or a liability. As this transaction creates an Indian asset for the NRI, it is a Capital Account transaction. (Under separate rules, giving a gift in India to an NRI is permitted subject to certain rules.)

In a similar manner, if an NRI gives a gift to an Indian resident by remitting funds in India, there is no restriction. However, if the NRI gives the funds abroad, the resident cannot keep it abroad. He has to bring it to India.

(C) 'Person' and 'Person resident in India': The definition of "person" is similar to the definition contained in the Income-tax Act, 1961. The term **'person'** includes entities such as companies, firms, individuals, HUF, Association of Persons (AOP), artificial juridical persons agencies, offices and branches. Agencies, offices and branches do not have independent status separate from its owner. Yet these have been considered as persons. The reasons are discussed later.

As far as the definition of the term **'person resident in India'** is concerned, it defines the status for individuals, entities incorporated or registered in India, and agencies, offices and branches. A "person resident outside India" (i.e. a non-resident) means a person who is - not a resident.

Individuals: To be considered as "resident", the person should have resided in India in the preceding financial year for more than 182 days. Citizenship is not the criteria for determining whether or not a person is resident in India.

There are 3 limbs in the definition. The first limb prescribes the number of days stay. Then there are two limbs which are exceptions to the first limb.

First limb – It states that a person who is in India for more than 182 days in the "preceding year" will be an Indian resident. Thus to start with, one has to consider the period of stay in the preceding

year. If for **example** a person is in India for more than 182 days in FY 2018-19, from 1st April 2019, the person will be an Indian resident. For FY 2018-19, one will have to start with FY 2017-18.

Then there are two exceptions provided in clauses (A) and (B). Clause (A) is for persons going out of India. Clause (B) is for persons coming into India. Exception means that even if a person is an Indian resident based on the test provided in first limb, the person will be a "non-resident" if he falls within limb (A) or limb (B).

Clause (A) – second limb – It states that if a person leaves India in any of the three situations, he will not be an Indian resident. Thus he will be a non-resident. The three situations are - where a person leaves India for:

(i) taking up employment outside India.

(ii) doing any business outside India.

(iii) staying in circumstances which indicate his intention to stay outside India for an uncertain period.

Thus in the example given for the first limb above, if a person leaves India on 1st November 2019, he will be a non-resident from 2nd November 2019 – even though his number of days in India was more than 182 days in FY 2018-19. Similarly, if a person goes and stays out of India for doing business, he will be a non-resident from that date. For FY 2019-20, the person will be an Indian resident till 1st November 2019. He will then become a non-resident. From 1st April 2020, the person will continue to be a non-resident as he stays out of India for employment.

In case of clause (iii), an example can be of a person who has a green card of USA. The green card entitles a person to stay in USA and eventually become a US citizen. If a person goes abroad and starts staying in USA, he will be a non-resident from that date as his stay abroad indicate that he is going to stay there for an uncertain period.

Clause (B) – third limb – This is a complex clause as first limb read with third limb has two exceptions. Limb one uses the phrase "but does not include". Third limb uses the phrase "otherwise than". Use of two exceptions make it complex reading.

It states that if a person has come to India for any reason other than for - employment, business or circumstances which indicate his intention to stay for uncertain period – he will be a non-resident. This will be so even if the person has stayed in India for more than 182 days in the preceding year.

For example, if a person comes to India on 1st June 2019 for visiting his parents. However his parents fall sick and he stays till 31st March 2020. Thereafter he continues to stay in India. It is however certain that he will leave India in next 6 months when his parents will recover. His stay in India is neither for employment, nor for business, nor for circumstances which show that he will stay in India for uncertain period. In such a case, even if he is India for more than 182 days in FY 2019-20, he will continue to be a non-resident from 1st April 2020 also. In FY 2019-20, he is of course a non-resident as he was not in India (less than 183 days) in FY 2018-19.

If a person comes in India on 1st June 2019 for employment, business or circumstances which indicate his intention to stay in India for an uncertain period, he will be a resident from 1st June 2019.

Residential status is not for a year. It is from a particular date that a person will be a resident or a non-resident. This is different from income-tax law. Under income-tax law, a person has to pay tax. Even if his status is known at the end of the year, it will only affect his tax. It will not affect his transactions. FEMA is a regulatory law. One has to know the person's status at the time of undertaking a transaction. If for **example**, a person comes to India for employment, and if his status can be known only when the year is completed, how will he and people do transactions with each other? If he is considered as a non-resident till the year is over, then people will not be able to do transactions with him. This is the reason why the residential status is not for a year but from particular date.

It is understood that this condition applies only to individuals. It will not apply to HUF, AOP or artificial juridical person as they cannot get employed, cannot go out of India or come to India. Hence they do not come within the ambit of this portion of the definition. These entities like HUF and AOP are not required to be registered or incorporated like corporate entities nor the definition can be far stretched to cover by applying the criteria of 'owned or controlled'. Hence legally the definition for HUF, AOP, BOI fail. Practically if the HUF, AOP etc. are in India, they will be considered as Indian residents.

Person or Body corporate: Any person of body corporate registered or incorporated in India, will be considered as Indian resident. This definition again does not apply to AOP, BOI etc.

Office, branch or agency: Any agency, branch or agency outside India but **owned or controlled by Indian resident** will be considered as resident in India. Thus one cannot set up a branch outside and escape FEMA provisions.

Any agency, branch or agency in India but **owned or controlled by a non-resident** will be considered as resident in India. This is relevant as Indian residents can deal with such branch in India without considering FEMA. If such branch is considered as non-resident, then it will be difficult to undertake several transactions.

Examples

(1) Mr. A had resided in India during the financial year 2015-2016 for less than 182 days. He had come to India again on April 1, 2016 for employment. What would be his residential status during the financial year 2016-2017?

Answer: Mr. A had come to India for taking up employment. During the financial year 2015-2016, he was in India for less than 182 days. Since, he has not fulfilled the condition of staying in India for more than 182 days, Mr. A will not be considered as a residential person for the financial year 2016-2017. Here, as he come to India on 1st April, 2016, so he may primarily cannot be considered as person resident in India from 1st April 2016. However as he has come for employment, he will be considered as Indian resident from 1st April 2016.

(2) Mr. X had resided in India during the financial year 2015-2016 for less than 182 days. He had come to India on April 1, 2016 for business. He intends to leave the business on April 30, 2017 and leave India on June 30, 2017. What would be his residential status during the financial year 2016-2017 and during 2017-2018 up to the date of his departure?

Answer: As explained in the above example, Mr. X will be considered 'as person resident in India' from 1st April 2016. As regards, financial year 2017-2018, Mr. X would continue to be an Indian resident from 1st April 2017.

If he leaves India for the purpose of taking up employment or for business/vocation outside India, or for any other purpose as would indicate his intention to stay outside India for an uncertain period, he would cease to be person resident in India from the date of his departure. It may be noted that even if Mr. X is a foreign citizen, if he has not left India for any these purposes, he would be considered, 'person resident in India' during the financial year 2017-2018. Thus it will depend on the purpose of leaving India which will decide his status from 1st July 2017.

(3) Mr. Z had resided in India during the financial year 2015-2016. He left India on 1st August, 2016 for United States for pursuing higher studies for 3 years. What would be his residential status during financial year 2016-2017 and during 2017-2018?

Answer: Mr. Z had resided in India during financial year 2015-2016 for more than 182 days. After that he has gone to USA for higher studies. In other words, he has not gone out of, or stayed outside India for or on taking up employment, or for carrying a business or any other purpose, in not circumstances as would indicate his intention to stay outside India for an uncertain period. Accordingly, he would be 'person resident in India' during the financial year 2016-2017. RBI has however clarified in its AP circular no. 45 dated 8th December 2003, that students will be considered as non-residents. This is because usually students start working there to take care of their stay and cost of studies.

For the financial year 2017-2018, he would not have been in India in the preceding financial year (2016-2017) for period exceeding 182 days. Accordingly, he would not be 'person resident in India' during the financial year 2017-2018.

(4) Toy Ltd. is a Japanese company having several business units all over the world. It has a robotic unit with its head quarter in Mumbai and has a branch in Singapore. Headquarter at Mumbai controls the branch of robotic unit. What would be the residential status of robotic unit in Mumbai and that of the Singapore branch?

Answer: Toy Ltd. being a Japanese company would be a person resident outside India. [Section 2(w)]. Section 2(u) defines 'person'. Under clause (viii) thereof person would include any agency, office or branch owned or controlled by such 'person'. The term such 'person' appears to refer to a person who is included in clauses (i) to (vi). Accordingly, robotic unit in Mumbai, being a branch of a company, would be a 'person'.

Section 2(v) defines 'person resident in India'. Under clause (iii) thereof 'person resident in India' would include an office, branch or agency in India owned or controlled by a person resident outside India. Robotic unit in Mumbai is owned or controlled by a person 'resident outside India'. Hence, it would be 'person resident in India'.

However, robotic unit in Mumbai, though not 'owned' controls Singapore branch, which is a person resident in India. Hence *prima facie*, it may be possible to hold a view that the Singapore branch is 'person resident in India'.

(5) Miss Alia is an airhostess with the British Airways. She flies for 12 days in a month and thereafter takes a break for 18 days. During the break, she is accommodated in 'base', which is normally the city where the airways are headquartered. However, for security considerations, she was based on Mumbai. During the financial year, she was accommodated at Mumbai for more than 182 days. What would be her residential status under FEMA?

Answer: Miss Alia stayed in India at Mumbai 'base' for more than 182 days in the preceding financial year. She is however employed in UK. She has not come to India for employment, business or circumstances which indicate her intention to stay for uncertain period. Under section 2(v)(B), such persons are not considered as Indian residents even if their stay exceeds 182 days in the preceding year. Thus, while Miss Alia may have stayed in India for more than 182 days, she cannot be considered to be an Indian resident.

If however she has been employed in Mumbai branch of British Airways, then she will be considered as Indian resident.

5. REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

❖ Dealing in foreign exchange, etc. [Section 3]

Save as otherwise provided in this Act, rules or regulations made thereunder, or with the general or special permission of the Reserve Bank, no person shall-

(a) deal in or transfer any foreign exchange or foreign security to any person not being an authorised person;

(b) make any payment to or for the credit of any person resident outside India in any manner;

(c) receive otherwise than through an authorised person, any payment by order or on behalf of any person resident outside India in any manner.

Explanation— For the purpose of this clause, where any person in, or resident in, India receives any payment by order or on behalf of any person resident outside India through any other person (including an authorised person) without a corresponding inward remittance

from any place outside India, then, such person shall be deemed to have received such payment otherwise than through an authorised person;

(d) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Explanation.—For the purpose of this clause, "financial transaction" means making any payment to, or for the credit of any person, or receiving any payment for, by order or on behalf of any person, or drawing, issuing or negotiating any bill of exchange or promissory note, or transferring any security or acknowledging any debt.

This section imposes blanket restrictions on the specified transactions. This section applies to residents and non-residents. **Consider following examples**:

(i) **Example pertaining to clause (a) -**Dealing in foreign exchange – A non-resident comes to India and would like to sell US$ 1,000 to his friend who is resident in India. The friend offers him a rate better than the banks. This cannot be done as it would amount to dealing in foreign exchange.

(ii) **Example pertaining to clause (b)** – NRI brother has an insurance policy in India. He requests his Indian brother to pay insurance premium. This will amount to payment for the credit of non-resident. This is not permitted.

(iii) **Example pertaining to clause (c)** – A foreign tourist comes to India and he takes food at a restaurant. He would like to pay US$ 20 in cash to the restaurant. The restaurant cannot accept cash as it will be a receipt otherwise than through Authorised Person. The restaurant will have to take a money changers license to accept foreign currency.

(iv) **Example pertaining to clause (d)** –Transactions covered by this sub-section are known as Hawala transactions. An Indian resident gives Rs. 70,000 in cash to an Indian dealer. For this transaction, the brother in Dubai will get US$ 1,000 from a Dubai dealer. The two dealers may settle the transactions later. However for the two brothers this transaction is not permitted.

❖ Holding of foreign exchange [Section 4]

Except as provided in this Act, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

This section prevents Indian residents to acquire, hold, own, possess or transfer any foreign exchange, foreign security or immovable property abroad. Then through separate notifications, acquisition of these assets has been permitted subject to certain conditions and compliance rules.

Example, if an Indian resident receives bank balance of US$ 10,000 from his NRI uncle in London, the Indian resident cannot hold on to the foreign funds. He is supposed to bring back the funds as provided in section 8.

❖ Current account transactions [Section 5]

Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction. Provided that the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as prescribed under the FEM (Current Account Transactions) Rules, 2000.

From the section, the intention is to permit receipts and payments freely on current account, though the Central Government may impose reasonable restrictions. On further analysis of the Section 5 two aspects have to be considered:

1. the section states that any person may sell or draw foreign exchange to or from an authorised person,
2. They may do so if such sale or drawal is a current account transaction. However, the Central Government may impose reasonable restrictions.

The wording implies that the section does not intend to permit a person to carry out a current account transaction freely. If a current account transaction involves dealing with foreign exchange and other provisions of the Act also get attracted, then the concerned person has to take necessary approvals under the Rules and Regulations etc.

As per Current account regulation, drawal of foreign exchange for certain current account transactions is prohibited, a few need permission of appropriate Govt. of India authority and some other transactions would require RBI permission if they exceed a certain ceiling. The three categories are:

I. SCHEDULE I

[1]*Transactions for which drawal of foreign exchange is prohibited:*

(i) Remittance out of lottery winnings.

(ii) Remittance of income from racing/riding, etc., or any other hobby.

(iii) Remittance for purchase of lottery tickets, banned/prescribed magazines, football pools, sweepstakes etc.

(iv) Payment of commission on exports made towards equity investment in Joint Ventures/Wholly Owned Subsidiaries abroad of Indian companies.

(v) Remittance of dividend by any company to which the requirement of dividend balancing is applicable.

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[1] Schedule I (Transactions which are prohibited)- Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time.

(vi) Payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco.

(vii) Payment related to "Call Back Services" of telephones.

(viii) Remittance of interest income on funds held in Non-resident Special Rupee Scheme a/c.

II. SCHEDULE II

[2]*Transactions, which require prior approval of the Government of India for drawal of foreign exchange:*

Purpose of Remittance	Ministry/Department of Govt. of India whose approval is required
Cultural Tours	Ministry of Human Resources Development (Department of Education and Culture)
Advertisement in foreign print media for the purposes other than promotion of tourism, foreign investments and international bidding (exceeding US$ 10,000) by a State Government and its Public Sector Undertakings.	Ministry of Finance, Department of Economic Affairs
Remittance of freight of vessel charted by a PSU	Ministry of Surface Transport (Chartering Wing)
Payment of import through ocean transport by a Govt. Department or a PSU on c.i.f. basis (i.e., other than f.o.b. and f.a.s. basis)	Ministry of Surface Transport (Chartering Wing)
Multi-modal transport operators making remittance to their agents abroad	Registration Certificate from the Director General of Shipping
Remittance of hiring charges of transponders by (a) TV Channels (b) Internet service providers	Ministry of Information and Broadcasting Ministry of Communication and Information Technology.
Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping	Ministry of Surface Transport (Director General of Shipping)

[2] Schedule II (Transactions which require prior approval of the Central Government)- Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time

Remittance of prize money/sponsorship of sports activity abroad by a person other than International/National/State Level sports bodies, if the amount involved exceeds US $ 100,000	Ministry of Human Resource Development (Department of Youth Affairs and Sports)
Remittance for membership of P & I Club	Ministry of Finance (Insurance Division)

[3]Transactions which require RBI's prior approval for drawal of foreign exchange:

SCHEDULE III

1. **Facilities for individuals—**Individuals can avail of foreign exchange facility for the following purposes within the limit of USD 2,50,000 only. Any additional remittance in excess of the said limit for the following purposes shall require prior approval of the Reserve Bank of India.

   (i) Private visits to any country (except Nepal and Bhutan)

   (ii) Gift or donation.

   (iii) Going abroad for employment

   (iv) Emigration

   (v) Maintenance of close relatives abroad

   (vi) Travel for business, or attending a conference or specialised training or for meeting expenses for meeting medical expenses, or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/ check-up.

   (vii) Expenses in connection with medical treatment abroad

   (viii) Studies abroad

   (ix) Any other current account transaction

   However, for the purposes mentioned at item numbers (iv), (vii) and (viii), the individual may avail of exchange facility for an amount in excess of the limit prescribed under the Liberalised Remittance Scheme as provided in regulation 4 to FEMA Notification 1/2000-RB, dated the 3rd May, 2000 (here in after referred to as the said Liberalised Remittance Scheme) if it is so required by a country of emigration, medical institute offering treatment or the university, respectively:

   Further, if an individual remits any amount under the said Liberalised Remittance Scheme in a financial year, then the applicable limit for such individual would be reduced from USD 250,000 (US Dollars Two Hundred and Fifty Thousand Only) by the amount so remitted:

[3] Schedule III- Notification no G.S.R. 426(E) dated 26th May 2015

Further, that for a person who is resident but not permanently resident in India and-

(a) is a citizen of a foreign State other than Pakistan; or

(b) is a citizen of India, who is on deputation to the office or branch of a foreign company or subsidiary or joint venture in India of such foreign company,

may make remittance up to his net salary (after deduction of taxes, contribution to provident fund and other deductions).

Explanation: For the purpose of this item, a person resident in India on account of his employment or deputation of a specified duration (irrespective of length thereof) or for a specific job or assignments, the duration of which does not exceed three years, is a resident but not permanently resident:

Further, a person other than an individual may also avail of foreign exchange facility, *mutatis mutandis*, within the limit prescribed under the said Liberalised Remittance Scheme for the purposes mentioned herein above.

2. **Facilities for persons other than individual—**The following remittances by persons other than individuals shall require prior approval of the Reserve Bank of India.

(i) Donations exceeding one per cent. of their foreign exchange earnings during the previous three financial years or USD 5,000,000, whichever is less, for-

a. creation of Chairs in reputed educational institutes,

b. contribution to funds (not being an investment fund) promoted by educational institutes; and

c. contribution to a technical institution or body or association in the field of activity of the donor Company.

(ii) Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or five percent of the inward remittance whichever is more.

(iii) Remittances exceeding USD 10,000,000 per project for any consultancy services in respect of infrastructure projects and USD 1,000,000 per project, for other consultancy services procured from outside India.

Explanation—For the purposes of this sub-paragraph, the expression "infrastructure' shall mean as defined in explanation to para 1(iv)(A)(a) of Schedule I of FEMA Notification 3/2000-RB, dated the May 3, 2000.

(iv) Remittances exceeding five per cent of investment brought into India or USD 100,000 whichever is higher, by an entity in India by way of reimbursement of pre-incorporation expenses.

3. **Procedure—**The procedure for drawal or remit of any foreign exchange under this schedule shall be the same as applicable for remitting any amount under the said Liberalised Remittance Scheme.

If the transaction is not listed in any of the above three schedules, it can be freely undertaken.

Exemption for remittance from RFC Account – If any remittance has to be made for the transactions listed in Schedule II and Schedule III above from RFC account, then no approval is required.

Exemption for remittance from EEFC Account – If any remittance has to be made for the transactions listed in Schedule II and Schedule III above from EEFC account, then also no approval is required. However if payment has to be made for the following transactions, approval is required even if payment is from EEFC account:

- Remittance for membership of P & I Club.
- Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or five per cent of the inward remittance whichever is more. Remittances exceeding five per cent of investment brought into India or USD 100,000 whichever is higher, by an entity in India by way of reimbursement of pre-incorporation expenses.

Exemption for payment by International Credit Card while on a visit abroad – If a person is on a visit abroad, he can incur expenditure stated in Schedule III if he incurs it through International credit card.

As per the Notification no. RBI/2014-15/620 A.P. (DIR Series) Circular No. 106, dated 1st June 2015, Authorised Dealer banks may now allow remittances by a resident individual up to USD 250,000 per financial year for any permitted current or capital account transaction or a combination of both. If an individual has already remitted any amount under the Liberalised Remittance Scheme, then the applicable limit for such an individual would be reduced from the present limit of USD 250,000 for the financial year by the amount already remitted.

Import of Goods and Services: Import of Goods and Services into India is being allowed in terms of Section 5 of the Foreign Exchange Management Act 1999, read with Notification No. G.S.R. 381(E) dated May 3, 2000 viz. Foreign Exchange Management (Current Account Transaction) Rules, 2000.

As per the section I of the Master Direction 17, Import trade is regulated by the Directorate General of Foreign Trade (DGFT) under the Ministry of Commerce & Industry, Department of Commerce, Government of India. Authorised Dealer Category – I banks should ensure that the imports into India are in conformity with the Foreign Trade Policy in force and Foreign Exchange Management (Current Account Transactions) Rules, 2000 and the Directions issued by Reserve Bank under Foreign Exchange Management Act, 1999 from time to time.

General Guidelines for Imports

(1) General Guidelines: Rules and regulations to be followed by the Authorised Dealer (AD) from the foreign exchange angle while undertaking import payment transactions on behalf of their clients are given in this para of the Section II of the Master direction. Where specific regulations do not exist, AD may be governed by normal trade practices and it may particularly adhere to "Know Your Customer" (KYC) guidelines (issued by Reserve Bank) in all their dealings.

(2) Remittances for Import Payments: AD may allow remittance for making payments for imports into India, after ensuring that all the requisite details are made available by the importer and the remittance is for bona fide trade transactions as per applicable laws in force.

(3) Obligation of Purchaser of Foreign Exchange: Following are the obligation of the purchaser to be complied with:

(i) **Utilization of acquired Foreign Exchange for the said purpose:** In terms of Section 10(6) of the Foreign Exchange Management Act, 1999 (FEMA), any person acquiring foreign exchange is permitted to use it either for the purpose mentioned in the declaration made by him to an Authorised or for any other purpose for which acquisition of foreign exchange is permissible under the said Act or Rules or Regulations framed there under.

(ii) **Evidence of import:** Where foreign exchange acquired has been utilised for import of goods into India, the AD should ensure that the importer furnishes evidence of import viz., as in IDPMS, Postal Appraisal Form or Customs Assessment Certificate, etc., and satisfy himself that goods equivalent to the value of remittance have been imported. AD should ensure that all import remittances outstanding on the notified date of IDPMS are uploaded in IDPMS (Import Data Processing and Monitoring System).

(iii) **Mode of payment**: A person resident in India may make payment for import of goods in foreign exchange through-

- an international card held by him/in rupees from international credit card/ debit card through the credit/debit card servicing bank in India against the charge slip signed by the importer, or
- as prescribed by Reserve Bank from time to time,

provided that the transaction is in conformity with the extant provisions and the import is in conformity with the Foreign Trade Policy in force.

(iv) **Other mode:** Any person resident in India may also make payment as under :

(a) **In rupees** towards meeting expenses on account of boarding, lodging and services related thereto or travel to and from and within India of a person resident outside India who is on a visit to India;

(b) **By means of a crossed cheque or a draft** as consideration for purchase of gold or silver in any form imported by such person in accordance with the terms and conditions

imposed under any order issued by the Central Government under the Foreign Trade (Development and Regulations) Act, 1992 or under any other law, rules or regulations for the time being in force;

(c) **A company or resident in India may make payment in rupees** to its non-whole time director who is resident outside India and is on a visit to India for the company's work and is entitled to payment of sitting fees or commission or remuneration, and travel expenses to and from and within India, in accordance with the provisions contained in the company's Memorandum of Association or Articles of Association or in any agreement entered into it or in any resolution passed by the company in general meeting or by its Board of Directors, provided the requirement of any law, rules, regulations, directions applicable for making such payments are duly complied with.

(4) Time Limit for Settlement of Import Payments:

(i) Time limit for Normal Imports:

(a) In terms of the extant regulations, remittances against imports should be completed not later than six months from the date of shipment, except in cases where amounts are withheld towards guarantee of performance, etc.

(b) AD may permit settlement of import dues delayed due to disputes, financial difficulties, etc. However, interest if any, on such delayed payments, usance bills (a bill of exchange which allows the drawee to have period of credit or term) or overdue interest is payable only for a period of up to three years from the date of shipment at the rate prescribed for trade credit from time to time.

(ii) Time Limit for Deferred Payment Arrangements: Deferred payment arrangements (including suppliers' and buyers' credit) upto five years, are treated as trade credits for which the procedural guidelines as laid down in the Master Circular for External Commercial Borrowings and Trade Credits may be followed.

(5) Extension of Time:

(i) limit of extension: AD can consider granting extension of time for settlement of import dues up to a period of six months at a time (maximum up to the period of three years) irrespective of the invoice value for delays on account of disputes about quantity or quality or non-fulfilment of terms of contract; financial difficulties and cases where importer has filed suit against the seller. In cases where sector specific guidelines have been issued by Reserve Bank of India for extension of time (i.e. rough, cut and polished diamonds), the same will be applicable.

(ii) Circumstances: While granting extension of time, AD must ensure that:

a. The import transactions covered by the invoices are not under investigation by Directorate of Enforcement / Central Bureau of Investigation or other investigating agencies;

b. While considering extension beyond one year from the date of remittance, the total outstanding of the importer does not exceed USD one million or 10 per cent of the average import remittances during the preceding two financial years, whichever is lower; and

c. Where extension of time has been granted by the AD, the date up to which extension has been granted may be indicated in the 'Remarks' column.

(iii) **In exceptional cases:** Cases not covered by the above instructions / beyond the above limits, may be referred to the concerned Regional Office of Reserve Bank of India.

(iv) **Noting of the extension:** The above extension period shall be reported in IDPMS as per message "Bill of Entry Extension" and the date up to which extension is granted will be indicated in "Extension Date" column.

(6) Import of Foreign Exchange / Indian Rupees:

(i) Except as otherwise provided in the Regulations, no person shall, without the general or special permission of the Reserve Bank, import or bring into India, any foreign currency. Import of foreign currency, including cheques, is governed by Section 6(3)(g) of the Foreign Exchange Management Act, 1999, and the Foreign Exchange Management (Export and Import of Currency) Regulations 2000.

(ii) Reserve Bank may allow a person to bring into India currency notes of Government of India and / or of Reserve Bank subject to such terms and conditions as the Reserve Bank may stipulate.

(7) Import of Foreign Exchange into India: A person may–

(i) **Send into India**, without limit, foreign exchange in any form (other than currency notes, bank notes and travellers cheques);

(ii) **Bring into India** from any place outside India, without limit, foreign exchange (other than unissued notes), subject to the condition that such person makes, on arrival in India, a declaration to the Custom Authorities at the Airport in the Currency Declaration Form (CDF) annexed to these Regulations;

Provided further that it shall not be necessary to make such declaration where the aggregate value of the foreign exchange in the form of currency notes, bank notes or travellers cheques brought in by such person at any one time does not exceed USD 10,000 (US Dollars ten thousand) or its equivalent and/or the aggregate value of foreign currency notes (cash portion) alone brought in by such person at any one time does not exceed USD 5,000 (US Dollars five thousand) or its equivalent.

(8) Import of Indian Currency and Currency Notes

(i) Any person resident in India who had gone out of India on a temporary visit, may bring into India at the time of his return from any place outside India **(other than from Nepal and Bhutan),** currency notes of Government of India and Reserve Bank of India notes up to an amount not exceeding Rs. 25,000 (Rupees twenty five thousand only).

(ii) **A person may bring into India from Nepal or Bhutan**, currency notes of Government of India and Reserve Bank of India for any amount in denominations up to Rs.100/-.

(9) Issue of Guarantees by an Authorised Dealer:

(i) An authorised dealer may give a guarantee in respect of any debt, obligation or other liability incurred by a person resident in India and owned to a person resident outside India, as an importer, in respect of import on deferred payment terms in accordance with the approval by the Reserve Bank of India for import on such terms.

(ii) An authorised dealer may give guarantee, Letter of Undertaking or Letter of Comfort in respect of any debt, obligation or other liability incurred by a person resident in India and owned to a person resident outside India (being an overseas supplier of goods, bank or a financial institution), for import of goods, as permitted under the Foreign Trade Policy announced by Government of India from time to time and subject to such terms and conditions as may be specified by Reserve Bank of India from time to time.

(iii) An authorised dealer may, **in the ordinary course of his business**, give a guarantee in favour of a non-resident service provider, on behalf of a resident customer who is a service importer, subject to such terms and conditions as stipulated by Reserve Bank of India from time to time:

Limit of providing guarantee:

Service importer	Amount of guarantee
Where a service importer is other than a Public Sector Company or a Department / Undertaking of the Government of India / State Government:	no guarantee for an amount exceeding USD 500,000 or its equivalent shall be issued
Where the service importer is a Public Sector Company or a Department / Undertaking of the Government of India / State Government	no guarantee for an amount exceeding USD 100,000 or its equivalent shall be issued without the prior approval of the Ministry of Finance, Government of India.

(iv) An authorised dealer may, subject to the directions issued by the Reserve Bank of India in this behalf, permit a person resident in India to **issue corporate guarantee in favour of an overseas lessor** for financing import through operating lease effected

in conformity with the Foreign Trade Policy in force and under the provisions of the Foreign exchange Management (Current Account Transactions) Rules, 2000, and the Directions issued by Reserve Bank of India under Foreign Exchange Management Act, 1999 from time to time.

❖ Capital account transactions [Section 6]

(1) Subject to the provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

(2) The Reserve Bank may, in consultation with the Central Government, specify:

(a) any class or classes of capital account transactions, which are permissible;

(b) the limit up to which foreign exchange shall be admissible for such transactions;

Provided that the Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortisation of loans or for depreciation of direct investments in the ordinary course of business.

(3) Without prejudicial to the generality of the provision of sub-section (2), the Reserve Bank may, by regulations, prohibit, restrict or regulate the following:

(a) transfer or issue of any foreign security by a person resident in India;

(b) transfer or issue of any security by a person resident outside India;

(c) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;

(d) any borrowing or lending in foreign exchange in whatever form or by whatever name called;

(e) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;

(f) deposits between persons resident in India and persons resident outside India;

(g) export, import or holding of currency or currency notes;

(h) transfer of immovable property outside India, other than a lease not exceeding five years, by person a resident in India;

(i) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;

(j) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred:

(i) by a person resident in India and owed to a person resident outside India; or

(ii) by a person resident outside India.

(4) A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

The RBI vide A.P. (DIR Series) Circular No. 90 dated 9th January, 2014 has issued a clarification on section 6(4) of the Act. This circular clarifies that section 6(4) of the Act covers the following transactions:

(i) Foreign currency accounts opened and maintained by such a person when he was resident outside India;

(ii) Income earned through employment or business or vocation outside India taken up or commenced which such person was resident outside India, or from investments made while such person was resident outside India, or from gift or inheritance received while such a person was resident outside India;

(iii) Foreign exchange including any income arising therefrom, and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India.

(iv) A person resident in India may freely utilize all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of Reserve Bank, provided the cost of such investments and/or any subsequent payments received therefor are met exclusively out of funds forming part of eligible assets held by them and the transactions is not in contravention to extant FEMA provisions.

(5) A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by a such person when he was resident in India or inherited from a person who was resident in India.

(6) Without prejudice to the provisions of this section, the Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

A capital account transaction as said earlier is a transaction, which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or persons resident outside India, and includes transactions referred to in sub-section (3). The section gives a liberty by providing that any person may sell or draw foreign exchange to or from an authorised person for capital account transactions. However, the liberty to do so is subject to the provisions of sub-section (2), which states that the Reserve Bank may in consultation with the Central Government specify class

or classes of capital account transactions, which are permissible, and the limit upto, which the foreign exchange shall be admissible for such transactions.

Capital account transaction is basically split into the following categories:

(I) transaction, which are permissible in respect of persons resident in India and outside India.

(II) transaction on which restrictions cannot be imposed; and

(III) transactions, which are prohibited.

I. Permissible Transactions

Under Sub-section (2) of Section 6, the RBI has issued the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000. The Regulations specify the list of transaction, which are permissible in respect of persons resident in India in Schedule-I and the classes of capital account transactions of persons resident outside India in Schedule-II.

Further, subject to the provisions of the Act or the rules or regulations or direction or orders made or issued thereunder, any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction specified in the Schedules; provided that the transaction is within the limit, if any, specified in the regulations relevant to the transaction.

SCHEDULE I

The list of permissible classes of transactions made by **persons resident in India** is:

(a) Investment by a person resident in India in foreign securities.

(b) Foreign currency loans raised in India and abroad by a person resident in India.

(c) Transfer of immovable property outside India by a person resident in India.

(d) Guarantees issued by a person resident in India in favour of a person resident outside India.

(e) Export, import and holding of currency/currency notes.

(f) Loans and overdrafts (borrowings) by a person resident in India from a person resident outside India.

(g) Maintenance of foreign currency accounts in India and outside India by a person resident in India.

(h) Taking out of insurance policy by a person resident in India from an insurance company outside India.

(i) Loans and overdrafts by a person resident in India to a person resident outside India.

(j) Remittance outside India of capital assets of a person resident in India.

[4](k) Undertake derivative contracts

SCHEDULE II

The list of permissible classes of transactions made by **persons resident outside India** is:

(a) Investment in India by a person resident outside India, that is to say,

(i) issue of security by a body corporate or an entity in India and investment therein by a person resident outside India; and

(ii) investment by way of contribution by a person resident outside India to the capital of a firm or a proprietorship concern or an association of a person in India.

(b) Acquisition and transfer of immovable property in India by a person resident outside India.

(c) Guarantee by a person resident outside India in favour of, or on behalf of, a person resident in India.

(d) Import and export of currency/currency notes into/from India by a person resident outside India.

(e) Deposits between a person resident in India and a person resident outside India.

(f) Foreign currency accounts in India of a person resident outside India.

(g) Remittance outside India of capital assets in India of a person resident outside India.

[5](h) Undertake derivative contracts

Transactions with no restriction

They are:

(1) For amortisation of loan and

(2) For depreciation of direct investments in ordinary course of business.

Also, restrictions cannot be imposed when drawal is of the purpose of repayments of loan instalments.

Prohibited Transactions

On certain transactions, the Reserve Bank of India imposes prohibition.

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[4]Substituted by Foreign Exchange Management (Permissible Capital Account Transactions) (Amendment) Regulations, 2019, w.e.f. 26-2-2019. Prior to its substitution clause (*k*) read as under:
"(*k*), Sale and purchase of foreign exchange derivatives in India and abroad and commodity derivatives abroad by a person resident in India."

[5] Inserted by Foreign Exchange Management (Permissible Capital Account Transactions) (Amendment) Regulations, 2019, w.e.f. 26-2-2019.

(a) no person shall undertake or sell or draw foreign exchange to or from an authorised person for any capital account transaction,

[6]provided that-

(i) subject to the provisions of the Act or the rules or regulations or directions or orders made or issued thereunder, a resident individual may, draw from an authorized person foreign exchange not exceeding USD 250,000 per financial year or such amount as decided by Reserve Bank from time to time for a capital account transaction specified in Schedule I.

Explanation: Drawal of foreign exchange as per item number 1 of Schedule III to Foreign Exchange Management (Current Account Transactions) Rules, 2000 dated 3rd May 2000 as amended from time to time, shall be subsumed within the limit under proviso (a) above.

(ii) Where the drawal of foreign exchange by a resident individual for any capital account transaction specified in Schedule I exceeds USD 250,000 per financial year, or as decided by Reserve Bank from time to time as the case may be, the limit specified in the regulations relevant to the transaction shall apply with respect to such drawal.

Provided further that no part of the foreign exchange of USD 250,000, drawn under proviso (a) shall be used for remittance directly or indirectly to countries notified as non-co-operative countries and territories by Financial Action Task Force (FATF) from time to time and communicated by the Reserve Bank of India to all concerned.

(b) The person resident outside India is prohibited from making investments in India in any form, in any company, or partnership firm or proprietary concern or any entity whether incorporated or not which is engaged or proposes to engage:

(i) In the business of chit fund; [7][Registrar of Chits or an officer authorised by the state government in this behalf, may, in consultation with the State Government concerned, permit any chit fund to accept subscription from Non-resident Indians. Non- resident Indians shall be eligible to subscribe, through banking channel and on non- repatriation basis, to such chit funds, without limit subject to the conditions stipulated by the Reserve Bank of India from time to time]

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[6]The Foreign Exchange Management (Permissible Capital Account Transactions) (Third Amendment) Regulations, 2015 vide Notification No. FEMA. 341/2015-RB dated May 26, 2015 substituted the existing proviso contained in Regulation 4 sub-regulation (a) of the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 with the above provisos in the principal regulations.

[7] Vide *Notification No. FEMA. 337/2015-RB* dated 2nd March, 2015, the Reserve Bank of India, in consultation with the Central Government through the Foreign Exchange Management (Permissible Capital Account Transactions) (Second Amendment) Regulations, 2015 added a explanation with respect to the business of chit fund.

(ii) As Nidhi company;

(iii) In agricultural or plantation activities;

(iv) In real estate business, or construction of farm houses or

Explanation: In "real estate business" the term shall not include shall not include development of townships, construction of residential /commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.; or

(v) In trading in Transferable Development Rights (TDRs).

[8][(c) No person resident in India shall undertake any capital account transaction which is not permissible in terms of Order S.O. 1549(E) dated April 21, 2017, as amended from time to time, of the Government of India, Ministry of External Affairs, with any person who is, a citizen of or a resident of Democratic People's Republic of Korea, or an entity incorporated or otherwise, in Democratic People's Republic of Korea, until further orders, unless there is specific approval from the Central Government to carry on any transaction.

(d) The existing investment transactions, with any person who is, a citizen of or resident of Democratic People's Republic of Korea, or an entity incorporated or otherwise in Democratic People's Republic of Korea, or any existing representative office or other assets possessed in Democratic People's Republic of Korea, by a person resident in India, which is not permissible in terms of Order S.O. 1549(E) dated April 21, 2017, as amended from time to time, of the Government of India, Ministry of External Affairs shall be closed/liquidated/disposed/settled within a period of 180 days from the date of issue of this Notification, unless there is specific approval from the Central Government to continue beyond that period."]

Repatriation of sale proceeds

A person referred to in sub-section (5) of section 6 of the Act, or his successor shall not, except with the prior permission of the Reserve Bank, repatriate outside India the sale proceeds of any immovable property referred to in that sub-section.

In the event of sale of immovable property other than agricultural land/farm house/plantation property in India by a person resident outside India who is a citizen of India or a person of Indian origin, the authorised dealer may allow repatriation of the sale proceeds outside India, provided the following conditions are satisfied, namely :

(i) the immovable property was acquired by the seller in accordance with the provisions of the foreign exchange law in force at the time of acquisition by him or the provisions of these Regulations;

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[8] Vide Foreign Exchange Management (Permissible Capital Account Transaction) (First Amendment) Regulations, 2019 w.e.f 7th March, 2019

(ii) the amount to be repatriated does not exceed (a) the amount paid for acquisition of the immovable property in foreign exchange received through normal banking channels or out of funds held in Foreign Currency Non-Resident Account, or (b) the foreign currency equivalent, as on the date of payment, of the amount paid where such payment was made from the funds held is Non-Resident External account for acquisition of the property; and

(iii) in the case of residential property, the repatriation of sale proceeds is restricted to not more than two such properties.

In the event of failure in repayment of external commercial borrowing availed by a person resident in India under the provisions of the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 (Notification No. FEMA 3/2000-RB, dated 3-5-2000) a bank which is an authorised dealer may permit the overseas lender or the security trustee (in whose favour the charge on immovable property has been created to secure the ECB) to sell the immovable property on which the said loan has been secured only to a (by the) person resident in India and to repatriate the sale proceeds towards outstanding dues in respect of the said loan and not any other loan.

Framework for raising loans through External Commercial Borrowings: Transactions on account of External Commercial Borrowings (ECB) are governed by section 6(3)(d) of FEMA. ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The para-meters apply in totality and not on a stand-alone basis. The framework for raising loans through ECB comprises the following three tracks:

Track I - Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years. [9]Manufacturing sector companies may raise foreign currency denominated ECBs with minimum average maturity period of 1 year.

Track II - Long term foreign currency denominated ECB with minimum average maturity of 10 years.

Track III - Indian Rupee (INR) denominated ECB with minimum average maturity of 3/5 years. Manufacturing sector companies may raise INR denominated ECBs with minimum average maturity period of 1 year.[10]

The term 'All-in-Cost' includes rate of interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or Indian Rupees (INR) but will not include commitment fees, pre-payment fees / charges, withholding tax payable in INR.

Forms of ECB: The ECB Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms:

i. Loans including bank loans;

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[9] Inserted vide A. P. (DIR Series) Circular No. 9 dated September 19, 2018
[10] Inserted vide A. P. (DIR Series) Circular No. 9 dated September 19, 2018

ii. Securitized instruments (e.g. floating rate notes and fixed rate bonds, nonconvertible, optionally convertible or partially convertible preference shares / debentures);

iii. Buyers' credit;

iv. Suppliers' credit;

v. Foreign Currency Convertible Bonds (FCCBs);

vi. Financial Lease; and

vii. Foreign Currency Exchangeable Bonds (FCEBs).

However, ECB framework is not applicable in respect of the investment in Nonconvertible Debentures (NCDs) in India made by Registered Foreign Portfolio Investors (RFPIs).

Available routes for raising ECB: Under the ECB framework, ECBs can be raised either under the automatic route or under the approval route. For the automatic route, the cases are examined by the Authorised Dealer Category-I (AD Category-I) banks. Under the approval route, the prospective borrowers are required to send their requests to the RBI through their ADs for examination. While the regulatory provisions are mostly similar, there are some differences in the form of amount of borrowing, eligibility of borrowers, permissible end-uses, etc. under the two routes. While the first six forms of borrowing, mentioned above under points i to vi, can be raised both under the automatic and approval routes, FCEBs can be issued only under the approval route.

Eligible Borrowers: The list of entities eligible to raise ECB under the three tracks is set out in the following list.

Track I

i. Companies in manufacturing and software development sectors.

ii. Shipping and airlines companies.

iii. Small Industries Development Bank of India (SIDBI).

iv. Units in Special Economic Zones (SEZs).

v. Export Import Bank of India (Exim Bank) (only under the approval route).

vi. Companies in infrastructure sector, Non-Banking Financial Companies - Infrastructure Finance Companies (NBFCIFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies (CICs). 12Also, Housing Finance Companies, regulated by the National Housing Bank, Port Trusts constituted under the Major Port Trusts Act, 1963 or Indian Ports Act, 1908.

Track II

i. All entities listed under Track I.

ii. Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (INVITs) coming under the regulatory framework of the Securities and Exchange Board of India (SEBI).

Track III

i. All entities listed under Track II.

ii. All Non-Banking Financial Companies (NBFCs) coming under the regulatory purview of the Reserve Bank.

iii. NBFCs-Micro Finance Institutions (NBFCsMFIs), Not for Profit companies registered under the Companies Act, 1956/2013, Societies, trusts and cooperatives (registered under the Societies Registration Act, 1860, Indian Trust Act, 1882 and State-level Cooperative Acts/Multilevel Cooperative Act/State-level mutually aided Cooperative Acts respectively), Non Government Organisations (NGOs) which are engaged in micro finance activities

iv. Companies engaged in miscellaneous services viz. research and development (R&D), training (other than educational institutes), companies supporting infrastructure, companies providing logistics services. Also, companies engaged in maintenance, repair and overhaul and freight forwarding.

v. Developers of Special Economic Zones (SEZs)/ National Manufacturing and Investment Zone.

Notes: 1. Entities engaged in micro-finance activities to be eligible to raise ECB: (i) should have a satisfactory borrowing relationship for at least three years with an AD Category I bank in India, and (ii) should have a certificate of due diligence on 'fit and proper' status from the AD Category I bank.

Recognised lender: The list of recognized lenders / investors for the three tracks will be as follows:

Track I	Track II	Track III
i. International banks. ii. International capital markets. iii. Multilateral financial institutions (such as, IFC, ADB, etc.) / regional financial institutions and Government owned (either wholly or partially) financial institutions. iv. Export credit agencies. v. Suppliers of equipment. vi. Foreign equity holders. vii. Overseas long term investors such as: a. Prudentially regulated financial entities; b. Pension funds; c. Insurance companies; d. Sovereign Wealth Funds;	All entities listed under Track I but for overseas branches / subsidiaries of Indian banks.	All entities listed under Track I but for overseas branches / subsidiaries of Indian banks. In case of NBFCs-MFIs, other eligible MFIs, not for profit companies and NGOs, ECB can also be availed from overseas organisations and individuals.

	e. Financial institutions located in International Financial Services Centres in India		
viii.	Overseas branches / subsidiaries of Indian banks		

Notes:

1. Overseas branches / subsidiaries of Indian banks can be lenders only under Track I. Further, their participation under this track is subject to the prudential norms issued by the Department of Banking Regulation, RBI.

2. Overseas Organizations proposing to lend ECB would have to furnish to the authorised dealer bank of the borrower a certificate of due diligence from an overseas bank, which, in turn, is subject to regulation of host-country regulators and such host country adheres to the Financial Action Task Force (FATF) guidelines on anti-money laundering (AML)/ combating the financing of terrorism (CFT). The certificate of due diligence should comprise the following:

   (i) that the lender maintains an account with the bank at least for a period of two years,

   (ii) that the lending entity is organised as per the local laws and held in good esteem by the business/local community, and

   (iii) that there is no criminal action pending against it.

   (iv) Individual lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence /documents such as audited statement of account and income tax return, which the overseas lender may furnish, need to be certified and forwarded by the overseas bank. Individual lenders from countries which do not adhere to FATF guidelines on AML / CFT are not eligible to extend ECB.

Individual Limits: The individual limits refer to the amount of ECB which can be raised in a financial year under the automatic route.

i. The individual limits of ECB that can be raised by eligible entities under the automatic route per financial year for all the three tracks are set out as under:

a. Up to USD 750 million or equivalent for the companies in infrastructure and manufacturing sectors, Non-Banking Financial Companies -Infrastructure Finance Companies (NBFC-IFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies;

b. Up to USD 200 million or equivalent for companies in software development sector;

c. Up to USD 100 million or equivalent for entities engaged in micro finance activities; and

d. Up to USD 500 million or equivalent for remaining entities.

ii. ECB proposals beyond aforesaid limits will come under the approval route. For computation of individual limits under Track III, exchange rate prevailing on the date of agreement should be taken into account.

iii. In case the ECB is raised from direct equity holder, aforesaid individual ECB limits will also subject to ECB liability: equity ratio requirement. The ECB liability of the borrower (including all outstanding ECBs and the proposed one) towards the foreign equity holder should not be more than seven times of the equity contributed by the latter. This ratio will not be applicable if total of all ECBs raised by an entity is up to USD 5 million or equivalent.

For the purpose of ECB liability: equity ratio, the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet can be reckoned for calculating the 'equity' of the foreign equity holder. Where there are more than one foreign equity holders in the borrowing company, the portion of the share premium in foreign currency brought in by the lender(s) concerned shall only be considered for calculating the ratio.

Procedure of raising ECB: For approval route cases, the borrowers may approach the RBI with an application in prescribed format Form ECB for examination through their AD Category I bank. Such cases shall be considered keeping in view the overall guidelines, macroeconomic situation and merits of the specific proposals. ECB proposals received in the Reserve Bank above certain threshold limit (refixed from time to time) would be placed before the Empowered Committee set up by the Reserve Bank. The Empowered Committee will have external as well as internal members and the Reserve Bank will take a final decision in the cases taking into account recommendation of the Empowered Committee. Entities desirous to raise ECB under the automatic route may approach an AD Category I bank with their proposal along with duly filled in Form 83. Formats of Form ECB and Form 83 are available at Annex I and II respectively of Part V of the Master Directions – Reporting under Foreign Exchange Management Act, 1999.

Routing of funds raised abroad to India: It may be noted that:

(i) Indian companies or their ADs are not allowed to issue any direct or indirect guarantee or create any contingent liability or offer any security in any form for such borrowings by their overseas holding / associate / subsidiary / group companies except for the purposes explicitly permitted in the relevant Regulations.

(ii) Further, funds raised abroad by overseas holding / associate / subsidiary / group companies of Indian companies with support of the Indian companies or their ADs as mentioned at (i) above cannot be used in India unless it conforms to the general or specific permission granted under the relevant Regulations.

(iii) Indian companies or their ADs using or establishing structures which contravene the above shall render themselves liable for penal action as prescribed under FEMA.

Borrowing and Lending in Foreign currency by persons other than authorised dealer

Borrowing in foreign currency by persons other than an authorised dealer: The circumstances and the conditions regarding borrowing in foreign currency by persons other than an authorised dealer are mentioned below:

i. **For execution of projects outside India and for exports on deferred payment terms:** A person resident in India may borrow, whether by way of loan or overdraft or any other credit facility, from a bank situated outside India, for execution outside India of a turnkey project or civil construction contract or in connection with exports on deferred payment terms, provided the terms and conditions stipulated by the authority which has granted the approval to the project or contract or export is in accordance with the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000.

ii. **For imports:** An importer in India may, for import of goods into India, avail of foreign currency credit for a period not exceeding six months extended by the overseas supplier of goods, provided the import is in compliance with the Export Import Policy of the Government of India in force.

iii. **Borrowing by resident individual:** An individual resident in India may borrow a sum not exceeding US$ 250,000/- or its equivalent from his close relative outside India, subject to the conditions that:

a. the minimum maturity period of the loan is one year;

b. the loan is free of interest; and

c. the amount of loan is received by inward remittance in free foreign exchange through normal banking channels or by debit to the NRE/FCNR account of the non-resident lender.

Lending in foreign currency by persons other than an authorised dealer: The circumstances and the conditions regarding lending in foreign currency by persons other than an authorised dealer are mentioned below:

(i) **Lending to WOS / JV:** An Indian entity may lend to its wholly owned subsidiary or joint venture abroad constituted in accordance with the provisions of Foreign Exchange Management (Transfer or issue of foreign security) Regulations, 2000.

(ii) **Lending by Select Institutions:** Export Import Bank of India, Industrial Development Bank of India, Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India Limited, Small Industries Development Bank of India Limited or any other institution in India may extend loans to their constituents in India out of the foreign currency borrowings raised by these institutions with the approval of the Central Government for the purpose of onward lending.

(iii) **Lending by Indian companies to their employees:** Indian companies in India may grant loans to the employees of their branches outside India for personal purposes provided that the loan shall be granted for personal purposes in accordance with the lender's Staff Welfare

Scheme/Loan Rules and other terms and conditions as applicable to its staff resident in India and abroad.

Overseas Direct Investments by resident individuals

Overseas investments (or financial commitment) in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues for promoting global business by Indian entrepreneurs. Joint Ventures are perceived as a medium of economic and business co-operation between India and other countries.

In keeping with the spirit of liberalisation, which has become the hallmark of economic policy in general, and Foreign Exchange regulations in particular, the Reserve Bank has been progressively relaxing the rules and simplifying the procedures both for current account as well as capital account transactions.

Relevant statutory provision: Section 6 of the Foreign Exchange Management Act, 1999 provides powers to the Reserve Bank to specify, in consultation with the Government of India the classes of permissible capital account transactions and limits up to which foreign exchange is admissible for such transactions. Section 6(3) of the aforesaid Act provides powers to the Reserve Bank to prohibit, restrict or regulate various transactions referred to in the sub-clauses of that sub-section, by making Regulations.

In exercise of the above powers conferred under the Act, the Reserve issued Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 vide Notification No. FEMA.120/RB-2004 dated July 7, 2004. The Notification seeks to regulate acquisition and transfer of a foreign security by a person resident in India i.e. investment (or financial commitment) by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India.

Relevant definitions: "**Direct investment outside India"** means investments, either under the Automatic Route or the Approval Route, by way of:

(i) contribution to the capital or subscription to the Memorandum of a foreign entity, or

(ii) purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange, signifying a long-term interest in the foreign entity (JV or WOS).

However, it does not include[11] Portfolio investment.

A resident individual may make overseas direct investment in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India. However, the limit of overseas direct investment by the resident individual is prescribed by RBI.

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[11] **Portfolio investments** are **investments** in the form of a group (**portfolio**) of assets, including transactions in equity, securities, such as common stock, and debt securities, such as banknotes, bonds, and debentures

"Financial Commitment" means the amount of direct investment by way of contribution to equity, loan and 100 per cent of the amount of guarantees and 50 per cent of the performance guarantees issued by an Indian Party to or on behalf of its overseas Joint Venture Company or Wholly Owned Subsidiary.

'Joint Venture' means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian Party makes a direct investment.

"Wholly Owned Subsidiary (WOS)" means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country, whose entire capital is held by the Indian Party.

"Indian Party" means a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932, or a Limited Liability Partnership (LLP), registered under the Limited Liability Partnership Act, 2008, making investment in a Joint Venture or Wholly Owned Subsidiary abroad, and includes any other entity in India as may be notified by the Reserve Bank. When more than one such company, body or entity make an investment in the foreign entity, all such companies or bodies or entities shall together constitute the "Indian Party".

"Host country" means the country in which the foreign entity receiving the direct investment from an Indian Party is registered or incorporated.

Mode of direct investment outside India:

(1) Automatic route for direct investment or financial commitment outside India: As per the Regulation 6 of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004, an Indian Party has been permitted to make investment/ undertake financial commitment in overseas Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS), as per the ceiling prescribed by the Reserve Bank.

With effect from July 03, 2014, it has been decided that any financial commitment (FC) exceeding USD 1 (one) billion (or its equivalent) in a financial year would require prior approval of the Reserve Bank even when the total FC of the Indian Party is within the eligible limit under the automatic route [i.e., within 400% of the net worth (Paid up capital + Free Reserves) as per the last audited balance sheet].

Limit permissible: The total financial commitment of the Indian Party in all the Joint Ventures/ Wholly Owned Subsidiaries shall comprise of the following:

a. 100% of the amount of equity shares and/ or Compulsorily Convertible Preference Shares (CCPS);

b. 100% of the amount of other preference shares;

c. 100% of the amount of loan;

d. 100% of the amount of guarantee (other than performance guarantee) issued by the Indian Party;

e. 100% of the amount of bank guarantee issued by a resident bank on behalf of JV or WOS of the Indian Party provided the bank guarantee is backed by a counter guarantee / collateral by the Indian Party.

f. 50% of the amount of performance guarantee issued by the Indian Party provided that if the outflow on account of invocation of performance guarantee results in the breach of the limit of the financial commitment in force, prior permission of the Reserve Bank is to be obtained before executing remittance beyond the limit prescribed for the financial commitment.

Requirements for investments/ financial commitments: The criteria for overseas direct investment under the Automatic Route is as under:

i. The Indian Party can invest up to the prescribed limit of its net worth (as per the last audited Balance Sheet) in JV / WOS for any bonafide activity permitted as per the law of the host country. The prescribed limit vis-a-vis the net worth will not be applicable where the investment is made out of balances held in the EEFC account of the Indian party or out of funds raised through ADRs/GDRs;

ii. The Indian Party is not on the Reserve Bank's exporters' caution list / list of defaulters to the banking system published/ circulated by the Credit Information Bureau of India Ltd. (CIBIL) /RBI or any other credit information company as approved by the Reserve Bank or under investigation by the Directorate of Enforcement or any investigative agency or regulatory authority; and

iii. The Indian Party routes all the transactions relating to the investment in a JV/WOS through only one branch of an authorised dealer to be designated by the Indian Party.

Process: The Indian Party should approach an Authorized Dealer with an application in Form ODI and the prescribed enclosures / documents for effecting the remittances towards such investments.

Investments (or financial commitment) in JV/WOS abroad by Indian Parties through the medium of a Special Purpose Vehicle (SPV) are also permitted under the Automatic Route if the Indian Party is not appearing in the Reserve Bank's caution list or is under investigation by the Directorate of Enforcement or included in the list of defaulters to the banking system circulated by the Reserve Bank/any other Credit Information company as approved by the Reserve Bank.

(2) Approval route for direct investment or financial commitment outside India

(i) Prior approval of the Reserve Bank would be required in all other cases of direct investment (or financial commitment) abroad.

(ii) Reserve Bank would, inter alia, take into account the following factors while considering such applications:

a) Prima facie viability of the JV / WOS outside India;

b) Contribution to external trade and other benefits which will accrue to India through such investment (or financial commitment);

c) Financial position and business track record of the Indian Party and the foreign entity; and

d) Expertise and experience of the Indian Party in the same or related line of activity as of the JV / WOS outside India.

Therefore, under the approval route (proposals not covered by the conditions under the automatic route) prior approval of the Reserve Bank would be required. For which a specific application in Form ODI with the documents prescribed therein is required to be made through the Authorized Dealer Category – I banks.

Overseas Direct Investments by resident individuals: With effect from August 05, 2013, a resident individual (single or in association with another resident individual or with an 'Indian Party' as defined in the Notification) satisfying the criteria as per Schedule V of the Notification, may make overseas direct investment in the equity shares and compulsorily convertible preference shares of a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) outside India. The limit of overseas direct investment by the resident individual shall be within the overall limit prescribed by the Reserve Bank of India under the provisions of Liberalised Remittance Scheme, as prescribed by the Reserve Bank from time to time.

Prohibitions on direct investment in abroad by an Indian party:

(a) Indian Parties are prohibited from making investment (or financial commitment) in foreign entity engaged in real estate (meaning buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction of residential/commercial premises, roads or bridges) or banking business, without the prior approval of the Reserve Bank.

(b) An overseas entity, having direct or indirect equity participation by an Indian Party, shall not offer financial products linked to Indian Rupee (e.g. non-deliverable trades involving foreign currency, rupee exchange rates, stock indices linked to Indian market, etc.) without the specific approval of the Reserve Bank.

General Permission: General permission has been granted to persons residents in India for purchase / acquisition of securities in the following manner:

(a) out of the funds held in RFC account;

(b) as bonus shares on existing holding of foreign currency shares; and

(c) when not permanently resident in India, out of their foreign currency resources outside India.

General permission is also available to sell the shares so purchased or acquired.

❖ Export of goods and services (Section 7)

(1) Every exporter of goods shall-(a) furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India, (b) furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter.

(2) The Reserve Bank may, for the purpose of ensuring that the full export value of the goods or such reduced value of the goods as the Reserve Bank determines, having regard to the prevailing market conditions, is received without any delay, direct any exporter to comply with such requirements as it deems fit.

(3) Every exporter of services shall furnish to the Reserve Bank or to such other authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services.

Regulations:

1. **Short title and commencement:** These Regulations may be called the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015 w.e.f. 12-1-2016.

2. **Definitions:- Some definitions:** In these Regulations, unless the context requires otherwise, -

   (i) 'export' includes the taking or sending out of goods by land, sea or air, on consignment or by way of sale, lease, hire-purchase, or under any other arrangement by whatever name called, and in the case of software, also includes transmission through any electronic media;

   (ii) 'export value' in relation to export by way of lease or hire-purchase or under any other similar arrangement, includes the charges, by whatever name called, payable in respect of such lease or hire-purchase or any other similar arrangement;

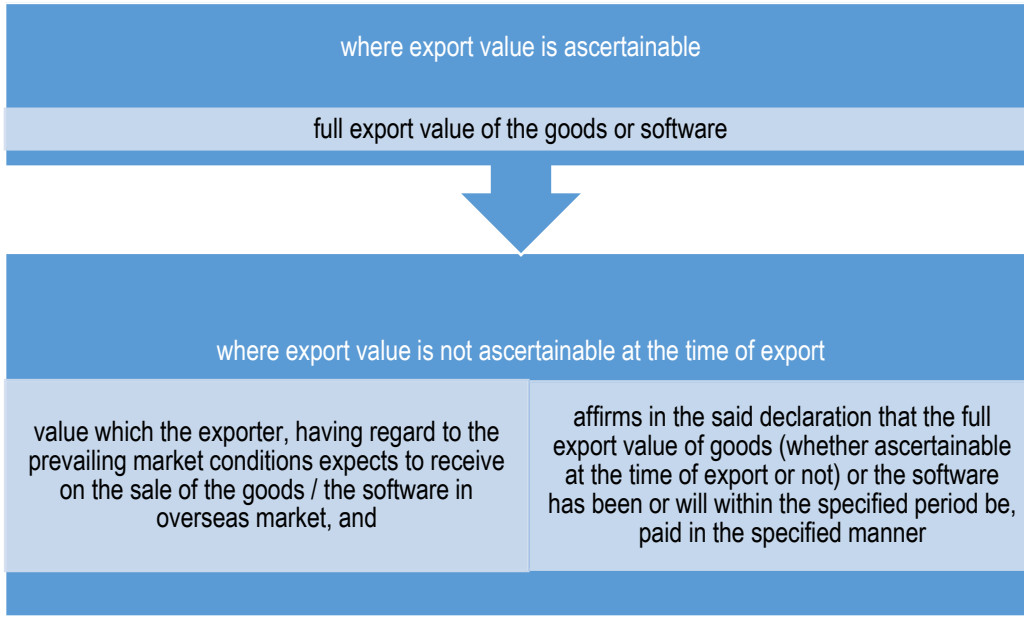
   (iii) 'form' means form annexed to these Regulations;

   (iv) 'software' means any computer programme, database, drawing, design, audio/video signals, any information by whatever name called in or on any medium other than in or on any physical medium;

   (v) 'specified authority' means the person or the authority to whom the declaration as specified in Regulation 3 is to be furnished;

3. **Declaration of exports: In case of exports taking place through Customs manual ports**: every exporter of goods or software in physical or any other form, either directly or indirectly, to any place outside India, other than Nepal and Bhutan, shall furnish to the specified authority-

a declaration in the forms set out in the Schedule with the support of evidence containing true and correct material particulars including the amount representing –



In respect of export of services to which none of the Forms specified in these Regulations apply: the exporter may export such services without furnishing any declaration, but shall be liable to realise the amount of foreign exchange which becomes due / accrues on account of such export, and to repatriate the same to India in accordance with the provisions of the Act, and these Regulations, as also other rules and regulations made under the Act.

Realization of export proceeds in respect of export of goods / software from third party should be duly declared by the exporter in the appropriate declaration form.

4. **Exemptions:** Export of goods / software may be made without furnishing the declaration in the following cases, namely:

(a) trade samples of goods and publicity material supplied free of payment;

(b) personal effects of travellers, whether accompanied or unaccompanied;

(c) ship's stores, trans-shipment cargo and goods supplied under the orders of Central Government or of such officers as may be appointed by the Central Government in this behalf or of the military, naval or air force authorities in India for military, naval or air force requirements;

(d) by way of gift of goods accompanied by a declaration by the exporter that they are not more than five lakh rupees in value

(e) aircrafts or aircraft engines and spare parts for overhauling and/or repairs abroad subject to their reimport into India after overhauling /repairs, within a period of six months from the date of their export;

(f) goods imported free of cost on re-export basis;

(g) the following goods which are permitted by the Development Commissioner of the Special Economic Zones, Electronic Hardware Technology Parks, Software Technology Parks or Free Trade Zones to be re-exported, namely:

(1) imported goods found defective, for the purpose of their replacement by the foreign suppliers/collaborators;

(2) goods imported from foreign suppliers/collaborators on loan basis;

(3) goods imported from foreign suppliers/collaborators free of cost, found surplus after production operations.

(ga) goods listed at items (1), (2) and (3) of clause (i) to be re-exported by units in Special Economic Zones, under intimation to the Development Commissioner of Special Economic Zones / concerned Assistant Commissioner or Deputy Commissioner of Customs

(h) replacement goods exported free of charge in accordance with the provisions of Foreign Trade Policy in force, for the time being.

(i) goods sent outside India for testing subject to re-import into India;

(j) defective goods sent outside India for repair and re-import provided the goods are accompanied by a certificate from an authorised dealer in India that the export is for repair and re-import and that the export does not involve any transaction in foreign exchange.

(k) exports permitted by the Reserve Bank, on application made to it, subject to the terms and conditions, if any, as stipulated in the permission.

5. Indication of importer-exporter code number: The importer-exporter code number (allotted by the Director General of Foreign Trade under Section 7 of the Foreign Trade (Development & Regulation) Act, 1992) shall be indicated on all copies of the declaration forms submitted by the exporter to the specified authority and shall be used in all correspondence of the exporter with the authorised dealer or the Reserve Bank, as the case may be.

6. Authority to whom declaration is to be furnished and the manner of dealing with the declaration:

Declaration in Form EDF	(i)	It shall be submitted in duplicate to the Commissioner of Customs.
	(ii)	After verification and authentication of

	the declaration form, the Commissioner of Customs shall forward the original declaration form/data to the nearest office of the Reserve Bank, and (iii) hand over the duplicate form to the exporter for being submitted to the authorised dealer.
Declaration in Form SOFTEX	(i) It shall be, in respect of export of computer software and audio/video/ television software, submitted in triplicate to the designated official of Ministry of Information Technology, Government of India at the Software Technology Parks of India (STPIs) or at the Free Trade Zones (FTZs) or Special Economic Zones (SEZs) in India. (ii) After certifying all three copies of the SOFTEX form, the designated official shall forward the original directly to the nearest office of the Reserve Bank and return the duplicate to the exporter. (iii) The triplicate shall be retained by the designated official for record.

Duplicate Declaration Forms to be retained with Authorised Dealers: On the realisation of the export proceeds, the duplicate copies of export declaration forms viz. EDF and SOFTEX shall be retained by the Authorised Dealers.

7. **Evidence in support of declaration:-** The Commissioner of Customs / the postal authority / the official of Department of Electronics, to whom the declaration form is submitted, may, in order to satisfy themselves of due compliance with Section 7 of the Act and these regulations, require such evidence in support of the declaration as may establish that –

(a) the exporter is a person resident in India and has a place of business in India;

(b) the destination stated on the declaration is the final place of the destination of the goods exported;

(c) the value stated in the declaration represents –

(i) the full export value of the goods or software; or

(ii) where the full export value of the goods or software is not ascertainable at the

time of export, the value which the exporter, having regard to the prevailing market conditions expects to receive on the sale of the goods in the overseas market.

Explanation—For the purpose of this regulation, 'final place of destination' means a place in a country in which the goods are ultimately imported and cleared through Customs of that country.

8. Manner of payment of export value of goods: Unless otherwise authorised by the Reserve Bank, the amount representing the full export value of the goods exported shall be paid through an authorised dealer in the manner specified in the Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2000 as amended from time to time.

Explanation—For the purpose of this regulation, re-import into India, within the period specified for realisation of the export value, of the exported goods in respect of which a declaration was made under Regulation 3, shall be deemed to be realisation of full export value of such goods.

9. Period within which export value of goods/software/ services to be realised:-

(1) **In ordinary case:** The amount representing the full export value of goods / software/ services exported shall be realised and repatriated to India **within nine months from the date of export**.

However, **where the goods are exported to a warehouse established outside India** with the permission of the Reserve Bank, the amount representing the full export value of goods exported shall be paid to the authorised dealer as soon as it is realised and in any case **within fifteen months from the date of shipment of goods**;

Extension of period: Further the Reserve Bank, or subject to the directions issued by that Bank in this behalf, the authorised dealer may, for a sufficient and reasonable cause, extend the period of nine months or fifteen months, as the case may be.

(2) Where the export of goods / software / services has been made by Units in Special Economic Zones (SEZ) / Status Holder exporter / Export Oriented Units (EOUs) and units in Electronics Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Bio-Technology Parks (BTPs) as defined in the Foreign Trade Policy in force, the amount representing the full export value of goods or software shall be realised and repatriated to India within nine months from the date of export.

Extension of period: Provided further that the Reserve Bank, or subject to the directions issued by the Bank in this behalf, the authorised dealer may, for a sufficient and reasonable cause shown, extend the period of nine months.

The Reserve Bank may for reasonable and sufficient cause direct that the said exporter/s shall cease to be governed by above sub-regulation (2). Such a direction

shall be given only when the unit has been given a reasonable opportunity to make a representation in the matter.

On such direction, the said exporter/s shall be governed by the provisions of sub-regulation (1), until directed otherwise by the Reserve Bank.

For the purpose of this regulation, the "date of export" in relation to the export of software in other than physical form, shall be deemed to be the date of invoice covering such export.

10. **Submission of export documents:** The documents pertaining to export shall be submitted to the authorised dealer mentioned in the relevant export declaration form, within 21 days from the date of export, or from the date of certification of the SOFTEX form:

Provided that, subject to the directions issued by the Reserve Bank from time to time, the authorized dealer may accept the documents pertaining to export submitted after the expiry of the specified period of 21 days, for reasons beyond the control of the exporter.

11. **Transfer of documents:** An authorised dealer may accept, for negotiation or collection, shipping documents including invoice and bill of exchange covering exports, from his constituent (not being a person who has signed the declaration in terms of Regulation 3):

Provided that before accepting such documents for negotiation or collection, the authorised dealer shall –

(a) where the value declared in the declaration does not differ from the value shown in the documents being negotiated or sent for collection, or

(b) where the value declared in the declaration is less than the value shown in the documents being negotiated or sent for collection, require the constituent concerned also to sign such declaration and thereupon such constituent shall be bound to comply with such requisition and such constituent signing the declaration shall be considered to be the exporter for the purposes of these Regulations to the extent of the full value shown in the documents being negotiated or sent for collection and shall be governed by these Regulations accordingly.

12. **Payment for the Export:** In respect of export of any goods / software for which a declaration is required to be furnished, no person shall except with the permission of the Reserve Bank or, subject to the directions of the Reserve Bank, permission of an authorised dealer, do or refrain from doing anything or take or refrain from taking any action which has the effect of securing –

(i) that the payment for the goods or software is made otherwise than in the specified manner; or

(ii) that the payment is delayed beyond the period specified under these Regulations; or

(iii) that the proceeds of sale of the goods or software exported do not represent the full export value of the goods or software subject to such deductions, if any, as may be

allowed by the Reserve Bank or, subject to the directions of the Reserve Bank, by an authorised dealer;

Provided that no proceedings in respect of contravention of these provisions shall be instituted unless the specified period has expired and payment for the goods or software representing the full export value, or the value after deductions allowed under clause (iii), has not been made in the specified manner within the specified period.

(iv) Export of services to which no Form specified in these Regulations apply, the exporter may export such services without furnishing any declaration, (i), (ii) & (iii) above shall apply.

13. Certain Exports requiring prior approval: Exports under trade agreement/rupee credit etc.

(i) Export of goods under special arrangement between the Central Government and Government of a foreign state, or under rupee credits extended by the Central Government to Govt. of a foreign state shall be governed by the terms and conditions set out in the relative public notices issued by the Trade Control Authority in India and the instructions issued from time to time by the Reserve Bank.

(ii) An export under the line of credit extended to a bank or a financial institution operating in a foreign state by the Exim Bank for financing exports from India, shall be governed by the terms and conditions advised by the Reserve Bank to the authorised dealers from time to time.

14. Delay in Receipt of Payment: Where in relation to goods or software export of which is required to be declared on the specified form and export of services, in respect of which no declaration forms has been made applicable, the specified period has expired and the payment therefor has not been made as aforesaid, the Reserve Bank may give to any person who has sold the goods or software or who is entitled to sell the goods or software or procure the sale thereof, such directions as appear to it to be expedient, for the purpose of securing,

(a) the payment therefor if the goods or software has been sold and

(b) the sale of goods and payment thereof, if goods or software has not been sold or reimport thereof into India as the circumstances permit, within such period as the Reserve Bank may specify in this behalf;

Provided that omission of the Reserve Bank to give directions shall not have the effect of absolving the person committing the contravention from the consequences thereof.

15. Advance payment against exports:

(1) **Where an exporter receives advance payment (with or without interest), from a buyer / third party** named in the export declaration made by the exporter, outside India, the exporter shall be under an obligation to ensure that –

(i) **the shipment of goods is made within one year** from the date of receipt of advance payment;

(ii) the rate of interest, if any, payable on the advance payment does not exceed the rate of interest London Inter-Bank Offered Rate (LIBOR) + 100 basis points and

(iii) the documents covering the **shipment are routed through the authorised dealer** through whom the advance payment is received;

Provided that in the event of the exporter's inability to make the shipment, partly or fully, within one year from the date of receipt of advance payment, no remittance towards refund of unutilized portion of advance payment or towards payment of interest, shall be made after the expiry of the period of one year, without the prior approval of the Reserve Bank.

(2) **Exemption:** Notwithstanding anything contained in clause (i) of sub-regulation (1), an exporter may receive advance payment where the export agreement itself duly provides for shipment of goods extending beyond the period of one year from the date of receipt of advance payment.

16. Issue of directions by Reserve Bank in certain cases:

(1) In relation to the export of goods or software which is required to be declared, the Reserve Bank may, for the purpose of ensuring that the full export value of the goods or the value which the exporter having regard to the prevailing market conditions expects to receive on the sale of goods or software in the overseas market, is received in proper time and without delay, by general or special order, direct from time to time that in respect of export of goods or software to any destination or any class of export transactions or any class of goods or software or class of exporters, the exporter shall, prior to the export, comply with the conditions as may be specified in the order, namely ;

(a) that the payment of the goods or software is covered by an irrevocable letter of credit or by such other arrangement or document as may be indicated in the order;

(b) that any declaration to be furnished to the specified authority shall be submitted to the authorised dealer for its prior approval, which may, having regard to the circumstances, be given or withheld or may be given subject to such conditions as may be specified by the Reserve Bank by directions issued from time to time.

(c) that a copy of the declaration to be furnished to the specified authority shall be submitted to such authority or organisation as may be indicated in the order for certifying that the value of goods or software specified in the declaration represents the proper value thereof.

(2) **Exception:** No direction under sub-regulation (1) shall be given by the Reserve Bank and no approval under clause (b) of that sub-regulation shall be withheld by the

Authorised Dealer, unless the exporter has been given a reasonable opportunity to make a representation in the matter.

17. Project exports:

(1) **Where an export of goods or services is proposed to be made on deferred payment terms or in execution of a turnkey project or a civil construction contract,** the exporter shall, before entering into any such export arrangement, submit the proposal for prior approval of the approving authority, which shall consider the proposal in accordance with the guidelines issued by the Reserve Bank of India from time to time.

(2) **In case a guarantee is required to be given prior to post award approval**, the same may be issued by an authorized dealer bank/ a person resident in India being an exporting company, for performance of a project outside India, or for availing of credit facilities, whether fund-based or non-fund based, from a bank or a financial institution outside India in connection with the execution of such project, provided that the contract / Letter of Award stipulates such requirements. Explanation:

For the purpose of this Regulation, 'approving authority' means the EXIM Bank of India or the authorised dealer.

❖ **Realisation and repatriation of foreign exchange [Section 8]**

Where any amount of foreign exchange is due or has accrued to any person resident in India, such person shall take all reasonable steps to realise and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

Exemption from realisation and repatriation in certain cases [Section 9]

The provisions of sections 4 and 8 shall not apply to the following, namely:—

(a) possession of foreign currency or foreign coins by any person up to such limit as the Reserve Bank may specify

(b) foreign currency account held or operated by such person or class of persons and the limit up to which the Reserve Bank may specify

(c) foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;

(d) foreign exchange held by a person resident in India up to such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c), including any income arising therefrom;

(e) foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means up to such limit as the Reserve Bank may specify; and

(f) such other receipts in foreign exchange as the Reserve Bank may specify.

6 AUTHORISED PERSON [SECTION 10]

(1) The Reserve Bank may, on an application made to it in this behalf, authorize any person to be known as authorized person to deal in foreign exchange or in foreign securities, as an authorized dealer, money changer or off-shre banking unit or in any other manner as it deems fit.[Sub-section(1)].

(2) An authorisation under this section shall be in writing and shall be subject to the conditions laid down therein [Sub-section (2)].

(3) An authorisation granted under sub-section (1) may be revoked by the Reserve Bank at any time if the Reserve Bank is satisfied that:

(a) it is in public interest so to do; or

(b) the authorised person has failed to comply with the condition subject to which the authorisation was granted or has contravened any of the provisions of the Act or any rule, regulation, notification, direction order made thereunder;

Provided that no such authorisation shall be revoked on any ground referred to in clause (b) unless the authorised person has been given a reasonable opportunity of making a representation in the matter.

(4) An authorised person shall, in all his dealings in foreign exchange or foreign security, comply with such general or special directions or orders as the Reserve Bank may, from time to time, think fit to give, and, except with the previous permission of the Reserve Bank, an authorised person shall not engage in any transaction involving any foreign exchange or foreign security which is not in conformity with the terms of his authorisation under this section.

(5) An authorised person shall, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and to give such information as will reasonable satisfy him that the transaction will not involve, and is not designed for the purpose of any contravention or evasion of the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder, and where the said person refuses to comply with any such requirement or makes only unsatisfactory compliance therewith, the authorised person shall refuse in writing to undertake the transaction and shall, if he has reason the believe that any such contravention or evasion as aforesaid is contemplated by the person, report the matter to the Reserve Bank.

(6) Any person, other than an authorised person, who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to authorised person under sub-section (5) does not use it for such purpose or does not surrender it to authorised person within the specified period or uses the foreign exchange so acquired or purchased for any other purpose for which purchase or acquisition of foreign exchange is not permissible under the provisions of the Act or the rules or regulations or direction or order made thereunder shall be deemed to have committed contravention of the provision of the Act for the purpose of this section.

❖ Reserve Bank's powers to issue directions to authorised person [Section 11]

(1) The Reserve Bank may, for the purpose of securing compliance with the provisions of this Act and of any rules, regulations, notifications or directions made thereunder, give to the authorised persons any direction in regard to making of payment or the doing or desist from doing any act relating to foreign exchange or foreign security.

(2) The Reserve Bank may, for the purpose of ensuring the compliance with the provisions of this Act or of any rule, regulation, notification direction or order made thereunder, direct any authorised person to furnish such information, in such manner, as it deems fit.

(3) Where any authorised person contravenes any direction given by the Reserve Bank under this Act or fails to file any return as directed by the Reserve Bank, the Reserve Bank may, after giving reasonable opportunity of being head, impose on the authorised person a penalty which may extend to ten thousand rupees and in the case of continuing contravention with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

❖ Power of Reserve Bank to inspect authorised person [Section 12]

(1) The Reserve Bank may, at any time, cause an inspection to be made by any officer of the Reserve Bank specially authorised in writing by the Reserve Bank in this behalf, of the business of any authorised person as may appear to it to be necessary or expedient for the purpose of:

(a) verifying the correctness of any statement, information or particulars furnished to the Reserve Bank;

(b) obtaining any information or particulars which such authorised person has failed to furnish on being called upon to do so;

(c) securing compliance with the provisions of this Act or of any rules, regulations, directions or orders made thereunder.

(2) It shall be the duty of every authorised person, and where such person is a company or a firm, every director, partner or other officer of such company or firm, as the case may be, to produce to any officer making an inspection under sub-section (1), such books, accounts and

other documents in his custody or power and to furnish any statement or information relating to the affairs of such person, company or firm as the said officer may require within such time and in such manner as the said officer may direct.

7. CONTRAVENTIONS AND PENALTIES IN BRIEF

Section No.	Contravention	Quantum of Penalty
Section 11	Authorised person contravenes any direction by RBI or failure to file any return as directed by RBI	➢ Upto ₹ 10,000. ➢ If continuing offence additional penalty upto ₹ 2,000 per day.
Section 13	Of any provision of the Act, or any rule, regulation, notification, direction or order or of any condition subject to which an authorisation issued	➢ Upto three times, the sum involved, if it is quantifiable. ➢ If not quantifiable upto ₹ 2 lacs. ➢ If continuing, further penalty upto ₹ 5,000 per day after first day.
Section 13(1A) and 13(1C)	Acquired any foreign exchange, foreign security or immovable property, situated outside India, of the aggregate value exceeding the threshold prescribed under the proviso to sub-section (1) of section 37A	➢ Upto three times, the sum involved. ➢ confiscation of the value equivalent of foreign assets involved in contravention, situated in India. ➢ Imprisonment upto 5 years with a fine if the amount of contravention exceeds the threshold prescribed under the proviso to sub-section (1) of section 37A.
Section 14	Failure to pay penalty as above – where demand is of an amount exceeding ₹ 1 crore. – in any other case	Civil imprisonment. ➢ Upto 3 years ➢ Upto 6 months.

If any Adjudicating Authority adjudging any contravention under section 13(1), may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any of the person committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with directions made in this behalf.

Explanation: For the purposes of this sub-section, "property" in respect of which contravention has taken place, shall include:

(a) deposits in a bank, where the said property is converted into such deposits;

(b) Indian currency, where the said property is converted into that currency; and

(c) any other property, which has resulted out of the conversion of that property.

❖ Enforcement of the orders of Adjudicating Authority [Section 14]

(1) **In case of failure to make full payment of the penalty:** if any person fails to make full payment of the penalty imposed on him under section 13 within a period of ninety days from the date on which the notice for payment of such penalty is served on him, he shall be liable to civil imprisonment under this section.

(2) **Order of arrest and detention in civil prison:** No order for the arrest and detention in civil prison of a defaulter shall be made unless the Adjudicating Authority has issued and served a notice upon the defaulter calling upon him to appear before him on the date specified in the notice and to show cause why he should not be committed to the civil prison, and unless the Adjudicating Authority, for reasons in writing, is satisfied:

(a) that the defaulter, with the object or effect of obstructing the recovery of penalty, has after the issue of notice by the Adjudicating Authority, dishonestly transferred concealed, or removed may part of his property, or

(b) that the defaulter has, or has had since the issuing of notice by the Adjudicating Authority, the means to pay the arrears or some substantial part thereof and refuses or neglects or has refused or neglected to the same.

(3) **Issue of warrant for the arrest of the defaulter:** a warrant for the arrest of the defaulter may be issued by the Adjudicating Authority if the Adjudicating authority is satisfied, by affidavit or otherwise, that with the object or effect of delaying the execution of the certificate the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority.

(4) **In case of absence pursuant to the notice served:** Where appearance is not made pursuant to a notice issued and served, the Adjudicating Authority may issue a warrant for the arrest of the defaulter.

(5) Every person arrested in pursuance of a warrant of arrest shall be brought before the Adjudicating Authority issuing the warrant as soon as practicable and in any event within twenty-four hours of his arrest (exclusive of the time required for the journey);

Provided that, if the defaulter pays the amount entered in the warrant of arrest as due and the costs of the arrest to the officer arresting him, such officer shall at once release him.

In case if HUF is a defaulter: where the defaulter is a Hindu undivided family, the karta thereof shall be deemed to be the defaulter.

(6) Where a defaulter appears before the Adjudicating Authority pursuant to a notice , the Adjudicating Authority shall give the defaulter an opportunity showing cause when he should not be committed to the civil prison.

(7) **In case of pending of an inquiry:** the adjudicating Authority may, in his discretion, order the defaulter to be detained in the custody of such officer as the Adjudicating Authority may think fit or release him on his furnishing the security to the satisfaction of the Adjudicating Authority for his appearance as and when required.

(8) **Upon the conclusion of the inquiry:** the Adjudicating Authority may make an order for the detention of the defaulter in the civil prison and shall in that event cause him to be arrested if he is not already under arrest:

(9) **Upon satisfaction of arrears: Provided** that in order to give a defaulter an opportunity of satisfying the arrears, the Adjudicating Authority may, before making the order of detention, leave the defaulter in the custody of the officer arresting him or of any other officer for a specified period not exceeding fifteen days, or release him on his furnishing security to the satisfaction of the adjudicating authority for his appearance at the expiration of the specified period if the arrears are not satisfied.

(10) **order of release:** When the Adjudicating Authority does not make an order of detention, he shall, if the defaulter is under arrest, direct his release.

(11) Every person detained in the civil prison in execution of the certificate may be so detained:

(a) where the certificate is for a demand of an amount exceeding rupees one crore, up to three years, and

(b) in any other case, up to six months:

Provided that he shall be released from such detention on the amount mentioned in the warrant for his detention being paid to the officer-in-charge of the civil prison.

(12) **Defaulter liable for payment of arrears:** A defaulter released from detention under this section shall not, merely by reason of his release, be discharged from his liability for the arrears, but he shall not be liable to be arrested under the certificate in execution of which he was detained in the civil prison.

(13) **Execution of detention order:** A detention order may be executed at any place in India in the manner provided for the execution of warrant of arrest under the Code of Criminal Procedure, 1973.

❖ **Power of recover arrears of penalty [Section 14A]**

(1) The Adjudicating Authority may, by order in writing, authorise an officer of Enforcement (not below the rank of Assistant Director) to recover any arrears of penalty from any person who

fails to make full payment of penalty imposed on him under section 13 within the period of ninety days from the date on which the notice for payment of such penalty is served on him.

(2) The officer of Enforcement, shall exercise all the like powers which are conferred on the income-tax authority in relation to recovery of tax under the Income-tax Act, 1961 and the procedure laid down under the Second Schedule to the said Act shall mutatis mutandis apply in relation to recovery of arrears of penalty under this Act.

8. COMPOUNDING OF OFFENCES

Compounding Authority: Persons authorized by Central Government under section 15 i.e. classes of officers of the Enforcement Directorate and classes of officers of the RBI can act as Compounding Authority.

According to section 15:

(1) **Period of compounding of an offence:** Any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and Officers of the Reserve Bank as may be authorised in this behalf by the Central Government in such manner as prescribed under the Foreign Exchange (Compounding Proceedings) Rules, 2000.

(2) **In case of compounding, no proceeding may be initiated:** Where a contravention has been compounded, no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the person committing such contravention under that section, in respect of the contravention so compounded.

9. ADJUDICATION AND APPEAL

Time limits

Section No.	Obligation	Time Limit
Section 14	Full penalty to be paid	Within 90 days from the date on which notice for payment of penalty is served.
Section 15	Compounding of Contravention under section 13	Within 180 days of receipt of application by Directorate of Enforcement or RBI
Section 16	Complaint under section 16(1) to	Within 1 year of receipt of complaint.

	be dealt by Adjudicated Authority	
Section 17	Appeal to Special Director (Appeals)	Within 45 days from receipt of order.
Section 19	Appeal to Appellate Tribunal	Within 45 days from receipt of order.
Section 19(5)	Appeal to be dealt with by Appellate Tribunal	Will try to dispose off the appeal within 180 days from receipt of appeal.
Section 35	Appeal to High Court	Within 60 days of communication of order or decision.

❖ Appointment of Adjudicating Authority

For the purpose of adjudication under section 13, the Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government as it may think fit, as the Adjudicating Authorities for holding an inquiry in the manner prescribed after giving the person alleged to have committed contravention under section 13, against whom a complaint has been made under sub-section (3) (hereinafter in this section referred to as the said person) a reasonable opportunity of being heard for the purpose of imposing any penalty:

Provided that where the Adjudicating Authority is of opinion that the said person is likely to abscond or is likely to evade in any manner, the payment of penalty, if levied, it may direct the said person to furnish a bond or guarantee for such amount and subject to such conditions as it may deem fit. [Section 16 (1)]

Every Adjudicating Authority shall deal with the complaint as expeditiously as possible and endeavour shall be made to dispose of the complaint finally within one year from the date of receipt of the complaint:

Provided that where the complaint cannot be disposed of within the said period, the Adjudicating Authority shall record periodically the reasons in writing for not disposing of the complaint within the said period. [Section 16 (6)]

❖ Appeal to Special Director (Appeals)

(1) The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities under this section and shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction. [Section 17(1)]

(2) Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement, may prefer an appeal of the Special Director (Appeals). [Section 17(2)]

(3) Every appeal shall be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person. [Section 17(3)]

(4) The Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.

❖ Appeal to Appellate Tribunal [Section 18]

The Appellate Tribunal constituted under section 12(1) of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, shall be the Appellate Tribunal for the purposes of this Act and the said Appellate Tribunal shall exercise the jurisdiction, powers and authority conferred on it by or under this Act. [Section 18].

The Central Government or any person aggrieved by an order made by an Adjudicating Authority, other than those referred to in sub-section (1) of section 17, or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal [Section 19(1)]. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government. [Section 19(2)]. Where any appeal could not be disposed of within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing of the appeal within the said period. [Section 19(5)]

❖ Appeal to High Court (Section 35)

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal on any question of law arising out of such order:

Provided that the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Explanation: In this section "High Court" means:

(a) the High Court within the jurisdiction of which the aggrieved party ordinarily resides or carries on business or personally works for gain; and

(b) where the Central Government is the aggrieved party, the High Court within the jurisdiction of which the respondent, or in a case where there are more than one respondent, any of the respondents, ordinarily resides or carries on business or personally works for gain.

10. DIRECTORATE OF ENFORCEMENT

❖ Directorate of Enforcement (Section 36)

(1) The Central Government shall establish a Directorate of Enforcement with a Director and such other officers or class of officers as it thinks fit, who shall be called officers of Enforcement, for the purposes of this Act.

(2) the Central Government may authorise the Director of Enforcement or an Additional Director of Enforcement or a Special Director of Enforcement or a Deputy Director of Enforcement to appoint officers of Enforcement below the rank of an Assistant Director of Enforcement.

(3) Subject to such conditions and limitations as the Central Government may impose, an officer of Enforcement may exercise the powers and discharge the duties conferred or imposed on him under this Act.

Power of search and seizure: The Director of Enforcement and other officers of Enforcement, not below the rank of an Assistant Director, shall take up for investigation the contravention referred to in section 13. [Section 37(1)]

❖ **Empowering other officers (Section 38)**

(1) The Central Government may, by order and subject to such conditions and limitations as it thinks fit to impose, authorise any officer of customs or any central excise officer or any police officer or any other officer of the Central Government or a State Government to exercise such of the powers and discharge such of the duties of the Director of Enforcement or any other officer of Enforcement under this Act as may be stated in the order.

(2) The officers referred to in sub-section (1) shall exercise the like powers which are conferred on the income-tax authorities under the Income-tax Act, 1961, subject to such conditions and limitations as the Central Government may impose.

11. MISCELLANEOUS

❖ **Presentation as to documents in certain cases [Section 39]**

Where any document:

(i) is produced or furnished by any person or has been seized from the custody or control of any person, in either case, under this Act or under any other law; or

(ii) has been received from any place outside India (duly authenticated by such authority or person and in such manner as may be prescribed) in the course of investigation of any contravention under this Act alleged to have been committed by any person, such document is tendered in any proceeding under this Act in evidence against him, or against him and any other person who is proceeded against jointly with him, the court or the Adjudicating Authority, as the case may be, shall:

(a) presume, unless the contrary is proved, that the signature and every other part of such document which purports to be in the handwriting of any particular person or which the court may reasonably assume to have been signed by, or to be in the handwriting of any particular person, is in that person's handwriting and in the case of a document

executed or attested, that it was executed or attested by the person by whom it purports to have been so executed or attested;

(b) admit the document in evidence notwithstanding that it is not duly stamped, if such document is otherwise admissible in evidence;

(c) in a case falling under clause (i), also presume, unless the contrary is proved, the truth of the contents of such document.

❖ Suspension of operation of this Act [Section 40]

(1) If the Central Government is satisfied that circumstances have arisen rendering it necessary that any permission granted or restriction imposed by this Act should cease to be granted or imposed, or if it considers necessary or expending so to do in public interest, the Central Government may, by notification, suspend or relax to such extent either indefinitely or for such period as may be notified, the operation of all or any of the provisions of this Act.

(2) Where the operation of any provision of this Act has under sub-section (1) been suspended or relaxed indefinitely, such suspension or relaxation may, at any time while this Act remains in force, be removed by the Central Government by notification.

(3) Every notification issued under this section shall be laid, as soon as may be after it issued, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification or both Houses agree that the notification should not be issued, the notification shall there after have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that notification.

❖ Power of Central Government to give directions [Section 41]

For the purposes of this Act, the Central Government may, from time to time, give to the Reserve bank such general or special directions as it thinks fit, and the Reserve bank shall, in the discharge of its functions under this Act, comply with any such directions.

❖ Contravention by companies [Section 42]

(1) **of Where a person committing a contravention any of the provisions of this Act or of any rule, direction or order made thereunder is a company,** every person who, at the time the contravention was committed, was in charge of, and was 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 contravention and shall be liable to be proceeded against and punished accordingly [Sub-section (1)].

Provided that nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention took place without his knowledge or that he exercised due diligence to prevent such contravention.

(2) **Where contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company** and it is proved that the contravention has taken place 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 of the company shall also be deemed to be guilty of the contravention and shall be liable to be proceed against and punished accordingly.

Explanation: For the purpose of this Section—

(i) "Company" means any body corporate and includes a firm or other association of individuals; and

(ii) "Director" in relation to a firm, means a partner in the firm.

❖ Death or insolvency in certain cases [Section 43]

Any right, obligation, liability, proceedings or appeal arising in relation to the provision of section 13 shall not abate by reason of death or insolvency of the person liable under that section and upon such death or insolvency such rights and obligations shall devolve on the legal representative of such person or the official receiver or the official assignee, as the case may be:

Provided that a legal representative of the deceased shall be liable only to the extent of the inheritance or estate of the deceased.

❖ Bar Legal proceedings [Section 44]

No suit, prosecution or other legal proceeding shall lie against the Central Government or the Reserve Bank or any officer of that Government or of the Reserve Bank or other person exercising any power or discharging any functions or performing any duties under this Act, for anything in good faith done or intended to be done under this Act or any rule, regulation, notification, direction or order made thereunder.

Students may note that though they are not expected to know the details of all the Rules/ Regulations/Clarifications/Notifications issued by various authorities from time to time. However, they should familiarise with such Notifications and other significant rules/regulations having a bearing on such provisions of the Act and which are covered as part of the Study Material and Revision Test Papers published from time to time.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. In September 2016, Mr. P, went to USA, London and Germany on a month long business trip. For this trip he got exchanged US$ 50000 from an authorized dealer. In December 2016 he remitted US$ 50000 to his son in Canada, who was studying there. In January 2017 he sent his mother and wife to America for his mother's treatment and for the purpose he remitted US$ 75000 to his younger brother, who was living there. In March 2017 his daughter got engaged and she opted for a destination marriage to be held in May 2017, in Switzerland. While on trip to Dubai in the March end, 2017, he spent US $ 35000 for his daughter's shopping in Dubai. Later, the event manager gave an estimate of US $ 250000 for the wedding. As per the provisions of FEMA, for how much remittance does he need to take prior approval of the Reserve bank of India.

   a) He does not need any prior approval at all

   b) For US $ 210000

   c) For US $ 250000

   d) For US $ 15000

2. Mr. Z was appointed as representative of ABC Company for a corporate programme organized in USA. During the said period in USA, he was diagnosed with the severe kidney disease, so decided to have a kidney transplant done in USA. State the maximum amount that can be drawn by Mr. Z as foreign exchange for the medical treatment abroad.

   (a) USD 1,25,000

   (b) USD 2,25,000

   (c) USD 2,50,000

   (d) As estimated by a medical institute offering treatment

3. Mr. Ram had resided in India during the Financial Year 2017-2018 for less than 183 days. He again came to India on 1st May, 2018 for higher studies and business and stayed upto 15th July, 2019. State the correct answer as to the residential status of Mr. Ram in the light of the given fact as per the Foreign Exchange Management Act, 1999

   (1) Mr. Ram can be considered as 'Person resident in India' during the financial year 2018-2019

   (2) Mr. Ram cannot be considered as 'Person resident in India' during the financial year 2018-2019

(3) Mr. Ram can be considered as 'Person resident in India' during the financial year 2019-2020

(a) Both the statement (1) & (3) are correct

(b) Both the statement (2) & (3) are correct

(c) Only statement (1) is correct

(d) Only statement (2) is correct

Descriptive Questions

Question 1

'Printex Computer' is a Singapore based company having several business units all over the world. It has a unit for manufacturing computer printers with its Headquarters in Pune. It has a Branch in Dubai which is controlled by the Headquarters in Pune. What would be the residential status under the FEMA, 1999 of printer units in Pune and that of Dubai branch?

Question 2

Mr. Ram had resided in India during the Financial Year 2014-2015 for less than 183 days. He again came to India on 1st May, 2015 for higher studies and business and stayed upto 15th July, 2016. State under the Foreign Exchange Management Act, 1999.

(i) If Mr. Ram can be considered 'person Resident in India' during the Financial year 2015-2016 and

(ii) Is citizenship relevant for determining such a status?

Question 3

Mr. Sane, an Indian National desires to obtain Foreign Exchange for the following purposes:

(i) Remittance of US Dollar 50,000 out of winnings on a lottery ticket.

(ii) US Dollar 1,00,000 for sending a cultural troupe on a tour of U.S.A.

Advise him whether he can get Foreign Exchange and if so, under what conditions?

Question 4

State which kind of approval is required for the following transactions under the Foreign Exchange Management Act, 1999:

(i) X, a Film Star, wants to perform along with associates in New York on the occasion of Diwali for Indians residing at New York. Foreign Exchange drawal to the extent of US dollars 20,000 is required for this purpose.

(ii) R wants to get his heart surgery done at United Kingdom. Up to what limit Foreign Exchange can be drawn by him and what are the approvals required?

Question 5

Referring to the provisions of the Foreign Exchange Management Act, 1999, examine whether V, an exporter is bound to make declaration on gift exported from India to United Kingdom a jewellery valued at ₹ 20,000 to his friend in Australia.

Question 6

Referring to the provisions of the Foreign Exchange Management Act, 1999, state the kind of approval required for the following transactions:

(i) M requires U.S. $ 5,000 for remittance towards hire charges of transponders.

(ii) P requires U.S. $ 2,000 for payment related to call back services of telephones.

Question 7

Mr. Suresh resided in India during the Financial Year 2013-14. He left India on 15th July, 2014 for Switzerland for pursuing higher studies in Biotechnology for 2 years. What would be his residential status under the Foreign Exchange Management Act, 1999 during the Financial Years 2014-15 and 2015-16?

Mr. Suresh requires every year USD 25,000 towards tuition fees and USD 30,000 for incidental and stay expenses for studying abroad. Is it possible for Mr. Suresh to get the required Foreign Exchange and, if so, under what conditions?

Question 8

Mrs. Chandra, a resident outside India, is likely to inherit from her father some immovable property in India. Are there any restrictions under the provisions of the Foreign Exchange Management Act, 1999 in acquiring or holding such property? State whether Mrs. Chandra can sell the property and repatriate outside India the sale proceeds.

Question 9

(i) Mr. P has won a big lottery and wants to remit US Dollar 20,000 out of his winnings to his son who is in USA. Advise whether such remittance is possible under the Foreign Exchange Management Act, 1999.

(ii) Mr. Z is unwell and would like to have a kidney transplant done in USA. He would like to know the formalities required and the amount that can be drawn as foreign exchange for the medical treatment abroad.

Question 10

(i) Mr. Rohan, an Indian Resident individual desires to obtain Foreign Exchange for the following purposes:

(ii) (A) US$ 1,20,000 for studies abroad on the basis of estimates given by the foreign university.

(B) Gift Remittance amounting US$ 10,000.

(iii) Advise him whether he can get Foreign Exchange and if so, under what condition(s)?

ANSWERS/SOLUTION

Answer to MCQ

1. **(a)** **Hint:** He does not need any prior approval, because during the year April 2016-March 2017 his all foreign exchange transactions were amounted to US $ 210000 and an individual does not require any prior approval for remittances made up to US $ 250000 during a year (as per the Schedule III of the FEMA regulation).

2. **(d)** **Hint:** A person who has fallen sick after proceeding abroad may also be released foreign exchange by an Authorised Dealer (without seeking prior approval of the Reserve Bank of India) for medical treatment outside India exceeding the limit USD 2,50,000 on the basis of the estimation given by the medical institute offering treatment.

3. **(b)** **Hint:** Mr. Ram cannot be considered 'Person resident in India' during the financial year 2018-2019 notwithstanding the purpose or duration of his stay in India during 2018-2019. An individual has to be present in India for more than 182 days in the preceding financial year. Mr. Ram does not satisfy this condition for the financial year 2018-2019. But shall be considered as 'Person resident in India' during the financial year 2019-2020.

Answer to Descriptive Questions

1. Printex Computer being a Singapore based company would be person resident outside India [(Section 2(w)]. Section 2 (u) defines 'person' under clause (viii) thereof, as person would include any agency, office or branch owned or controlled by such person. The term such person appears to refer to a person who is included in clause (i) to (vi). Accordingly, Printex unit in Pune, being a branch of a company would be a 'person'.

Section 2(v) defines a person resident in India. Under clause (iii) thereof person resident in India would include an office, branch or agency in India owned or controlled by a person resident outside India. Printex unit in Pune is owned or controlled by a person resident outside India, and hence it, would be a 'person resident in India.'

However, Dubai Branch though not owned is controlled by Print unit in Pune which is a person resident in India. Hence prima facie, it may be possible to hold a view that the Dubai Branch is a person resident in India.

2. **(i)** No. Mr. Ram cannot be considered 'Person resident in India' during the financial year 2015-2016 notwithstanding the purpose or duration of his stay in India during 2015-2016. An individual has to be present in India for more than 182 days in the preceding financial year. Mr. Ram does not satisfy this condition for the financial year 2015-2016.

(ii) No. Citizenship is no more relevant for determining the status.

3. Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions, prior permission of Reserve Bank of India is required.

(i) In respect of item No.(i), i.e., remittance out of lottery winnings, such remittance is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, Mr. Sane can not withdraw Foreign Exchange for this purpose.

(ii) Foreign Exchange for meeting expenses of cultural tour can be withdrawn by any person after obtaining permission from Government of India, Ministry of Human Resources Development, (Department of Education and Culture) as prescribed in Second Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, in respect of item (ii), Mr. Sane can withdraw the Foreign Exchange after obtaining such permission.

In all the cases, where remittance of Foreign Exchange is allowed, either by general or specific permission, the remitter has to obtain the Foreign Exchange from an Authorised Person as defined in Section 2(c) read with section 10 of the Foreign Exchange Management Act, 1999.

4. **Approval to the following transactions under FEMA, 1999:**

(i) Foreign Exchange drawals for cultural tours require prior permission/approval of the Government of India irrespective of the amount of foreign exchange required. Therefore, in the given case X, the Film Star is required to seek permission of the Government of India.

(ii) Individuals can avail of foreign exchange facility within the limit of USD 2,50,000 only. Any additional remittance in excess of the said limit for the expenses in connection with medical treatment abroad, shall require prior approval of the Reserve Bank of India. Therefore, R can draw foreign exchange up to the USD 2,50,000 and for additional remittance in excess of this limit for bearing the expenses of medical treatment in UK, prior permission/approval of RBI will be required. Provided, the individual may avail of exchange facility for an amount in excess of the limit prescribed under the Liberalised Remittance Scheme if it is so estimated by a medical institute offering treatment.

5. In accordance with provisions of the FEMA, 1999 as contained in section 7 read with section 8, it imposes on an exporter to make appropriate declaration of the value of the goods being exported and he is also required to repatriate the foreign exchange due to India in respect of such exports to India in the manner within the time as may be prescribed. Under section 8,

the exporter is under an obligation to realise and repatriate to India such foreign. However, if there is an delay in the receipt of export, it will not be a violation which shall be punishable. Section 8 applies to a resident who shall take all the reasonable steps, depending upon the individual case.

There are certain categories of export for which declaration need not be made. These are given under the Regulation 4 of the Foreign Exchange Management (Export of Goods & Services) Regulations, 2015. According to the regulation, export of goods by way of gift shall be accompanied by a declaration by the exporter that they are not more than five lakh rupees in value. Taking into consideration the above, since the value of gift of jewellery to V's friend in Australia is less than ` 5 lac in value, the gift does not need any declaration to be furnished by exporter to the specified authority.

6. Under section 5 of the Foreign Exchange Management Act, 1999, and Rules relating thereto, some current account transactions require prior approval of the Central Government, some others require the prior approval of the Reserve Bank of India, some are free transactions and some others are prohibited transactions. Accordingly,

(i) It is a current account transaction, where M is required to take approval of the Central Government for drawal of foreign exchange for remittance of hire charges of transponders.

(ii) Withdrawal of foreign exchange for payment related to call back services of telephone is a prohibited transaction. Hence, Mr. P will not succeed in acquiring US $ 2,000 for the said purpose.

7. **Residential Status:** According to section 2(v) of the Foreign Exchange Management Act, 1999, 'Person resident in India' means a person residing in India for more than 182 days during the course of preceding financial year [Section 2(v)(i)]. However, it does not include a person who has gone out of India or who stays outside India for employment outside India or for any other purpose in such circumstances as would indicate his intention to stay outside India for an uncertain period.

Generally, a student goes out of India for a certain period. In this case, Mr. Suresh who resided in India during the financial year 2013-14 left on 15.7.2014 for Switzerland for pursuing higher studies in Biotechnology for 2 years, he will be resident for 2014-15, as he has gone to stay outside India for a 'certain period' (If he goes abroad with intention to stay outside India for an 'uncertain period' he will not be resident with effect from 16-7-2014.

Mr. Suresh will not be resident during the Financial Year 2015-2016 as he did not stay in India during the relevant previous financial year i.e. 2014-15.

Foreign Exchange for studies abroad: According to Para I of Schedule III to Foreign Exchange Management (Current Account Transactions), Amendment Rule, 2015 dated 26th May , 2015, individuals can avail of foreign exchange facility for the studies abroad within the limit

of USD 2,50,000 only. Any additional remittance in excess of the said limit shall require prior approval of the RBI. Further proviso to Para I of Schedule III states that individual may be allowed remittances (without seeking prior approval of the RBI) exceeding USD 2,50,000 based on the estimate received from the institution abroad. In this case the foreign exchange required is only USD 55,000 per academic year and hence approval of RBI is not required.

8. As per sub-section 5 of section 6 of the FEMA, 1999, a person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

Accordingly, in the problem, Mrs. Chandra, a resident outside India, may acquire or hold any immovable property of his father in India by way of inheritance in both the conditions, firstly, where her father, a resident outside India, had acquired the property in accordance with the provisions of the foreign exchange law in force at the time of acquisition by him or as per the provisions of these Regulations or secondly, where her father, a resident in India.

Repatriation of sale proceeds: A person referred to in sub-section (5) of section 6 of the Act, or his successor shall not, except with the prior permission of the Reserve Bank, repatriate outside India the sale proceeds of any immovable property.

Thus, accordingly Mrs. Chandra can sell the property and repatriate outside India the sale proceeds only with the prior permission of the RBI.

9. Remittance of Foreign Exchange (Section 5 of the Foreign Exchange Management Act, 1999): According to section 5 of the FEMA, 1999, any person may sell or draw foreign exchange to or from an authorized person if such a sale or drawal is a current account transaction. Provided that Central Government may, in public interest and in consultation with the reserve bank, impose such reasonable restrictions for current account transactions as may be prescribed.

As per the rules, drawal of foreign exchange for current account transactions are categorized under three headings-

1. Transactions for which drawal of foreign exchange is prohibited,
2. Transactions which need prior approval of appropriate government of India for drawal of foreign exchange, and
3. Transactions which require RBI's prior approval for drawl of foreign exchange.

(i) Mr. P wanted to remit US Dollar 20,000 out of his lottery winnings to his son residing in USA. Such remittance is prohibited and the same is included in the Foreign Exchange Management (Current Account Transactions) Rules, 2000.

Hence Mr. P cannot withdraw foreign exchange for this purpose.

(ii) "Remittance of foreign exchange for medical treatment abroad" requires prior

permission or approval of RBI where the individual requires withdrawal of foreign exchange exceeding USD 2,50,000. The Schedule also prescribes that for the purpose of expenses in connection with medical treatment, the individual may avail of exchange facility for an amount in excess of the limit prescribed under the Liberalized Remittance Scheme, if so required by a medical institute offering treatment.

Therefore, Mr. Z can draw foreign exchange up to the USD 2,50,000 and no prior permission/ approval of RBI will be required. For amount exceeding the above limit, authorised dealers may release foreign exchange based on the estimate from the doctor in India or hospital or doctor abroad.

10 **(A)** **Remittance of Foreign Exchange for studies abroad:** Foreign exchange may be released for studies abroad up to a limit of US $ 2,50,000 for the studies abroad without any permission from the RBI. Above this limit, RBI's prior approval is required. Further proviso to Para I of Schedule III states that individual may be allowed remittances exceeding USD 2,50,000 based on the estimate received from the institution abroad. In this case since US $ 1,20,000 is the drawal of foreign exchange, so permission of the RBI is not required.

(B) **Gift remittance exceeding US $ 10,000:** Under the provisions of Section 5 of FEMA 1999, certain Rules have been made for drawal of foreign exchange for current account transactions. Gift remittance is a current account transaction. Gift remittance exceeding US $ 2,50,000 can be made after obtaining prior approval of the RBI. In the present case, since the amount to be gifted by an individual, Mr. Rohan is USD 10,000, so there is no need for any permission from the RBI.

CHAPTER 2

THE SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002

LEARNING OUTCOMES

By the end of this Chapter, you will be able to:

- Explain the concept of Securitisation and Reconstruction
- Know the objective and key features of SARFAESI Act
- Understand the framework for regulation of securitisation and reconstruction of financial assets & enforcement of security interest by banks and Financial Institutions

1. INTRODUCTION

The financial sector has been one of the key drivers in India's efforts to achieve success in rapidly developing its economy. Since our existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms. This has resulted in slow pace of recovery of defaulting loans and mounting levels of nonperforming assets of banks and financial institutions.

Narasimham Committee I and II and Andhyarujina Committee was constituted by the Central Government for the purpose of examining banking sector reforms have considered the need for changes in the legal system in respect of these areas. These Committees, among others, have suggested enactment of a new legislation for securitisation and empowering banks and financial

institutions to take possession of the securities and to sell them without the intervention of the court. Acting on these suggestions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was promulgated on the 21st June, 2002 to regulate securitisition and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. It extended to the whole of India.

Amendment in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) vide the enforcement of the Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016.

Ministry of Law and Justice on 16th August, 2016 hereby published for general information in the Official Gazette, the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016.

It is an Act further to amend four laws:

(i) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI),

(ii) Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI),

(iii) Indian Stamp Act, 1899 and

(iv) Depositories Act, 1996, and for matters connected therewith or incidental thereto.

Chapter II, of this amendment Act deals with the amendments to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

This amendment Act is "an act to regulate securitisation and reconstruction of financial assets and enforcement of security interest and to provide for a central database of security interests created on property rights, and for matters connected therewith or incidental thereto."

The Act deals with the following:

- Registration and regulation of Asset Reconstruction Companies (ARCs) by the Reserve Bank of India;
- Facilitating securitisation of financial assets of banks and financial institutions with or without the benefit of underlying securities;
- Facilitating easy transferability of financial assets by the ARC to acquire financial assets of banks and financial institutions by issue of debentures or bonds or any other security in the nature of a debenture;
- Empowering ARCs to raise funds by issue of security receipts to qualified buyers;
- Facilitating reconstruction of financial assets acquired by exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred on the banks and financial institutions;

- Declaration of any securitisation company or reconstruction company registered with the Reserve Bank of India as a public financial institution for the purpose of section 4A of the Companies Act, 1956;
- Defining 'security interest' as any type of security including mortgage and change on immovable properties given for due repayment of any financial assistance given by any bank or financial institution;
- Empowering banks and financial institutions to take possession of securities given for financial assistance and sell or lease the same or take over management in the event of default, i.e. classification of the borrower's account as non-performing asset in accordance with the directions given or under guidelines issued by the Reserve Bank of India from time to time;
- The rights of a secured creditor to be exercised by one or more of its officers authorised in this behalf in accordance with the rules made by the Central Government;
- An appeal against the action of any bank or financial institution to the concerned Debts Recovery Tribunal and a second appeal to the Appellate Debts Recovery Tribunal;
- Setting up or causing to be set up a Central Registry by the Central Government for the purpose of registration of transactions relating to securitisation, asset reconstruction and creation of security interest;
- Application of the proposed legislation initially to banks and financial institutions and empowerment of the Central Government to extend the application of the proposed legislation to non-banking financial companies and other entities
- Non-application of the proposed legislation to security interests in agricultural lands, loans not exceeding rupees one lakh and cases where eighty per cent, of the loans are repaid by the borrower.

2. STRUCTURE

The Act is divided into six chapters and 42 sections:

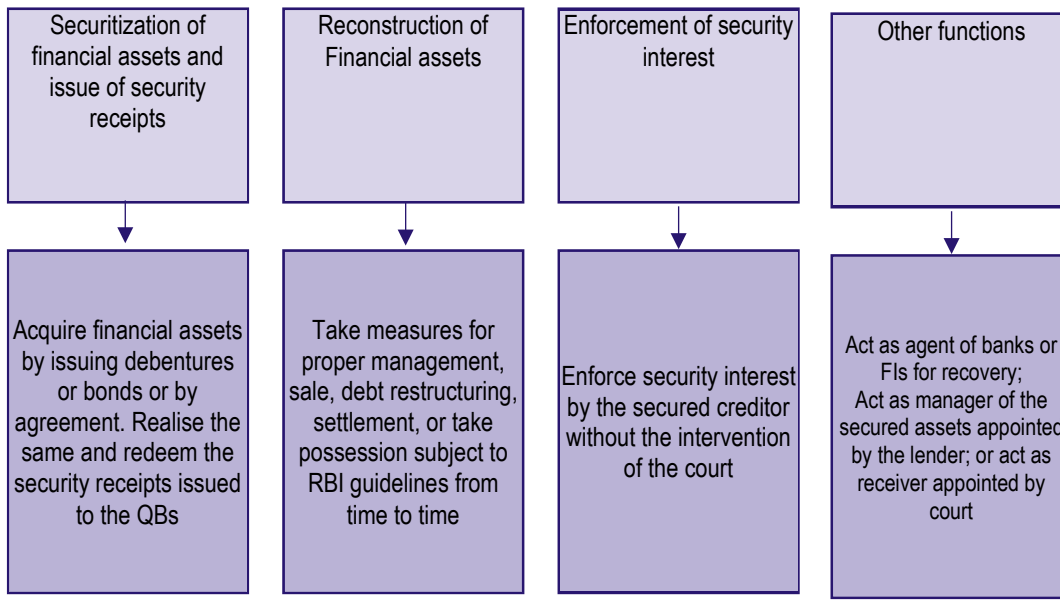
Chapter I- Preliminary (Section 1-2)
Chapter II- Regulation of securitisation and reconstruction of financial assets of banks and financial institutions (Section 3- 12A)
Chapter III- Enforcement of security interest (Section 13- 19)
Chapter IV- Central registry (Section 20-26A)
Chapter IVA- Registration by secured creditors and other creditors (Section 26B-26E)
Chapter V- Offences and penalties (Section 27-30)
Chapter VI- Miscellaneous (Section 37-42)

3. IMPORTANT CONCEPTS

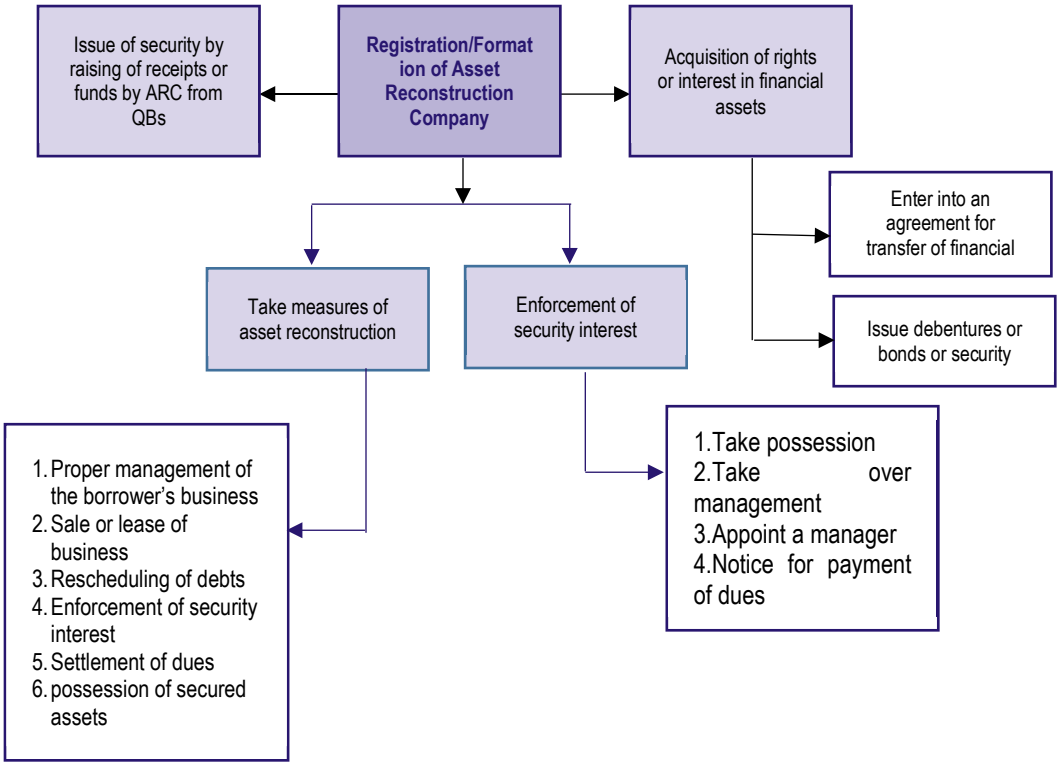
The Act introduced multiple new concepts and infrastructures to support ease of recovery actions such as:

- Formation of Securitisation or reconstruction companies
- Recovery without interference of courts
- Framework for revival or reconstruction of the borrowers' business
- Central registry
- Qualified buyers
- Security receipts

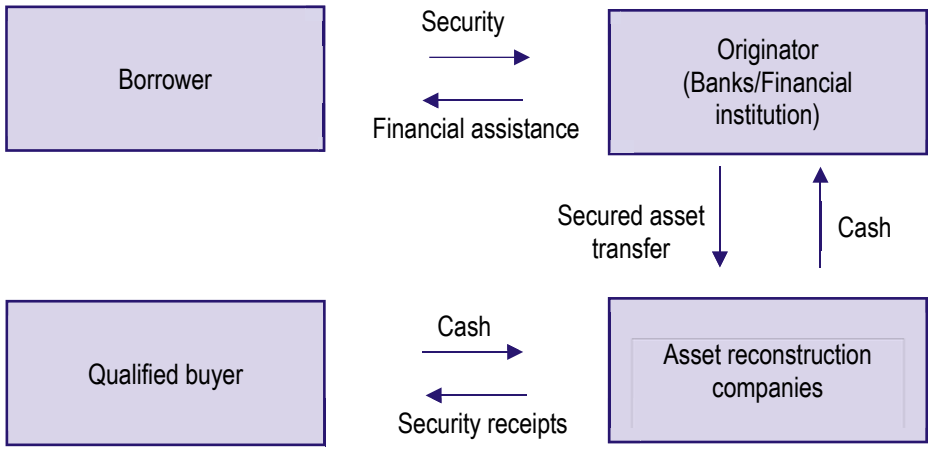
4. ROLE OF THE ACT



5. FUNCTIONING OF ARC IN A NUT SHELL



Alternative presentation (simpler version):



6. DEFINITIONS

Some key definitions is explained as below:

- **"Asset reconstruction"** means acquisition by any securitisation company (SC) or reconstruction company (RC) of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance **[Section 2(b)]**

  The term **"financial assistance"** means any loan or advance granted or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution; **[Section 2(k)]**

  The purpose of acquisition by securitisation company (SC) or reconstruction company (RC) is to realise such assets and not to stay invested by becoming the shareholders of the company. However it has the right to take over the management of the business, subject to RBI's guidelines from time to time. Such realised amount should be held and applied towards redemption of investments and payment of returns assured to the QIBs

- **"Asset reconstruction company (ARC)"** means a company registered with Reserve Bank under section 3 for the purposes of carrying on the business of asset reconstruction or securitisation, or both. **[Section 2(ba)]**

  An ARC is not a banking company although it is regulated by RBI. Such company cannot carry out any other business other than securitisation or reconstruction.

- **"Borrower"** means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance or who has raised funds through issue of debt securities . **[Section 2(f)]**

- **"Default"** means:

  (a) non-payment of any debt or any other amount payable by the borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor; or

  (b) non-payment of any debt or any other amount payable by the borrower with respect to debt securities after notice of ninety days demanding payment of dues served upon such borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of such debt securities. **[Section 2(j)]**

Conditions for calling default under this Act is:

- debt or any other amount- The amount due should be in the nature of debt.
- Secured creditor- An unsecured creditor doesn't have recourse to this act
- Classification of NPA- A stressed asset which is yet to be classified as NPA cannot be resolved through this Act.
- For non-payment of debenture or bonds to be called default, a notice of 90 days is a pre-requisite by the debenture trustee or beneficiary of the security.

- **"Debt"** shall have the meaning assigned to it in clause (g) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and includes—

  (a) unpaid portion of the purchase price of any tangible asset given on hire or financial lease or conditional sale or under any other contract;

  (b) any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable any borrower to acquire the intangible asset or obtain licence of such asset; **[Section 2(ha)]**

- **"Financial asset"** means debt or receivables and includes-

  (i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or

  (ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or

  (iii) a mortgage, charge, hypothecation or pledge of movable property; or

  (iv) any right or interest in the security, whether full or part underlying such debt or receivables; or

  (v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or

  (va) any beneficial right, title or interest in any tangible asset given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire such tangible asset; or

  (vb) any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise

extended to enable the borrower to acquire such intangible asset or obtain licence of the intangible asset;

(vi) any financial assistance; **[Section 2(l)]**

An asset which is not a financial asset cannot be securitised, acquired or transferred under this Act.

Example: Value of an unsecured land in the balance sheet of the borrower cannot be acquired by an ARC by way of issuing security receipts.

- **"Non-performing asset (NPA)"** means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset,

  (a) in case such bank or financial institution is administered or regulated by an authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;

  (b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank. **[Section 2(o)]**

- **"Qualified buyer"** means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or asset reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3 or any asset management company making investment on behalf of mutual fund or pension fund or a foreign institutional investor registered under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or regulations made thereunder, any category of non-institutional investors as may be specified by the Reserve Bank under sub-section (1) of section 7 or any other body corporate as may be specified by the Board; **[Section 2(u)]**

  An ARC cannot raise funds from investors which is not a qualified buyer (QB) as defined above.

  For example, a manufacturing company looking to invest surplus cash by investing in the ARC, or a Public sector unit, or a strategic investor who wish to acquire the assets of the borrower company etc.

- **"Securitisation"** means acquisition of financial assets by any asset reconstruction company from any originator, whether by raising of funds by such asset reconstruction company from qualified buyers by issue of security receipts representing undivided interest in such financial assets or otherwise **[Section 2(z)];**

  The process of securitisation helps the ARC to acquire financial assets like Loans from banks due to which the ARC shall be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.

- **"Secured creditor"** means-
  - ♦ any bank or financial institution or any consortium or group of banks or financial institutions holding any right, title or interest upon any tangible asset or intangible asset as specified in clause (l);
  - ♦ debenture trustee appointed by any bank or financial institution; or
  - ♦ an asset reconstruction company whether acting as such or managing a trust set up by such asset reconstruction company for the securitisation or reconstruction, as the case may be; or
  - ♦ debenture trustee registered with the Board appointed by any company for secured debt securities; or
  - ♦ any other trustee holding securities on behalf of a bank or financial institution,

  in whose favour security interest is created by any borrower for due repayment of any financial assistance **[section 2 (zd)]**
- **"Security interest"** means right, title and interest of any kind, other than those specified in section 31, upon property created in favour of any secured creditor and includes—
  - (a) any mortgage, charge, hypothecation, assignment or any right, title or interest of any kind, on tangible asset, retained by the secured creditor as an owner of the property, given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit provided to enable the borrower to acquire the tangible asset; or
  - (b) such right, title or interest in any intangible asset or assignment or licence of such intangible asset which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation incurred or any credit provided to enable the borrower to acquire the intangible asset or licence of intangible asset [Section 2(zf)];

  A creditor shall not be called as secured creditor unless its interest over the assets of the debtor or borrower is covered under the above definition. Refer section 31 (Provisions of this Act not to apply in certain cases) for specific exclusions of rights that shall not be treated as security interest.

7. REGULATION OF SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS OF BANKS AND FINANCIAL INSTITUTIONS

This part of the Act is covered in chapter II of the Act, comprising of Sections 3 – 12.

(I) Registration of ARCs (Section 3)

- **Commencement of business of securitisation or asset reconstruction:** Such a company can commence or carry on the business of securitisation or asset reconstruction only after obtaining a certificate of registration granted under this section and having the net owned

fund of not less than [1]one hundred crore rupees or such other higher amount as the Reserve Bank, may, by notification, specify.

However, the term "net owned fund" is not defined in the Act and hence we have to refer to the definition of "net owned fund" as mentioned in the explanation to Section 45I of the Reserve Bank of India Act.

Every asset reconstruction company shall make an application for registration to the Reserve Bank.

- **Conditions:** The Reserve Bank may be required to check in, by an inspection of records or books of such asset reconstruction company or otherwise, compliance with the following conditions, to grant its approval for registration of an ARC to commence or carry on the business of securitisation or asset reconstruction.

  (a) that the ARC has not incurred losses in any of the three preceding financial years;

  (b) that such ARC has made adequate arrangements for realisation of the financial assets acquired for the purpose of securitisation or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the investments made in the company by the qualified buyers or other persons;

  (c) that the directors of ARC have adequate professional experience in matters related to finance, securitisation and reconstruction;

  (d) that any of its directors has not been convicted of any offence involving moral turpitude;

  (e) that a sponsor of an ARC is a fit and proper person in accordance with the criteria as may be specified in the guidelines issued by the Reserve Bank for such persons;

  (f) that ARC has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.

  (g) that ARC has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose.

- **Issue of certificate of registration to ARC:** A certificate of registration is granted to the ARC to commence or carry on business of securitisation or asset reconstruction, and it must be noted that the Reserve Bank may also prescribe any other conditions, which it may consider, fit to impose. In case the Reserve Bank is of the opinion that the above conditions are not satisfied then it may reject the application, after the applicant is given a reasonable opportunity of being heard.

[1] Minimum Net Owned Fund requirement for ARCs is fixed at ₹ 100 crore with effect from the date of the Notification notified on April 28, 2017.

- **Requirement of prior approval of RBI:** Once a company is registered as an ARC, it must obtain prior approval of the Reserve Bank for the following purposes:-

  (a) any substantial change in its management, including appointment of any director managing director or chief executive officer

  (b) change of location of its registered office

  (c) change in its name

- **Decision of RBI shall be final & binding:** The decision of the Reserve Bank, whether the change in management of an ARC is a substantial change in its management or not, shall be final and binding. The expression "substantial change in management" means the change in the management by way of transfer of shares or change affecting the sponsorship in the company by way of transfer of shares or amalgamation or transfer of the business of the company.

(II) Cancellation of certificate of registration (Section 4)

- The Reserve Bank may cancel a certificate of registration granted to an ARC, if such company-

  (i) ceases to carry on the business of securitisation or asset reconstruction; or

  (ii) ceases to receive or hold any investment from a qualified buyer; or

  (iii) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or

  (iv) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or

  (v) fails to-

    (a) comply with any direction issued by the Reserve Bank under the provisions of this Act; or

    (b) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or

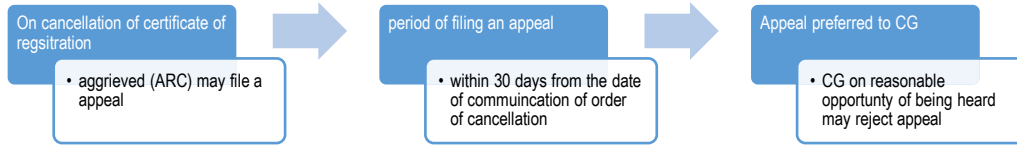
    (c) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or

    (d) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

- Before cancelling a certificate of registration on the ground that the ARC has failed to comply with the provisions of clause (c) or has failed to fulfil any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank, unless it is of the opinion that the delay

in cancelling the certificate of registration granted under section 3(4) shall be prejudicial to the public interest or the interests of the investors or the ARC, shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfilment of such conditions.

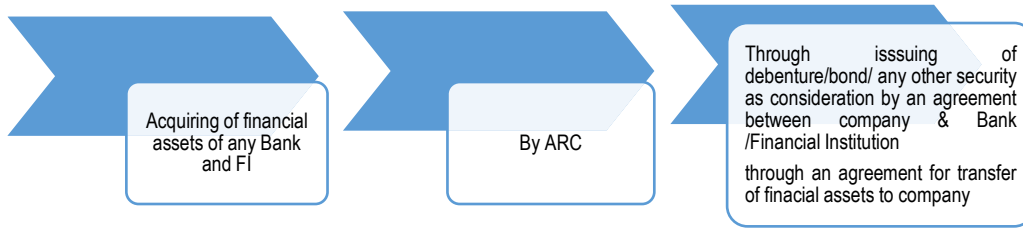
- **Appeal to an order of cancellation:** In case the ARC is aggrieved by the order of cancellation of certificate of registration by the Reserve Bank, then it may prefer an appeal, within a period of thirty days from the date on which such order of cancellation is communicated to it, to the Central Government (Secretary, Ministry of Finance, and Government of India). The Central Government must also give such company a reasonable opportunity of being heard before rejecting the appeal.



It must be noted that an ARC, which is holding investments of qualified buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation be deemed to be an ARC until it repays the entire investments held by it (together with interest, if any) within such period as specified by the Reserve Bank.

(III) Acquisition of rights or interest in financial assets (Section 5)

- **Acquiring of financial assets of any bank or financial institution:** Any ARC may acquire financial assets of any bank or financial institution.



- **Exemption from stamp duty:** Any document executed by any bank or financial institution as mentioned above, in favour of the ARC acquiring financial assets for the purposes of asset reconstruction or securitisation shall be exempted from stamp duty in accordance with the provisions of section 8F of the Indian Stamp Act, 1899.

  Provided that the above stated sub-section shall not apply where the acquisition of the financial assets by the asset reconstruction company is for the purposes other than asset reconstruction or securitisation.

Such exemption is provided in order to encourage banks or FIs to resolve non performing assets (NPA) issues by offloading it to ARCs.

Debenture as we commonly known, is an acknowledgement of debt. Bond also refers to the same nature of instrument as a debenture. Both of them acknowledge a debt and hence an obligation to pay.

- **In case where bank or financial institution is a lender in relation to any financial assets acquired by the ARC:** Then such ARC shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to the subject financial assets.

  Vesting of right, title or interest related to said financial asset in ARC: If the bank or financial institution is holding any right, title or interest upon any tangible asset or intangible asset to secure payment of any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire the tangible asset or assignment or licence of intangible asset, such right, title or interest shall vest in the asset reconstruction company on acquisition of such assets.

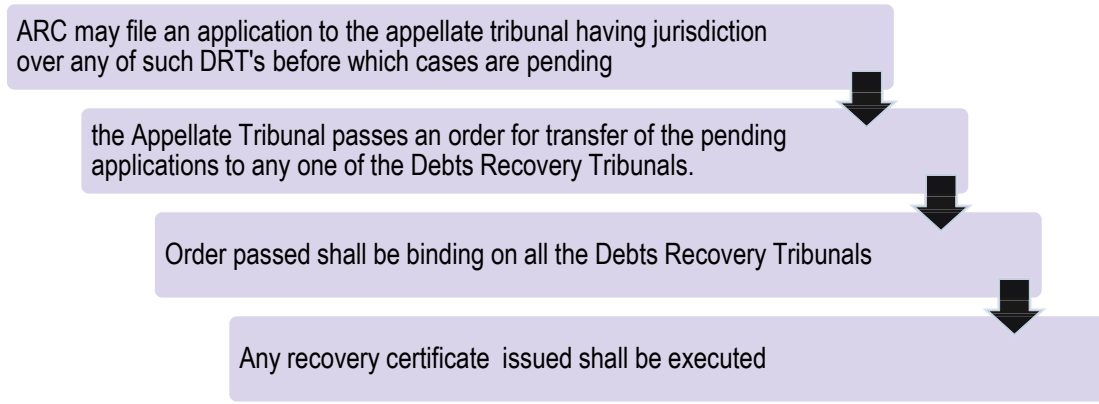
  Effect on implementation and execution of legal document: All contracts, deeds, bonds, agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the ARC, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, securitisation company or reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of ARC, as the case may be.

  Pending Suit, appeal or other proceeding is not prohibited: If, on the date of acquisition of financial asset, any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the ARC, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the ARC, as the case may be.

  On acquisition of financial assets, the ARC, may with the consent of the originator, file an application before the Debts Recovery Tribunal or the Appellate Tribunal or any court or other Authority for the purpose of substitution of its name in any pending suit, appeal or other proceedings and on receipt of such application, such Debts Recovery Tribunal or the Appellate Tribunal or court or Authority shall pass orders for the substitution of the ARC in such pending suit, appeal or other proceedings.

(IV) Transfer of pending applications to any one of Debts Recovery Tribunals in certain cases (Section 5A)

- **Transfer of pending cases to single DRT:** If any financial asset, of a borrower acquired by an ARC, comprise of secured debts of more than one bank or financial institution, and for recovery of which such banks or financial institutions has filed applications before two or more Debts Recovery Tribunals, the ARC may file an application to the Appellate Tribunal having jurisdiction over any of such Tribunals in which such applications are pending, for transfer of all pending applications to any one of the Debts Recovery Tribunals as it deems fit.
- **Order for transfer by appellate Tribunal**: On receipt of such application for transfer of all pending applications, the Appellate Tribunal may, after giving the parties to the application an opportunity of being heard, pass an order for transfer of the pending applications to any one of the Debts Recovery Tribunals.
- **Binding of order on all the DRT's:** Any order passed by the Appellate Tribunal shall be binding on all the Debts Recovery Tribunals as if such order had been passed by the Appellate Tribunal having jurisdiction on each such Debts Recovery Tribunal.
- **Execution of recovery certificate:** Any recovery certificate, issued by the Debts Recovery Tribunal to which all the pending applications are transferred, shall be executed in accordance with the provisions contained in section 19(23) and other provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) shall, accordingly, apply to such execution.



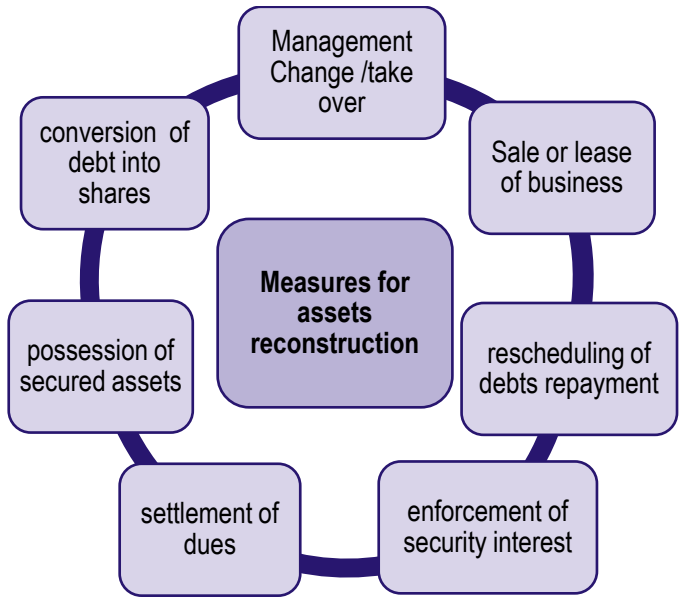
(V) Notice to obligor and discharge of obligation of such obligor (Section 6)

- The bank or financial institution may give a notice of acquisition of financial assets by any ARC to the concerned obligor and any other concerned person and to the concerned registering authority.
- The obligor shall make payment to the concerned ARC in discharge of any of the obligations in relation to the financial asset specified in the notice.

(VI) Measures for assets reconstruction (Section 9)

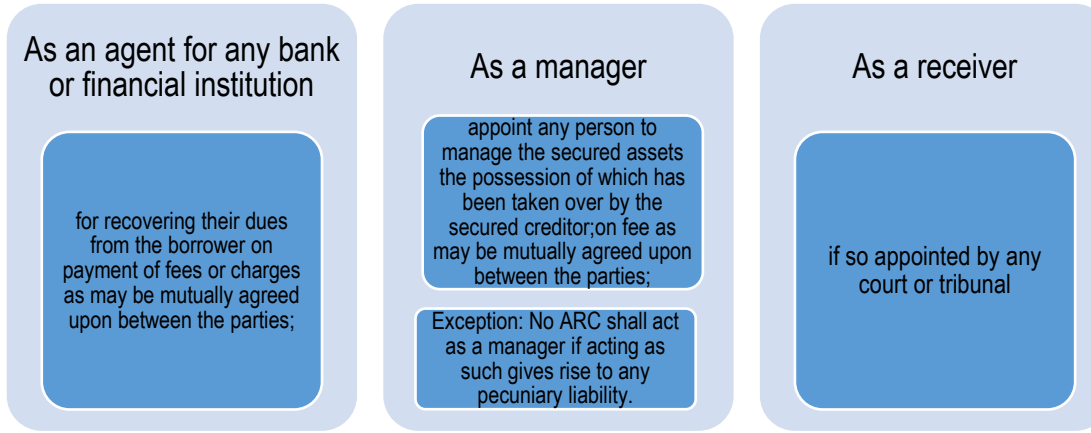
- An ARC may, provide for any one or more of the following measures, for the purposes of asset reconstruction-
  - ♦ the proper management of the business of the borrower, by change in, or takeover of, the management of the business of the borrower;
  - ♦ the sale or lease of a part or whole of the business of the borrower;
  - ♦ rescheduling of payment of debts payable by the borrower;
  - ♦ enforcement of security interest in accordance with the provisions of this Act;
  - ♦ settlement of dues payable by the borrower;
  - ♦ taking possession of secured assets in accordance with the provisions of this Act;
  - ♦ conversion of any portion of debt into shares of a borrower company:

  Provided that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.
- The Reserve Bank shall, for the purposes as given above, determine the policy and issue necessary directions including the direction for regulation of management of the business of the borrower and fees to be charged.
- The asset reconstruction company shall take measures as stated above in accordance with policies and directions of the Reserve Bank as determined.



(VII) Other functions of ARC (Section 10)

- **Role of ARC:** Any ARC may perform the following roles:

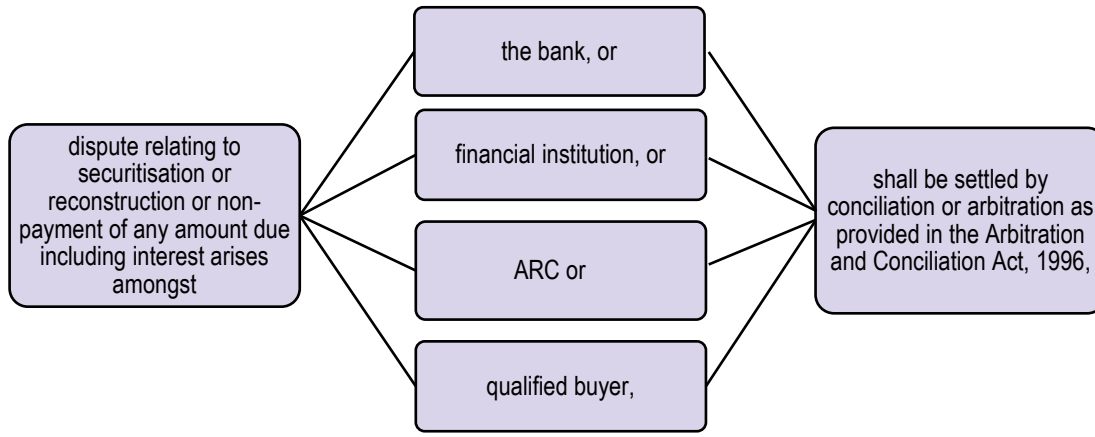


- **Commencement of any other business by ARC**: No ARC which has been granted a certificate of registration section 3(4), shall commence or carry on, without prior approval of the Reserve Bank, any business other than that of securitisation or asset reconstruction.

  In case of conduct of business (other than the business of securitisation or asset reconstruction) on or before the commencement of this Act: an ARC which is carrying on, on or before the commencement of this Act, any business other than the business of securitisation or asset reconstruction or business (as referred in para first of this heading mentioning "Role of ARC"), shall cease to carry on any such business within one year from the date of commencement of this Act.

- For the purposes of this section, ARC does not include its subsidiary.

(VIII) Resolution of disputes (Section 11)



(IX) Power of Reserve Bank to determine policy and issue directions (Section 12)

- In the public interest, Reserve bank may determine the policy and give directions to any ARC in matters relating to income recognition, accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weights for assets and also relating to deployment of funds by the ARC.
- Besides, the Reserve bank may give directions to any ARC in particular as to:

  (a) the type of financial asset of a bank or Financial institution which can be acquired and procedure for acquisition of such assets and valuation thereof;

  (b) the aggregate value of financial assets which may be acquired by any securitisation company or reconstruction company.

  (c) the fee and other charges which may be charged or incurred for management of financial assets acquired by any asset reconstruction company;

  (d) transfer of security receipts issued to qualified buyers

(X) Power of Reserve Bank to Call for Statements and information (Section 12 A)

The Reserve Bank may direct ARC to furnish it within such time as may be specified by the Reserve Bank, with such statements and information relating to the business or affairs of such securitisation company or reconstruction company (including any business or affairs with which such company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purpose of this Act.

(XI) Power of Reserve Bank to carry out audit and inspection (Section 12 B)

- The Reserve Bank may, for the purposes of this Act, carry out or caused to be carried out audit and inspection of an asset reconstruction company from time to time.
- It shall be the duty of an asset reconstruction company and its officers to provide assistance and cooperation to the Reserve Bank to carry out audit or inspection.
- Where on audit or inspection or otherwise, the Reserve Bank is satisfied that business of an asset reconstruction company is being conducted in a manner detrimental to public interest or to the interests of investors in security receipts issued by such asset reconstruction company, the Reserve Bank may, for securing proper management of an asset reconstruction company, by an order—

  (a) remove the Chairman or any director or appoint additional directors on the board of directors of the asset reconstruction company; or

  (b) appoint any of its officers as an observer to observe the working of the board of directors of such asset reconstruction company: Provided that no order for removal of Chairman or director under clause (a) shall be made except after giving him an opportunity of being heard.

- It shall be the duty of every director or other officer or employee of the asset reconstruction company to produce before the person, conducting an audit or inspection under sub-section (1), all such books, accounts and other documents in his custody or control and to provide him such statements and information relating to the affairs of the asset reconstruction company as may be required by such person within the stipulated time specified by him.

8. ENFORCEMENT OF SECURITY INTEREST (13-19)

(I) Enforcement of security interest (Section 13): Any security interest created in favour of any secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.

- **Where borrower makes a default in payment of debt:** Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset(NPA), then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under Section 13(4).

  Exceptions:

  (i) the requirement of classification of secured debt as non-performing asset ,shall not apply to a borrower who has raised funds through issue of debt securities; and

  (ii) in the event of default, the debenture trustee shall be entitled to enforce security interest in the same manner as provided under this section with such modifications as may be necessary and in accordance with the terms and conditions of security documents executed in favour of the debenture trustee;

(II) Serving of Notice: The notice served shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.

- **Objection or rejection to the borrower on the notice:** If, on receipt of the notice , the borrower makes any representation or raises any objection, the secured creditor on consideration of the representation/ objection concludes that such representation or objection is not acceptable or tenable, he shall communicate within 15 days of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower.

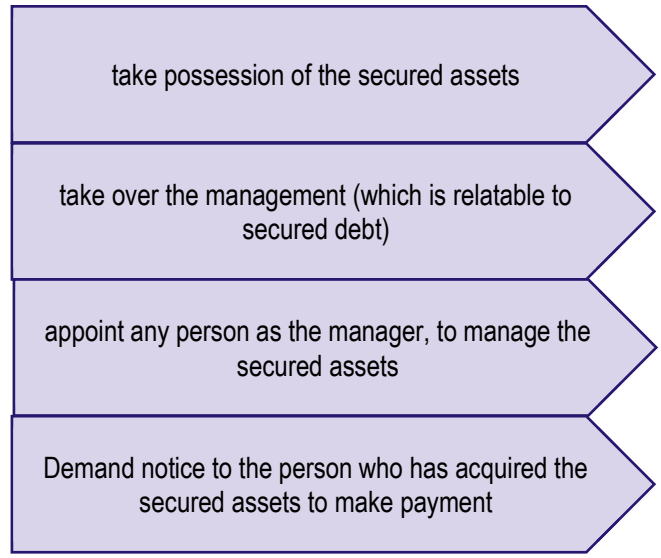
  The reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.

(III) In case of failure to discharge the liability: if the borrower fails to discharge his liability in full within the above specified period, the secured creditor may take recourse to one or more of the following measures to recover his secured debt:-

- **take possession of the secured assets of the borrower** including the right to transfer by way of lease, assignment or sale for realising the secured asset;
- **take over the management of the business of the borrower** including the right to transfer by way of lease, assignment or sale for realising the secured asset;

  Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:

  Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt;
- **appoint any person** (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
- **require at any time by notice in writing, any person** who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, **to pay the secured creditor**, so much of the money as is sufficient to pay the secured debt.



(IV) Discharge from payment: Any payment made by any person referred to in section 5(4)(d) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

- **Right with respect to the immovable property :** Where the sale of an immovable property, for which a reserve price has been specified, has been postponed for want of a bid of an amount not less than such reserve price, it shall be lawful for any officer of the secured creditor, if so authorised by the secured creditor in this behalf, to bid for the immovable property on behalf of the secured creditor at any subsequent sale **[sub-section (5A)]**

  Where the secured creditor, referred to in sub-section (5A), is declared to be the purchaser of the immovable property at any subsequent sale, the amount of the purchase price shall be adjusted towards the amount of the claim of the secured creditor for which the auction of enforcement of security interest is taken by the secured creditor, under section 13(4) **[Sub-section (5B)]**

  The provisions of section 9 of the Banking Regulation Act, 1949 shall, as far as may be, apply to the immovable property acquired by secured creditor under sub-section (5A). **[Sub-section (5C)]**

- **Right related to transfer of secured assets by the secured creditor:** Any transfer of secured asset after taking possession thereof or takeover of management under sub-section (4), by the secured creditor or by the manager on behalf of the secured creditor shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset.

- **Recovery of expenses from the borrower:** Where any action has been taken against a borrower, all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied-

  - ♦ firstly, in payment of such costs, charges and expenses and
  - ♦ secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

(V) Payment of dues of the secured creditors: Where the amount of dues of the secured creditor together with all costs, charges and expenses incurred by him is tendered to the secured creditor at any time before the date of publication of notice for public auction or inviting quotations or tender from public or private treaty for transfer by way of lease, assignment or sale of the secured assets,—

(a) the secured assets shall not be transferred by way of lease assignment or sale by the secured creditor; and

(b) in case, any step has been taken by the secured creditor for transfer by way of lease or assignment or sale of the assets before tendering of such amount under this sub-section, no

further step shall be taken by such secured creditor for transfer by way of lease or assignment or sale of such secured assets.

- **Joint Financing:** Subject to the provisions of the Insolvency and Bankruptcy Code, 2016, in the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than sixty per cent in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors. [Section 13(9)]. But in case of a company in liquidation, the amount realised from the sale of secured assets shall be distributed in accordance with the provisions of section 529A of the Companies Act, 1956 (Corresponding section 326 of the Companies Act, 2013).
- **In the case of a company being wound up on or after the commencement of this Act:** In this case, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under proviso to sub -section (1) of section 529 of the Companies Act, 1956 (Corresponding section 325 of the Companies Act, 2013), may retain the sale-proceeds of his secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529A (Corresponding section 326 of the Companies Act, 2013) of that Act.
- **Role of liquidator with respect to workmen dues:** Provided also that liquidator referred above, shall intimate the secured creditor the workmen's dues in accordance with the provisions of section 529A of the Companies Act, 1956 (Corresponding section 326 of the Companies Act, 2013) and in case such workmen's dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmen's dues under that section to the secured creditor and in such case the secured creditor may retain the sale proceeds of the secured assets after depositing the amount of such estimate dues with the liquidator.
- **In case of deposits of amount of workmen dues by secured creditor:** Provided also that in case the secured creditor deposits the estimated amount of workmen's dues, such creditor shall be liable to pay the balance of the workmen's dues or entitled to receive the excess amount, if any, deposited by the secured creditor with the liquidator.

  Furnishing of undertaking by secured creditor: Provided also that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.
- **Explanation**- For the purposes of this sub-section,-
  - **"record date"** means the date agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding on such date;

- "**amount outstanding"** shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.

(VI) Filing of an application by secured creditor: Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

(VII) Rights of secured creditors in relation to secured assets: secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measured specifies in clause (a) to (d) of sub-section (4) in relation to the secured assets under this Act.

The rights of a secured creditor under this Act may be exercised by one or more of his officers authorized in this behalf in such manner as may be prescribed.

(VIII) No transfer of secured assets by borrower: No borrower shall, after receipt of notice, transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor.

(IX) Chief Metropolitan Magistrate or District Magistrate to assist secured creditor in taking possession of secured asset (Section 14)

The secured creditor may, for the purpose of taking possession or control of secured asset, request, in writing, the Chief Metropolitan Magistrate (CMM) or the District Magistrate (DM) within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the CMM or, as the case may be, the DM shall, on such request being made to him--

- take possession of such asset and documents relating thereto; and
- forward such asset and documents to the secured creditor

within a period of thirty days from the date of application.

Condonation of Delay: In case of no order within the said period of thirty days for reasons beyond the control of CMM or DM, he may, after recording reasons in writing , pass the order within such further period but not exceeding in aggregate sixty days.

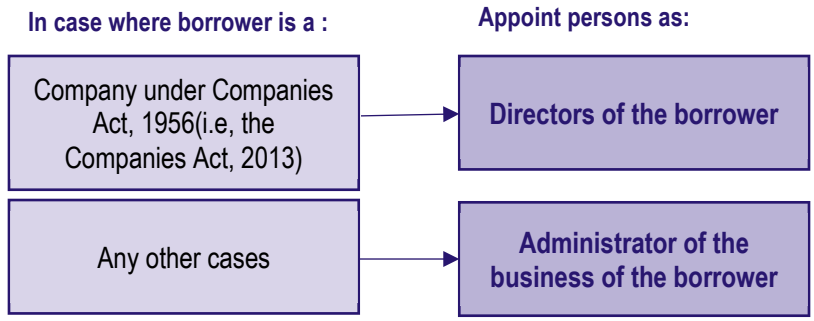
(X) Manner and effect of takeover of management (Section 15)

- **Appointment of persons by secured creditors**: When the management of business of a borrower is taken over by an ARC under section 9(a) or, by a secured creditor under section 13(4)(b) as the case may be, the secured creditor may, by publishing a notice in a newspaper published in English language and in a newspaper published in an Indian language in

circulation in the place where the principal office of the borrower is situated, appoint as many persons as it thinks fit-

- in a case in which the borrower is a company under the Companies Act, 1956, to be the directors of that borrower in accordance with the provisions of that Act; or
- in any other case, to be the administrator of the business of the borrower

Manner and effect of takeover of management



- **Effect of publishing a notice**: All persons holding office as directors of the company (if the borrower is a company) and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the above notice, shall be deemed to have vacated their offices.
- **Effect on any contract of management entered before publishing of a notice: :** Any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the above notice, shall be deemed to be terminated. The directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the above notice.
- **Exercise of the powers of the person so appointed for the borrowers:** All directors appointed in accordance with the above notice shall, for all purposes, be the directors of the company of the borrower and such directors or the administrators (if the borrower is other than a company) appointed under section 15, shall only be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source.

- **Management of borrower taken by the secured creditor:** Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956 (i.e., the Companies Act, 2013), is taken over by the secured creditor, then, notwithstanding anything contained, such borrower- in the said Act or in the memorandum or articles of association of such company -
  - ♦ it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
  - ♦ no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
  - ♦ no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.
- **Obligation of secured creditor:** The secured creditor is under an obligation to restore the management of the business of the borrower, on realisation of his debt in full, in case of takeover of the management of the business of a borrower by such secured creditor.

  Provided that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower.

(XI) No compensation to directors for loss of office (Section 16)

Irrespective of anything contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act. However any such managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

(XII) Application against measures to recover secured debts (Section 17)

- **Filing of an application:** Any person (including borrower), aggrieved by any of the measures given in section 13(4) taken by the secured creditor or his authorised officer under this Chapter, may make an application along with such fee, as may be prescribed to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken.

  Provided that different fees may be prescribed for making the application by the borrower and the person other than the borrower.

Explanation: For the removal of doubts, it is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons to the borrower shall not entitle the person (including borrower) to make an application to the Debts Recovery Tribunal under this sub-section.

- **Jurisdiction :** An application shall be filed before the Debts Recovery Tribunal within the local limits of whose jurisdiction—

  (a) the cause of action, wholly or in part, arises;

  (b) where the secured asset is located; or

  (c) the branch or any other office of a bank or financial institution is maintaining an account in which debt claimed is outstanding for the time being.

- **Measures taken shall be in compliance:** The Debts Recovery Tribunal shall consider whether any of the measures referred to in section 13(4) taken by the secured creditor for enforcement of security are in accordance with the provisions of this Act and the rules made thereunder.

- If, the Debts Recovery Tribunal, after examining the facts and circumstances of the case and evidence produced by the parties, comes to the conclusion that any of the measures referred to in section 13(4), taken by the secured creditor are not in accordance with the provisions of this Act and the rules made thereunder, and require restoration of the management or restoration of possession, of the secured assets to the borrower or other aggrieved person, it may, by order,—

  - ♦ declare the recourse to any one or more measures referred to in section 13(4) taken by the secured creditor as invalid; and
  - ♦ restore the possession of secured assets or management of secured assets to the borrower or such other aggrieved person, who has made an application under sub-section (1), as the case may be; and
  - ♦ pass such other direction as it may consider appropriate and necessary in relation to any of the recourse taken by the secured creditor under sub-section (4) of section 13.

- **Remedies opted by the securities creditor:** If, the Debts Recovery Tribunal declares the recourse taken by a secured creditor under sub-section (4) of section 13, is in accordance with the provisions of this Act and the rules made thereunder, the secured creditor shall be entitled to take recourse to one or more of the measures specified under sub-section (4) of section 13 to recover his secured debt.

  Where—

  (i) any person, in an application, claims any tenancy or leasehold rights upon the secured asset, the Debt Recovery Tribunal, after examining the facts of the case and evidence

produced by the parties in relation to such claims shall, for the purposes of enforcement of security interest, have the jurisdiction to examine whether lease or tenancy,—

(a) has expired or stood determined; or

(b) is contrary to section 65A of the Transfer of Property Act, 1882; or

(c) is contrary to terms of mortgage; or

(d) is created after the issuance of notice of default and demand by the Bank under sub-section (2) of section 13 of the Act; and

(ii) the Debt Recovery Tribunal is satisfied that tenancy right or leasehold rights claimed in secured asset falls under the sub-clause (a) or sub-clause (b) or sub-clause (c) or sub-clause (d) of given in above clause (i), then, the Debt Recovery Tribunal may pass such order as it deems fit in accordance with the provisions of this Act.

- **Time limit for disposal of an application:** Any application made shall be dealt with by the Debts Recovery Tribunal as expeditiously as possible and disposed of within sixty days from the date of such application.

  Provided that the Debts Recovery Tribunal may, from time to time, extend the said period for reasons to be recorded in writing, so, however, that the total period of pendency of the application with the Debts Recovery Tribunal, shall not **exceed four months** from the date of making of such application.

- **Order by the appellate tribunal for expeditious disposal of the pending application:** If the application is not disposed of by the Debts Recovery Tribunal within the period of four months as specified above, any party to the application may make an application, in such form as may be prescribed, to the Appellate Tribunal for directing the Debts Recovery Tribunal for expeditious disposal of the application pending before the Debts Recovery Tribunal and the Appellate Tribunal may, on such application, make an order for expeditious disposal of the pending application by the Debts Recovery Tribunal.

- The Debts Recovery Tribunal shall, as far as may be, dispose of the application in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI Act) and the rules made thereunder.

(XIII) Making of application to Court of District Judge in certain cases (Section 17A)

In the case of a borrower residing in the State of Jammu and Kashmir, the application under section 17 shall be made to the Court of District Judge in that State having jurisdiction over the borrower which shall pass an order on such application.

Explanation: It is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action

of the secured creditor at the stage of communication of reasons shall not entitle the person (including borrower) to make an application to the Court of District Judge under this section.

(XIV) Appeal to Appellate Tribunal (Section 18)

- **Appeal to an order of DRT:** Any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal along with fee, to the Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal.

  Provided that different fees may be prescribed for filing an appeal by the borrower or by the person other than the borrower;

- **Condition for the appeal:** Provided further that no appeal shall be entertained unless the borrower has deposited with the Appellate Tribunal fifty per cent. of the amount of debt due from him, as claimed by the secured creditors or determined by the Debts Recovery Tribunal, whichever is less. Provided also that the Appellate Tribunal may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent of debt referred above.

- **Dispose of appeal as per the RDDBFI Act, 1993:** the Debts Recovery Tribunal under section 17 or the Appellate Tribunal under section 18 shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act(RDDBFI), 1993 and rules made thereunder.

(XV) Appeal to High Court in certain cases (Section 18B)

- **Any borrower residing in the State of Jammu and Kashmir** and **aggrieved by any order made by the Court of District Judge** under section 17A-

  ✓ may prefer an appeal, to the High Court having jurisdiction over such Court, within thirty days from the date of receipt of the order of the Court of District Judge.

- **Requirement for preferring an appeal:** No appeal shall be preferred unless the borrower has deposited, with the Jammu and Kashmir High Court, fifty per cent. of the amount of the debt due from him as claimed by the secured creditor or determined by the Court of District Judge, whichever is less. Provided further that the High Court may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent. of the debt referred here.

(XVI) Right to lodge a caveat (Section 18C)

- **Filing of a caveat:** Where an application or an appeal is expected to be made or has been made under section 17(1) or section 17A or section 18(1) or section 18B,

  ♦ the secured creditor, or

- any person claiming a right to appear before the Tribunal or the Court of District Judge or the Appellate Tribunal or the High Court, as the case may be, on the hearing of such application or appeal,

may lodge a caveat in respect thereof.

- **Notice of caveat**: Where a caveat has been lodged -
  - the secured creditor by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made .
  - any person by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made.
- **Notice on the caveator by adjudicating authority:** Where after a caveat has been lodged, any application or appeal is filed before the Tribunal or the court of District Judge or the Appellate Tribunal or the High Court, as the case may be, the Tribunal or the District Judge or the Appellate Tribunal or the High Court, as the case may be, shall serve a notice of application or appeal filed by the applicant or the appellant on the caveator.
- **Furnishing of copy of application and documents:** Where a notice of any caveat has been served on the applicant or the Appellant, he shall periodically furnish the caveator with a copy of the application or the appeal made by him and also with copies of any paper or document which has been or may be filed by him in support of the application or the appeal.
- **Validity of period of caveat :** Where a caveat has been lodged, such caveat shall not remain in force after the expiry of the period of ninety days from the date on which it was lodged unless the application or appeal has been made before the expiry of the period.

(XVII) Right of borrower to receive compensation and costs in certain cases (Section 19)

- If the Debts Recovery Tribunal or the Court of District Judge, on an application made under section 17 or section 17A or the Appellate Tribunal or the High Court on an appeal preferred under section 18 or section 18A, holds that the possession of secured assets by the secured creditor is not in accordance with the provisions of this Act and rules made thereunder, and
- directs the secured creditors to return such secured assets to concerned borrowers or any other aggrieved person, who has filed the application under section 17 or section 17A or appeal under section 18 or section 18A, as the case may be,
- the borrower or such other person shall be entitled to the payment of such compensation and costs as may be determined by such Tribunal or Court of District Judge or Appellate Tribunal or the High Court referred to in section 18B.

Examples

1. Facts

- XYZ Finance Ltd. is an NBFC company with total assets of 550 crore, and an NPA of 50 crore in its balance sheet.
- The 50 crore loan consists of 9 cases of 5 crore each and 10 cases of 50 lakhs each.
- The management of the company wants to sell bad loans worth 50 crore to an ARC. Of the ₹ 50 crore, 45 crore is secured against various properties, while one case of 5 crore is unsecured.
- During detailed discussion with the in-house legal counsel, it came to light that 2 crore of the secured bad loan has not been registered with the central registry CERSAI, however this was not informed to the buyer in the preliminary discussion.
- Please analyse and advise the CEO of XYZ finance Ltd. how much bad loan can he sell to the ARC?

Analysis:

- SARFAESI is applicable to only those notified NBFC which has an asset base of 500 crore or above, hence in this case the XYZ finance Ltd. shall be able to sell the bad loans to ARCs through SARFAESI.
- Further SARFAESI is applicable to secured loans only, therefore only 45 crore of bad loans can be sold to ARC under SARFAESI.
- As per section 26D no secured creditor shall be entitled to exercise the rights of enforcement of securities under Chapter III unless the security interest created in its favour by the borrower has been registered with the Central Registry, therefore the buyer may not be keen to take over the unregistered loan of 5 crore.
- Further NBFCs can invoke SARFAESI for only those cases which are over 1 crore, therefore the 10 cases of 50 lacs each cannot be sold to ARC under SARFAESI.
- Therefore, we are left with 8 cases of 5 crore each which can be sold to ARC subject to meeting all other conditions of the law.

2. Facts

- A newly formed ARC has acquired secured interest on few assets in steel sector. The sector is undergoing cyclical recession due to global meltdown and increase in raw material price.
- The management is now contemplating various options through which it can realise its assets.
- What are the measures with the ARC management under the SARFAESI law?

Analysis:

- Section 9 deals with measures for asset reconstruction which provides for the following measures:
  - the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;
  - the sale or lease of a part or whole of the business of the borrower;
  - rescheduling of payment of debts payable by the borrower;
  - enforcement of security interest in accordance with the provisions of this Act;
  - settlement of dues payable by the borrower;
  - taking possession of secured assets in accordance with the provisions of this Act;
  - conversion of any portion of debt into shares of a borrower company: Provided that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.
- Further Chapter III deals with the enforcement of security interest, which provides for the following modes of security enforcement:
  - take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
  - take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset:
  - Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:
  - Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt;
  - appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
  - require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

4. Facts

- ABC limited has issued listed bonds five years ago, which is due to be redeemed in the current year worth 50 crore. Market analyst feels that the projected cash flows and profitability seems inadequate to repay the bond value.
- The single largest bond holder BH Ltd. holds bonds worth 20 crore, and wants to explore its options under SARFAESI law, in case ABC limited fails to repay the debt.
- Please advise whether BH Ltd. can have recourse to the SARFAESI Act.

Analysis:

- The definition of secured creditor under section 2(zd) of SARFAESI Act has been amended so as to include debenture trustee appointed in respect of debt securities, and corresponding changes have also been made in SARFAESI Act and RDDBFI Act. Hence it shall have recourse to all options available to any secured creditor under the law such as enforcement of security, sale of loans to ARC etc. Unlike NBFC for which a threshold of assets of 500 crore is put for applicability of the SARFAESI Act, there is no such limit for debenture holders.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Minimum threshold prescribed for applicability of SARFAESI Act on NBFCs is –

(a) 1 crore

(b) 10 crore

(c) 100 crore

(d) 500 crore

2. State under which given situation, a lender can avail the benefits of SARFAESI Act -

(i) An insolvency application has been launched against the borrower

(ii) The borrower is under BIFR

(iii) A winding up petition has been made against the borrower

(iv) A criminal proceeding has been launched by the lender against the borrower

(a) In situations (i) & (iii)

(b) In situations (ii) & (iv)

(c) In situations (ii), (iii) & (iv)

(d) In all the given situations (i), (ii), (iii) & (iv)

Descriptive Questions

Question 1

RST Ltd. is a securitization and reconstruction company under SARFAESI Act, 2002. The certificate of registration granted to it was cancelled. State the authority which can cancel the registration and the right of RST Ltd. against such cancellation.

Question 2

Referring to the provisions of the Securitisation & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 state the circumstances under which the Reserve Bank of India may cancel the certificate of registration granted to a Securitisation Company.

Question 3

Apex Limited failed to repay the amount borrowed from the bankers, ACE Bank Limited, which is holding a charge on all the assets of the company. The Bank took over management of the company in accordance with the provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by appointing four persons as directors. The company is

managed by a Managing Director, Mr. X. Referring to the provisions of the said Act, examine whether Mr. X is entitled to compensation for loss of office and also explain the effect of such takeover on certain rights of the shareholders of the company.

ANSWERS/SUGGESTED

Answers to MCQ

1. **(d)** **Hint:** Sarfaesi is applicable to only those notified NBFC which has an asset base of amount 500 crore or above.

2. **(c)** **Hint:** Except in situation (i) i.e. Where an insolvency application is launched against the borrower, a secured lender shall not be able to exercise its powers under the SARFAESI Act during the first moratorium granted by the Adjudicating Authority under section 14(1)(c) of the Insolvency and Bankruptcy Code, 2016 for a period of 180 days from the date of admission of the application, which is extendable for another period of 90 days, rest in all other cases SARFAESI is applicable.

Answers to Descriptive Questions

1. **Cancellation of Certificate of Registration under SARFAESI Act, 2002:**

The Reserve Bank of India may cancel a certificate of registration granted to a securitisation and reconstruction company for the reasons stated in Section 4 of SARFAESI Act, 2002.

RST Ltd., can prefer an appeal to the Central Government (Secretary, Ministry of Finance, Government of India) within a period of 30 days from the date on which order of cancellation was communicated to it. The Central Government must also give such company a reasonable opportunity of being heard before rejecting the appeal. If RST Ltd., is holding investments of qualified institutional buyers at the time of cancellation of certificate of registration, it shall be deemed to be a securitisation and reconstruction company until it repays the entire investments held by it, together with interest if any, within such period as may be specified by the Reserve Bank.

2. **Cancellation of Certificate of Registration (Section 4 of the securitisation & reconstruction of financial assets & enforcement of Security Interest Act, 2002)**

As per the section 4 of the Securitisation & Reconstruction of Financial Assets & Enforcement of security Interest Act, 2002, the Reserve Bank may cancel a certificate of registration granted to a securitization company or a reconstruction company, if such company-

(i) ceases to carry on the business of securitisation or asset reconstruction; or

(ii) ceases to receive or hold any investment from a qualified institutional buyer; or

(iii) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or

(iv) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of section 3(3); or

(v) fails to-

(a) comply with any direction issued by the Reserve Bank under the provisions of this Act; or

(b) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or

(c) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or

(d) obtain prior approval of the Reserve Bank required under section 3(6).

3. Apex Limited failed to repay the amount borrowed from the bankers, ACE Bank Limited, which is holding a charge on all the assets of the company. The bank took over management of the company in accordance with the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by appointing four persons as directors. The company is managed by a Managing Director, Mr. X.

Here, Apex Limited is a borrower and ACE Bank Limited is a secured creditor.

Compensation to Managing director (Mr. X) for loss of office:

According to section 16 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, irrespective of anything contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act. However any such managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

Effect of takeover on rights of the shareholders:

Where the management of the business of a borrower, being a company as defined in the Companies Act is taken over by the secured creditor, then, notwithstanding anything contained, such borrower- in the said Act or in the memorandum or articles of association of such company -

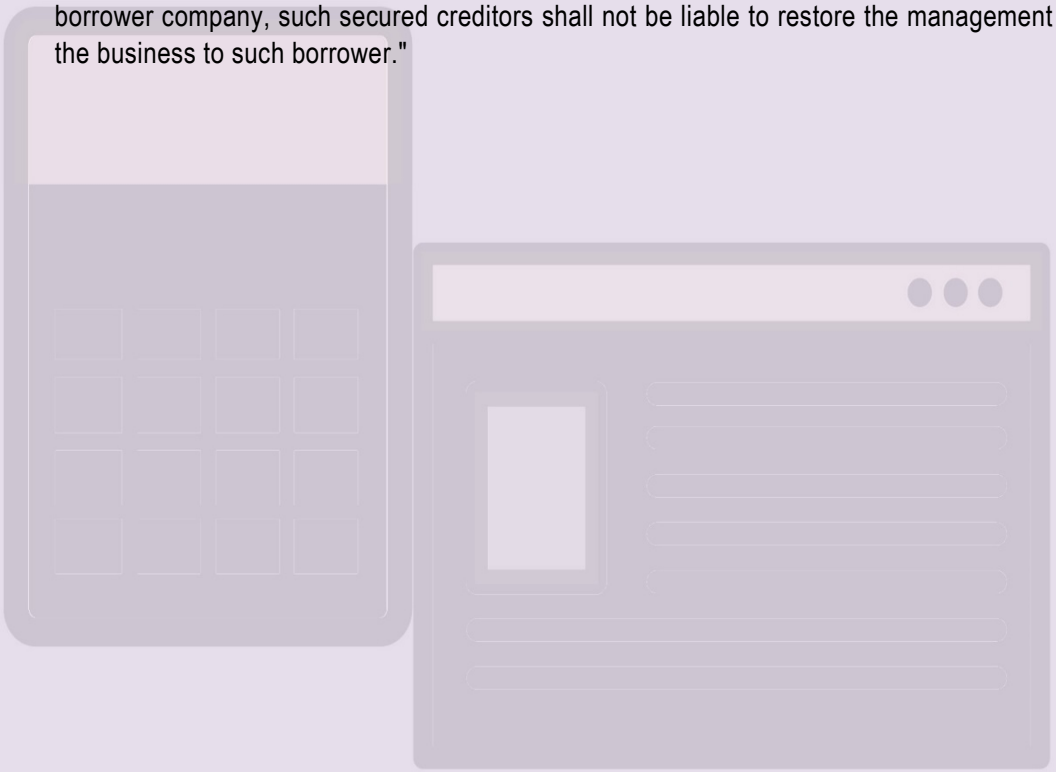
(1) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;

(2) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

(3) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

The secured creditor is under an obligation to restore the management of the business of the borrower, on realisation of his debt in full, in case of takeover of the management of the business of a borrower by such secured creditor.

"Provided that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower."



CHAPTER 3

THE PREVENTION OF MONEY LAUNDERING ACT, 2002

LEARNING OUTCOMES

After reading this chapter, you will be able to:

- Learn the measures to prevent and control money laundering
- Know when the property obtained from the laundered money be confiscated and seized
- Know the penalties imposed and the adjudication process in money laundering cases

1. INTRODUCTION

Money Laundering

It is a highly sophisticated act to cover up or camouflage the identity/origin of illegally obtained earnings so that they appear to have derived from lawful sources.

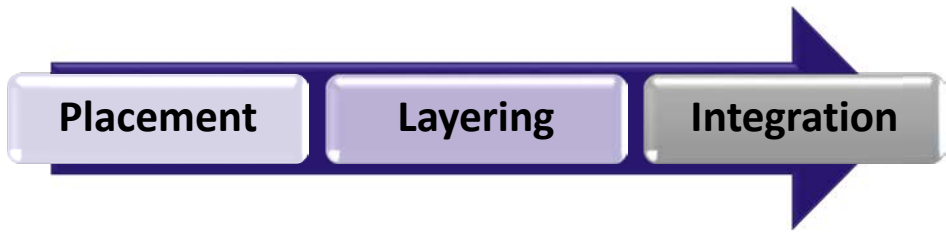
It is the process by which illegal funds and assets are converted into legitimate funds and assets. In other words it is basically the process of converting illegal/ black money of a person in a legal or white money. It is the process used by criminals' to wash their "tainted" money to make it "clean."

Illegal / Dirty Money → **Legal / White Money**

The **Prevention of Money Laundering Act, 2002** is known to have been legislated basically to sub-serve twin purpose firstly, is to prevent money laundering and secondly to provide for confiscation of property derived from, or involved in money laundering, and to ensure of the curbing of the tendency of committing scheduled offences.

Money laundering is a single process however; its cycle can be broken down into three distinct stages

1. **Placement:** It is the first and the initial stage when the crime money is injected into the formal financial System.
2. **Layering:** Then under the second stage, money injected into the system is layered and moved or spread over various transactions in different accounts and different countries. Thus, it will become difficult to detect the origin of the money.
3. **Integration:** Under the third and final stage, money enters the financial system in such a way that original association with the crime is sought to be obliterated so that the money can then be used by the offender or person receiving as clean money.



There are multiple methods through which money can be laundered and huge profit is being made, some of them are:

- Cash Smuggling: Moving cash from one location to another or depositing the cash in Swiss Bank Account;
- Structuring: Cash is broken down into formal receipts to buy money orders etc., smaller amounts are hard to detect;
- Laundering via Real Estate: Buying a land for money and then selling it making the profits legal.
- Stock Markets scams
- By creating bogus companies.
- Drug Trafficking;
- Bribery and Corruption;
- Kidnapping and Extortion.

If left unchecked, money laundering can erode a nation's economy by changing the demand for cash, making interest and exchange rates more volatile, and by causing high inflation in countries where criminal elements are operating. The draining of huge amounts of money a year from normal economic growth poses a real danger for the financial health of every country which in turn adversely affects the global market.

In view of an urgent need for the enactment of a comprehensive legislation for preventing money laundering and connected activities, confiscation of proceeds of crime, setting up of agencies and mechanisms for coordinating measures for combating money laundering etc., the Prevention of Money Laundering Bill, 1998 was introduced in the Parliament on 4th August, 1998. The Bill received the assent of the President and became the Prevention of Money Laundering Act, 2002 on 17th January 2003. The Act has come into force with effect from 1st July 2005. It has been amended in 2005, 2009 and then in 2012.

The objective of the Act is to prevent money-laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for matters connected.

Understanding Money Laundering

Let us understand Money Laundering with the example of Hawala.

How Hawala Works: Hawala system works with a network of operators called Hawaladars or Hawala agents. For a Hawala transaction a customer contacts a Hawala agent at the source location. The Hawala agent at that end collects money from the person who wishes to make a transfer. The agent then calls up his counterpart in the country where the transfer has to be made.

This counterpart then hands over the cash to the recipient after deducting a commission. The source agent promises to settle the debt to the destination agent through an informal settlement.

For example, a person in country 'A' who wants to transfer some money to someone in country 'B' gives the money to the Hawala broker in country 'A'. The agent accepts it and calls up his colleague in country 'B'. His colleague gives the money in country 'B's' currency to the person in country 'B' to whom it has to be transferred. An identification code is requested, ensuring the authenticity of the receiver.

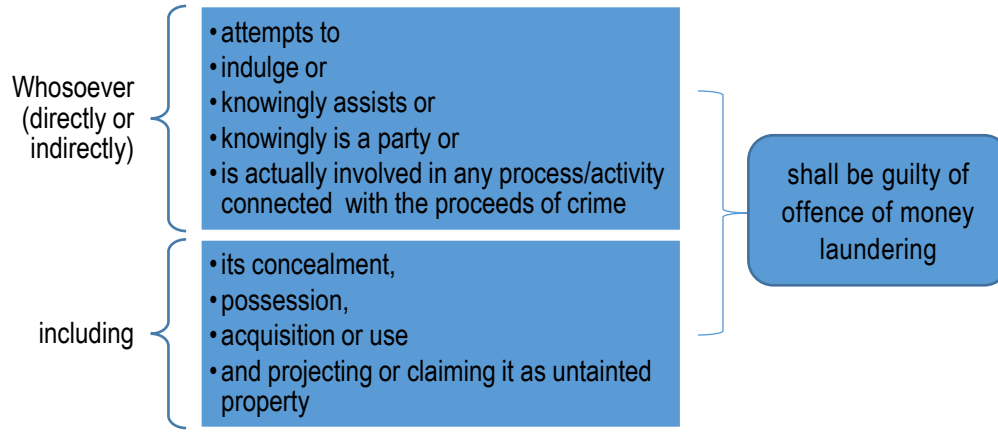
In a Hawala transfer, the money enters the hawala system in local currency and leaves as foreign currency. The currency exchange happens at a rate set by the agents and not the official rates. This way they make an addition profit than the commission.

Then, if anybody does the act which is in contravention to above, or in contravention to the provision of the act will be liable for the punishment under section 4 of the Act.

2. DEFINITIONS

To understand the meaning of money – laundering it is essential to define proceeds of crime, property and scheduled offence. Infact, all the above definitions have to be read together.

I. Clause (p) of sub section (1) of section 2 provides that **"money-laundering"** has the meaning assigned to it in section 3. Moving to section 3, it is observed that whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of offence of money laundering.



II. Section 2(1)(u) defines **"proceeds of crime"** as any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence or the value of any such property or where such property is taken or held outside the country, then the property equivalent in value held within the country or abroad;

III. Now, let us understand what is this **Property** as talked above. In terms of clause (v) of sub – section (1) of section 2, "property" means any property or assets of every description, whether corporeal or incorporeal, movable or immovable, tangible or intangible and includes deeds and instruments evidencing title to, or interest in, such property or assets, wherever located. The term "property" includes property of any kind used in the commission of an offence under this Act or any of the scheduled offences;

IV. In terms of clause (rb) of sub – section (1) of section 2 **"payment system"** means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them.

It includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations;

V. The term **"scheduled offence"** has been defined in clause (y) of sub-section (1) of section 2. It means –

(a) the offences specified under Part A of the Schedule; or

(b) the offences specified under Part B of the Schedule if the total value involved in such offences is one crore rupees or more; or

(c) The offences specified under Part C of the Schedule.

VI. **"Transfer"** includes sale, purchase, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien.

Other Definitions

"Banking company" means a banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies and includes any bank or banking institution referred to in section 51 of that Act.

"Beneficial owner" means an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person

"Client" means a person who is engaged in a financial transaction or activity with a reporting entity and includes a person on whose behalf the person who engaged in the transaction or activity, is acting.

"Financial institution" means a financial institution as defined in clause (c) of section 45 I of the Reserve Bank of India Act, 1934 and includes a chit fund company, a housing finance institution, an authorised person, a payment system operator, a non-banking financial company and the Department of Posts in the Government of India.

"Intermediary" means,

(i) a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser or any other intermediary associated with securities market and registered under section 12 of the Securities and Exchange Board of India Act, 1992; or

(ii) an association recognised or registered under the Forward Contracts (Regulation) Act, 1952 or any member of such association; or

(iii) intermediary registered by the Pension Fund Regulatory and Development Authority; or

(iv) a recognised stock exchange referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956.

"Records" include the records maintained in the form of books or stored in a computer or such other form as may be prescribed.

"Reporting entity" means a banking company, financial institution, intermediary or a person carrying on a designated business or profession.

3. PUNISHMENT FOR THE OFFENCE OF MONEY LAUNDERING [SECTION 3 AND 4]

Section 3 deals with the offence of money laundering which has been discussed in the definition part above.

Section 4 provides for the Punishment for Money-Laundering- Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine.

But where the proceeds of crime involved in money-laundering relate to any offence specified under paragraph 2 of Part A of the Schedule (i.e. Offences under the Narcotic Drugs and Psychotropic Substances Act, 1985)[1], the maximum punishment may extend to ten years instead of seven years.

Whoever commits the offence of money-laundering shall be punishable	Where the proceeds of crime involved in money-laundering relate to any offences pertaining to the NDPS Act, 1985
☐ with rigorous imprisonment from 3 to 7 years, and	☐ the maximum punishment may extend to ten years
☐ fine	☐ fine

4. OBLIGATION OF BANKING COMPANIES, FINANCIAL INSTITUTIONS AND INTERMEDIARIES

Reporting entity to maintain records

Section 12 provides for the obligation of Banking Companies, Financial Institutions and Intermediaries i.e. the reporting entity to maintain records of transactions.

1. **Maintenance of records:** According to sub-section (1), every reporting entity shall –

   (a) maintain a record of all transactions, including information relating to transactions covered under clause (b), in such manner as to enable it to reconstruct individual transactions;

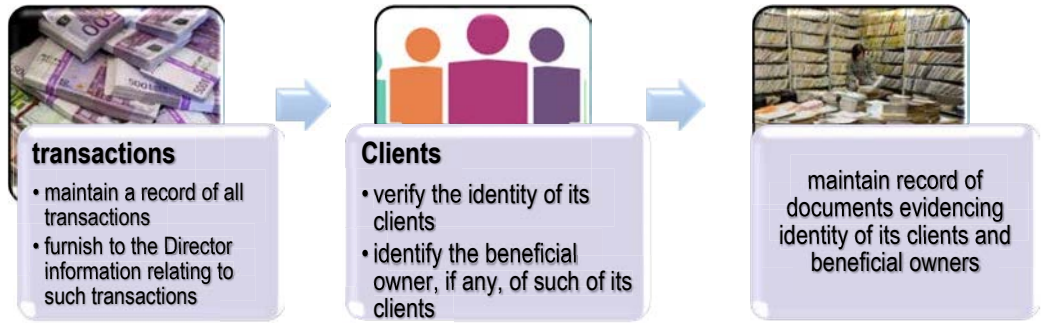
[1] Paragraph 2 of Part A deals with Offences under the Narcotics Drugs and Psychotropic Substances Act, 1985, which mainly consist of contravention in relation to poppy straw, opium, cannabis plant, cannabis, psychotropic substances, manufactured drugs.

(b) furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed;

(c) verify the identity of its clients in such manner and subject to such conditions, as may be prescribed;

(d) identify the beneficial owner, if any, of such of its clients, as may be prescribed;

(e) maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.



2. **Confidentiality:** Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force shall be kept confidential.

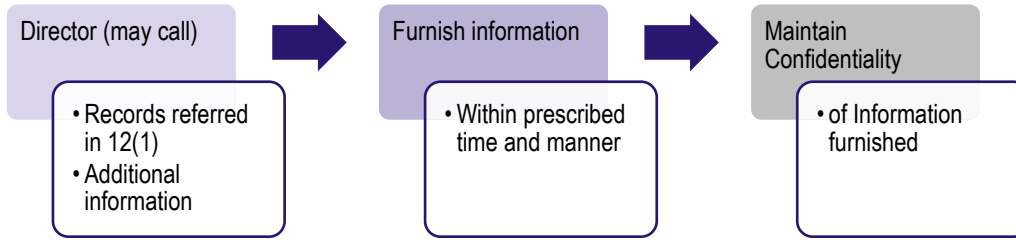
3. **Maintenance of records (for clause a):** The records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

4. **Maintenance of records (for clause e):** The records referred to in clause (e) of sub-section (1) shall be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

5. **Exemption by the Central Government:** The Central Government may, by notification, exempt any reporting entity or class of reporting entities from any obligation under this chapter.

Access to information [Section 12A]

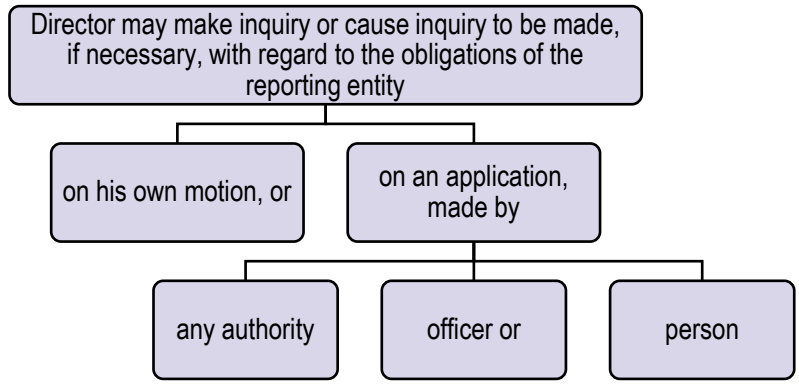
This section empowers Director to call for any of the above records and for any additional information as he considers necessary, from any reporting entity. Every reporting entity shall furnish to the Director the required information within such time and manner as he may specify. Every information sought by the Director shall be kept confidential.



Power of director to impose fine [Section 13]

According to the section following are the powers of the Directors:

Order to make an inquiry:



Direct to audit the records: If at any stage of inquiry or any other proceedings before him, the Director having regard to the nature and complexity of the case, is of the opinion that it is necessary to do so, he may direct the concerned reporting entity to get its records, audited by an accountant from amongst a panel of accountants, maintained by the Central Government for this purpose. The expenses of, and incidental to, any such audit shall be borne by the Central Government.

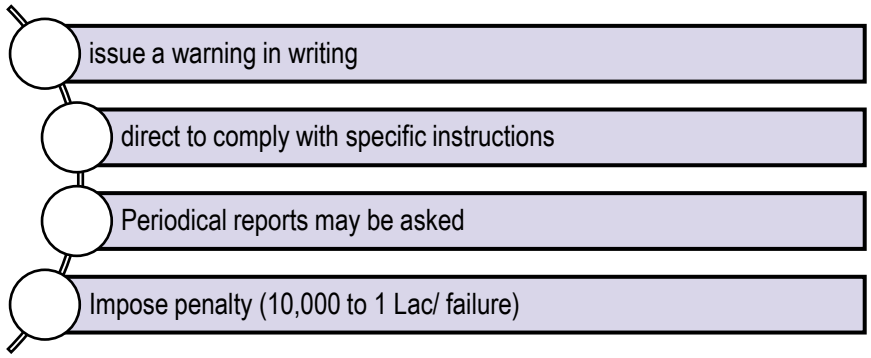
In case of non-compliance with the obligations under this chapter by the reporting entity and others: If the Director, during inquiry, finds that a reporting entity / its designated director on the Board /any of its employees has failed to comply with the obligations under this Chapter, then, he may

(a) issue a warning in writing; or

(b) direct such reporting entity or its designated director on the Board or any of its employees, to comply with specific instructions; or

(c) direct such reporting entity or its designated director on the Board or any of its employees, to send reports at such interval as may be prescribed on the measures it is taking; or

(d) by an order, impose a monetary penalty on such reporting entity or its designated director on the Board or any of its employees, which shall not be less than ten thousand rupees but may extend to one lakh rupees for each failure.



Copy of order to be forwarded to the reporting entity: The Director shall forward a copy of the order passed to every banking company, financial institution or intermediary or person who is a party to the proceedings.

No civil or criminal proceedings: Act gives immunity to reporting entity, its directors etc., against civil or criminal proceedings for furnishing information under clause (b) of sub-section (1) of section 12. **(Section 14)**

Whereas as per **Section 15** the Central Government may, in consultation with the Reserve Bank of India, prescribe the procedure and the manner of maintaining and furnishing information under section 12(1) for the purpose of implementing the provisions of this Act.

5. ATTACHMENT, ADJUDICATION AND CONFISCATION

"Attachment" means prohibition of transfer, conversion, disposition or movement of property by an order issued under Chapter III of the Act.

"Adjudicating Authority" means an Adjudicating Authority appointed under sub-section (1) of section 6.

The Prevention of Money Laundering Act gives extremely wide powers to the authorities to attach properties suspected to be involved in Money Laundering.

Attachment of property involved in money-laundering [Section 5]

1. **Order for provisional attachment:** Where the Director or any other officer (not below the rank of Deputy Director authorised by the Director), has reason to believe (the reason for such belief to be recorded in writing), on the basis of material in his possession, that—

   (a) any person is in possession of any proceeds of crime; and

(b) such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceeds of crime under this Chapter,

he may, by order in writing, provisionally attach such property for a period not exceeding one hundred and eighty days from the date of the order, in such manner as may be prescribed.

Condition for attachment: Provided that no such order of attachment shall be made unless, in relation to the scheduled offence:

- a report has been forwarded to a Magistrate under section 173 of the Code of Criminal Procedure, 1973, or
- a complaint has been filed by a person authorised to investigate the offence mentioned in that Schedule, before a Magistrate or court for taking cognizance of the scheduled offence, as the case may be, or
- a similar report or complaint has been made or filed under the corresponding law of any other country.

Provided further that, any property of any person may be attached under this section if the Director or any other officer not below the rank of Deputy Director authorised by him has reason to believe (the reasons for such belief to be recorded in writing), on the basis of material in his possession, that if such property involved in money-laundering is not attached immediately under this Chapter, the non-attachment of the property is likely to frustrate any proceeding under this Act.

Computation of period of attachment: Provided also that for the purposes of computing the period of one hundred and eighty days, the period during which the proceedings under this section is stayed by the High Court, shall be excluded and a further period not exceeding thirty days from the date of order of vacation of such stay order shall be counted.

2. **Forward of copy of attachment to adjudicating authority:** The Director, or any other officer not below the rank of Deputy Director, shall, immediately after attachment ,forward a copy of the order, along with the material in his possession, , to the Adjudicating Authority, in a sealed envelope, in the prescribed manner and such Adjudicating Authority shall keep such order and material for such period as may be prescribed.

3. **Period of validity of attachment order:** Every order of attachment made, shall cease to have effect after the expiry of the period i.e., one hundred and eighty days from the date of the order, or on the date of an order made under section 8(3), whichever is earlier.

4. **No effect on the right to enjoy the property:** This section shall not prevent the person interested in the enjoyment of the immovable property attached from such enjoyment.

"**person interested",** in relation to any immovable property, includes all persons claiming or entitled to claim any interest in the property.

5. **Complaint against the attachment before the AA:** The Director or any other officer who provisionally attaches any property shall, within a period of thirty days from such attachment, file a complaint stating the facts of such attachment before the Adjudicating Authority (AA).

Adjudication [Section 8]

(1) **Serving of notice:** On receipt of a complaint under section 5 (5), or applications made under section 17(4) or under section 18 (10), if the Adjudicating Authority has reason to believe that any person has committed an offence under section 3 or is in possession of proceeds of crime, it may serve a notice of not less than 30 days on such person calling upon him to indicate-

- the sources of his income, earning or assets, out of which or by means of which he has acquired the property attached under section 5(1), or, seized or frozen under section 17 or section 18,
- the evidence on which he relies, and
- other relevant information and particulars, and
- to show cause why all or any of such properties should not be declared to be the properties involved in money-laundering and confiscated by the Central Government.

Person on behalf of any other person holds property specified in notice: Where a notice under this sub-section specifies any property as being held by a person on behalf of any other person, a copy of such notice shall also be served upon such other person:

In case of joint holding of property: Where more than one person holds such property jointly, such notice shall be served to all persons holding such property.

(2) **Order of AA:** The Adjudicating Authority(AA) shall by an order, after—

(a) considering the reply, if any, to the notice issued;

(b) hearing the aggrieved person and the Director or any other officer authorised by him in this behalf; and

(c) taking into account all relevant materials placed on record before him,

record a finding whether all or any of the properties referred to in the notice issued , are involved in money-laundering.

If the property is claimed by a person, other than a person to whom the notice had been issued, such person shall also be given an opportunity of being heard to prove that the property is not involved in money-laundering.

(3) **Order for attachment/retention of property etc**.: Where the Adjudicating Authority decides that any property is involved in money-laundering, he shall, by an order in writing, confirm the

attachment of the property or retention of property or record seized or frozen under section 17 or section 18 and record a finding to that effect.

Period for attachment, retention, or freezing of the seized or frozen property or record: Whereupon such attachment, retention, or freezing of the seized or frozen property or record, AA shall—

(a) continue during investigation, for a period not exceeding [2]three hundred and sixty-five days or the pendency of the proceedings relating to any offence under this Act before a court or under the corresponding law of any other country, before the competent court of criminal jurisdiction outside India, as the case may be; and

(b) become final after an order of confiscation is passed under section 8(7) or section 8(5) or section 58B or section 60(2A) by the Special Court .

[3]For the purposes of computing the period of three hundred and sixty-five days under clause (a), the period during which the investigation is stayed by any court under any law for the time being in force shall be excluded.

(4) **Confirmation of provisional order:** Where the provisional order of attachment made under section 5(1) has been confirmed as stated above as per section 8(3), the Director or any other officer authorized by him in this behalf shall forthwith take the possession of the property attached under section 5 or frozen under section 17(1A).

If if it is not practicable to take possession of a property frozen, the order of confiscation shall have the same effect as if the property had been taken possession of.

(5) **Final order on confirmation of commission of Act:** Where on conclusion of a trial of an offence under this Act, the Special Court finds that the offence of money-laundering has been committed, it shall order that such property involved in the money laundering or which has been used for commission of the offence of money-laundering shall stand confiscated to the Central Government.

Where on conclusion of a trial under this Act, the Special Court finds that the offence of money laundering has not taken place or the property is not involved in money-laundering, it shall order release of such property to the person entitled to receive it.

(6) **Where the trial under this Act cannot be conducted** by reason of the death of the accused or the accused being declared a proclaimed offender or for any other reason or having commenced but could not be concluded-

there in such case, the Special Court shall, on an application moved by the Director or a person claiming to be entitled to possession of a property in respect of which an order has

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[2] Substituted for "ninety days" by the Finance Act, 2019, w.e.f. **20-3-2019**.
[3] Inserted by the Finance Act, 2019, w.e.f. **20-3-2019**

been passed under section 8(3), pass appropriate orders regarding confiscation or release of the property, as the case may be, involved in the offence of money-laundering after having regard to the material before it.

(7) Where a property stands confiscated to the Central Government under section 8(5), the Special Court, in such manner as may be prescribed, may also direct the Central Government to restore such confiscated property or part thereof of a claimant with a legitimate interest in the property, who may have suffered a quantifiable loss as a result of the offence of money laundering:

Provided that the Special Court shall not consider such claim unless it is satisfied that the claimant has acted in good faith and has suffered the loss despite having taken all reasonable precautions and is not involved in the offence of money laundering.

Provided further that the Special Court may, if it thinks fit, consider the claim of the claimant for the purposes of restoration of such properties during the trial of the case in such manner as may be prescribed.

Vesting of property in Central Government [Section 9]

Where an order of confiscation has been made under section 8(5) or section 8(7) or section 58B or section 60(2A) in respect of any property of a person, all the rights and title in such property shall vest absolutely in the Central Government free from all encumbrances.

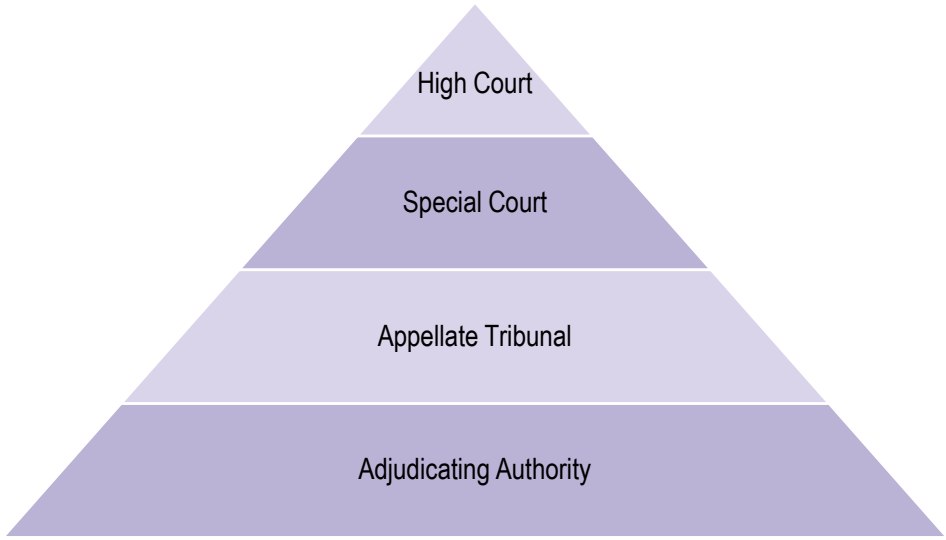
However, where the Special Court or the Adjudicating Authority, as the case may be, after giving an opportunity of being heard to any other person interested in the property attached under this Chapter, or seized or frozen, is of the opinion that any encumbrance on the property or lease-hold interest has been created with a view to defeat the provisions of this Chapter, it may, by order, declare such encumbrance or lease-hold interest to be void and thereupon the aforesaid property shall vest in the Central Government free from such encumbrances or lease-hold interest.

Further, nothing in this section shall operate to discharge any person from any liability in respect of such encumbrances, which may be enforced against such person by a suit for damages.

The Administrator appointed by Central Government, shall receive and manage the property in relation to which an order has been made under sub-section (5) or sub-section (6) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60. The Administrator shall also take such measures, as the Central Government may direct, to dispose of the property which is vested in the Central Government. [Section 10]

6. APPELLATE TRIBUNAL

Hierarchy under the Prevention of Money Laundering Act, 2002



Section 48 provides for the following classes of authorities for the purposes of this Act, namely:-

1. Director or Additional Director or Joint Director,
2. Deputy Director,
3. Assistant Director, and
4. such other class of officers as may be appointed for the purposes of this Act.

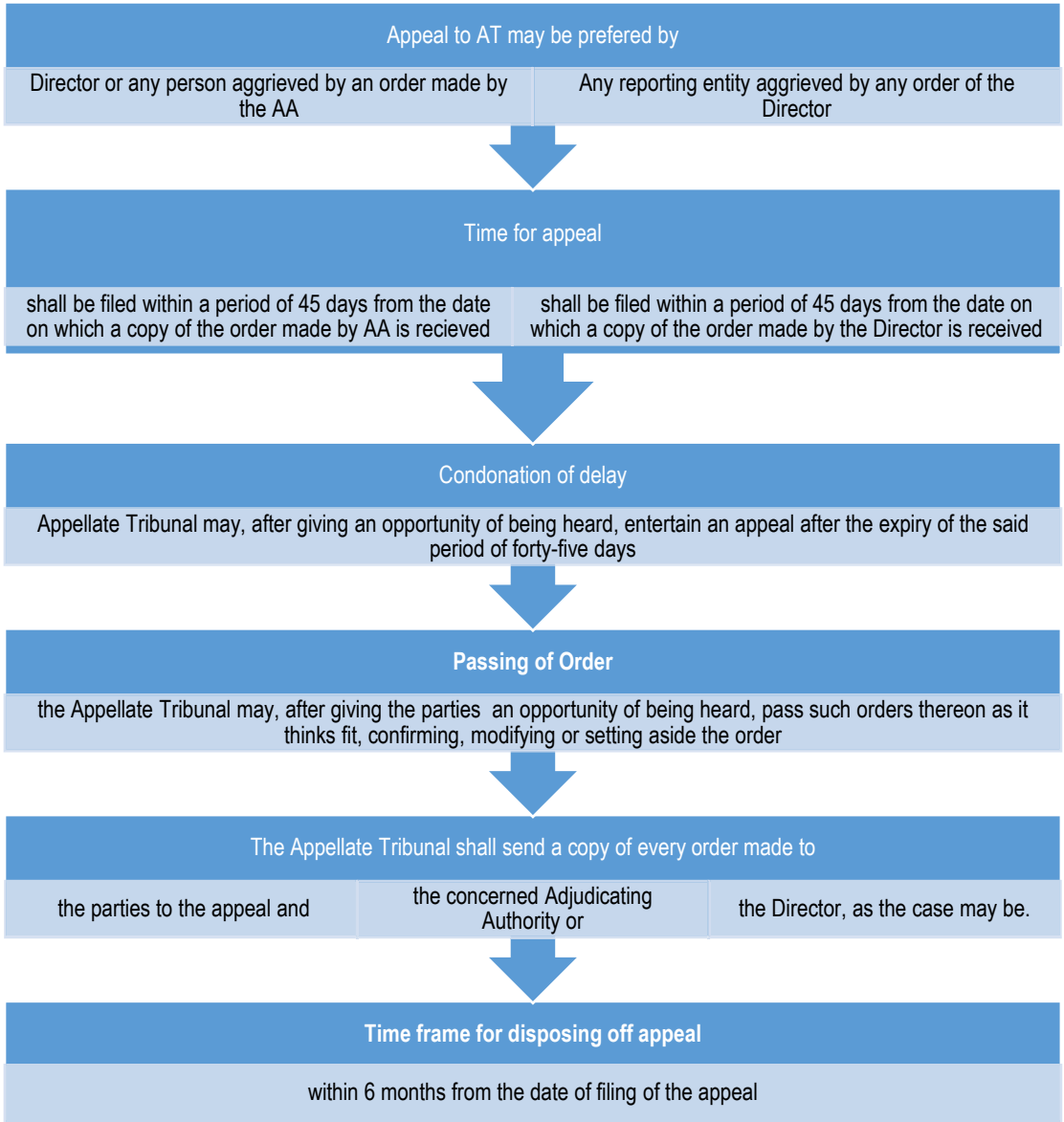
As per section 2(1) clause (b), **Appellate Tribunal** means the Appellate Tribunal referred to in section 25.

Appellate Tribunal [Section 25]

The Appellate Tribunal constituted under section 12(1) of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, shall be the Appellate Tribunal for hearing appeals against the orders of the Adjudicating Authority and the other authorities under this Act.

Appeals to Appellate Tribunal [Section 26]

Section 26 deals with the right and time frame to make an appeal to the Appellate Tribunal (AT).



Decision to be by majority [Section 38]

If the Members of a Bench consisting of two Members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairman who shall either hear the point or points himself or refer the case for hearing on such point or points by third Member of the Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the Members of the Appellate Tribunal who have heard the case, including those who first heard it.

Civil court not to have jurisdiction [Section 41]

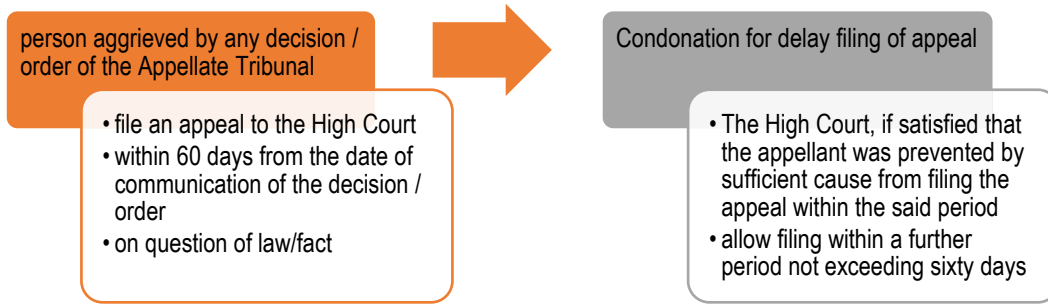
No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Director, an Adjudicating Authority or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to High Court [Section 42]

"High Court" means—

(i) the High Court within the jurisdiction of which the aggrieved party ordinarily resides or carries on business or personally works for gain; and

(ii) where the Central Government is the aggrieved party, the High Court within the jurisdiction of which the respondent, or in a case where there are more than one respondent, any of the respondents, ordinarily resides or carries on business or personally works for gain.



7. SPECIAL COURTS

"Special Court" means a Court of Session designated as Special Court under section 43(1).

Sections 43 – 47 deals with provision relating to Special Courts.

Section 43 empowers the Central Government in consultation with the Chief Justice of the High Court for trial of offence of money laundering (offence punishable under section 4), to designate one or more Courts of Sessions as Special Court or Special Courts for such area or areas or for such cases as may be prescribed in the notification to this effect.

Jurisdiction of special courts: Section 44 clearly provides for the offences triable by Special Courts. It overrides the provisions of the Code of Criminal Procedure, 1973 and provides that –

(i) **Trail of offence punishable under section 4 and any scheduled offence:** an offence punishable under section 4 and any scheduled offence committed under this Act, shall be triable by the Special Court constituted for the area in which the offence has been committed.

The Special Court, trying a scheduled offence before the commencement of this Act, shall continue to try such scheduled offence; or

(ii) **Cognizance of offence under section 3 by special Court:** a Special Court may, upon a complaint made by an authority authorised in this behalf take cognizance of offence under section 3, without the accused being committed to it for trial; or

(iii) **Transfer of scheduled offence to special court:** if the court which has taken cognizance of the scheduled offence is other than the Special Court which has taken cognizance of the complaint of the offence of money-laundering under sub-clause (b), it shall, on an application by the authority authorised to file a complaint under this Act, commit the case relating to the scheduled offence to the Special Court and the Special Court shall, on receipt of such case proceed to deal with it from the stage at which it is committed; or

(iv) **Same power as that of session court for trial of offences:** a Special Court while trying the scheduled offence or the offence of money-laundering shall hold trial in accordance with the provisions of the Code of Criminal Procedure, 1973, as it applies to a trial before a Court of Session.

The provisions of Section 44 shall not be deemed to affect the special powers of the High Court regarding bail under section 439 of the Code of Criminal Procedure, 1973 and the High Court may exercise such powers including the power under clause (b) of sub-section (1) of that section as if the reference to "Magistrate" in that section includes also a reference to a "Special Court" designated under section 43.

Nature of offence committed under the Act: Section 45 provides that the offences under the Act shall be cognizable and non-bailable. Person accused of an offence under this Act shall not be released on bail or on his own bond unless-

(i) The Public Prosecutor has been given an opportunity to oppose the application for such release and

(ii) Where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

Exceptions: In case of any person who is under the age of 16 years or in case of a woman or in case of a sick or infirm or is accused either on his own or along with other co-accused of money-laundering a sum of less than one crore rupees, may be released on bail, if the Special Court so directs.

Cognizance of offence: The Special Court cannot take cognizance of any offence under the Act, unless a complaint in writing is made by:-

(a) The Director or

(b) Any officer of the Central Government or a State Government authorised in writing in this behalf by the Central Government by a general or special order made in this behalf by that Government.

Investigation by Police officer: Police officer shall investigate into an offence under this Act only when specifically authorised, by the Central Government by a general or special order, and, subject to such conditions as may be prescribed.

Section 46 provides that the provisions of the Code of Criminal Procedure, 1973 (including the provisions as to bails or bonds) shall apply to the proceedings before a Special Court and the Special Court shall be deemed to be a Court of Session and the persons conducting the prosecution before the Special Court, shall be deemed to be a Public Prosecutor.

Section 47 empowers the High Court to exercise (so far as applicable) all the powers granted by Chapter XXIX or Chapter XXX of the Code of Criminal Procedure 1973 related to appeal and revision, on Special Court within its jurisdiction, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

8. RECIPROCAL ARRANGEMENT FOR ASSISTANCE IN CERTAIN MATTERS

Definitions

"Corresponding law" means any law of any foreign country corresponding to any of the provisions of this Act or dealing with offences in that country corresponding to any of the scheduled offences

"Offence of cross border implications", means— (i) any conduct by a person at a place outside India which constitutes an offence at that place and which would have constituted an offence specified in Part A, Part B or Part C of the Schedule, had it been committed in India and if such person transfers in any manner the proceeds of such conduct or part thereof to India; or (ii) any offence specified in Part A, Part B or Part C of the Schedule which has been committed in India and the proceeds of crime, or part thereof have been transferred to a place outside India or any attempt has been made to transfer the proceeds of crime, or part thereof from India to a place outside India.

Explanation.—Nothing contained in this clause shall adversely affect any investigation, enquiry, trial or proceeding before any authority in respect of the offences specified in Part A or Part B of the Schedule to the Act before the commencement of the Prevention of Money laundering (Amendment) Act, 2009.

According to **section 55,** unless the context otherwise requires-

"Contracting State" means any country or place outside India in respect of which arrangements have been made by the Central Government with the Government of such country through a treaty or otherwise;

Contracting State	any country or place **outside India**
	arrangement is made by **CG with the other country**
	Through **Treaty** or otherwise

Agreements with foreign countries [Section 56]

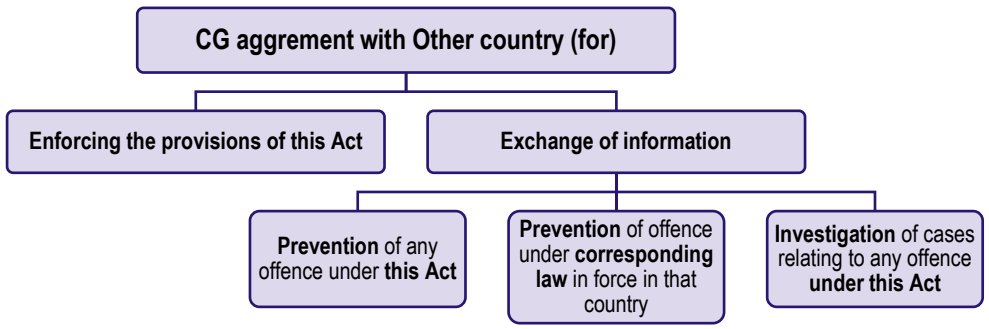
1. The Central Government may enter into an agreement with the Government of any country outside India for—

   (a) enforcing the provisions of this Act;

   (b) exchange of information for the prevention of any offence under this Act or under the corresponding law in force in that country or investigation of cases relating to any offence under this Act,

   and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

2. The Central Government may, by notification in the Official Gazette, direct that the application of this Chapter in relation to a contracting State with which reciprocal arrangements have been made, shall be subject to such conditions, exceptions or qualifications as are specified in the said notification.



Letter of request to a contracting State in certain cases [Section 57]

1. **Issue of letter of request by special court for investigation to a contracting State:** If, in the course of an investigation into an offence or other proceedings under this Act, an application is made to a Special Court by the Investigating Officer or any officer superior in rank to the Investigating Officer that any evidence is required in connection with investigation into an offence or proceedings under this Act and he is of the opinion that such evidence may be available in any place in a contracting State, and the Special Court, on being satisfied that such evidence is required in connection with the investigation into an offence or proceedings

under this Act, may issue a letter of request to a court or an authority in the contracting State competent to deal with such request to-

(i) examine facts and circumstances of the case,

(ii) take such steps as the Special Court may specify in such letter of request, and

(iii) forward all the evidence so taken or collected to the Special Court issuing such letter of request.

2. **Mode of communication of letter of request:** The letter of request shall be transmitted in such manner as the Central Government may specify in this behalf.

3. **Nature of evidence :** Every statement recorded or document or thing received shall be deemed to be the evidence collected during the course of investigation.

Letter of request to contracting state	**When**: When an application is received by Special court that any evidence is required in respect of investigation
	From whom: (i) by the **Investigating Officer** or (ii) any officer **superior** in rank to the Investigating Office
	Opinion of officer: That such evidence may be available with contracting state
	Statisfaction of Special Court: is necessary
	Letter to whom: to a **court** or an **authority in the contracting State** competent to deal with such request

Assistance to a contracting State in certain cases [Section 58]

Where a letter of request is received by the Central Government from a court or authority in a contracting State requesting for investigation into an offence or proceedings under this Act and forwarding to such court or authority any evidence connected therewith, the Central Government may forward such letter of request to the Special Court or to any authority under the Act as it thinks fit for execution of such request in accordance with the provisions of this Act or, as the case may be, any other law for the time being in force.

Letter of request from Contracting state	**Received by**: CG	
	From: Contracting State	
	For: request for investigation into an offence or proceedings under this Act	
	Forward to: CG forward the request to:	(i) Special Court (ii) to any authority under the Act as it thinks fit for execution of such request

9. DISCLOSURE OF INFORMATION [SECTION 66]

(1) The Director or any other authority specified by him by a general or special order in this behalf may furnish or cause to be furnished to-

(i) any officer, authority or body performing any functions under any law relating to imposition of any tax, duty or cess or to dealings in foreign exchange, or prevention of illicit traffic in the narcotic drugs and psychotropic substances under the Narcotic Drugs and Psychotropic Substances Act, 1985 or

(ii) such other officer, authority or body performing functions under any other law as the Central Government may, if in its opinion it is necessary so to do in the public interest, specify by notification in the Official Gazette in this behalf, any information received or obtained by such Director or any other authority, specified by him in the performance of their functions under this Act, as may, in the opinion of the Director or the other authority so specified by him, be necessary for the purpose of the officer, authority or body specified in clause (i) or clause (ii) to perform his or its functions under that law.

(2) If the Director or other authority specified under sub-section (1) is of the opinion, on the basis of information or material in his possession, that the provisions of any other law for the time being in force are contravened, then the Director or such other authority shall share the information with the concerned agency for necessary action.

10. RECOVERY OF FINE OR PENALTY

Punishment for vexatious search [Section 62]

Any authority or officer exercising powers under this Act or any rules made thereunder, who, without reasons recorded in writing,-

(a) searches or causes to be searched any building or place; or

(b) detains or searches or arrests any person, shall for every such offence be liable on conviction for imprisonment for a term which may extend to two years or fine which may extend to fifty thousand rupees or both.

Punishment for false information or failure to give information, etc. [Section 63]

1. Any person wilfully and maliciously giving false information and so causing an arrest or a search to be made under this Act shall on conviction be liable for imprisonment for a term which may extend to two years or with fine which may extend to fifty thousand rupees or both.

2. If any person,-

   (a) being legally bound to state the truth of any matter relating to an offence under section 3, refuses to answer any question put to him by an authority in the exercise of its powers under this Act; or

   (b) refuses to sign any statement made by him in the course of any proceedings under this Act, which an authority may legally require to sign; or

   (c) to whom a summon is issued under section 50 either to attend to give evidence or produce books of account or other documents at a certain place and time, omits to attend or produce books of account or documents at the place or time,

   he shall pay, by way of penalty, a sum which shall not be less than 500 rupees but which may extend to 10,000 rupees for each such default or failure.

3. No order under this section shall be passed by an authority referred to in sub-section (2) (i.e. point 2 above) unless the person on whom the penalty is proposed to be imposed is given an opportunity of being heard in the matter by such authority.

4. Notwithstanding anything contained in clause (c) of sub-section (2), a person who intentionally disobeys any direction issued under section 50 shall also be liable to be proceeded against under section 174 of the Indian Penal Code.

Cognizance of offences [Section 64]

1. No court shall take cognizance of any offence under section 62 or sub-section (1) of section 63 except with the previous sanction of the Central Government.

2. The Central Government shall, by an order, either give sanction or refuse to give sanction within ninety days of the receipt of the request in this behalf.

Code of Criminal Procedure, 1973 to apply [Section 65]

The provisions of the Code of Criminal Procedure, 1973 shall apply, in so far as they are not inconsistent with the provisions of this Act, to arrest, search and seizure, attachment, confiscation investigation, prosecution and all other proceedings under this Act.

Recovery of fine or penalty [Section 69]

Where any fine or penalty imposed on any person under section 13 or section 63 is not paid within six months from the day of imposition of fine or penalty, the Director or any other officer authorised by him in this behalf may proceed to recover the amount from the said person in the same manner as prescribed in Schedule II of the Income-tax Act, 1961 for the recovery of arrears and he or any officer authorised by him in this behalf shall have all the powers of the Tax Recovery Officer mentioned in the said Schedule for the said purpose.

Offences by companies [Section 70]

1. Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention was committed, was in charge of and was 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 contravention and shall be liable to be proceeded against and punished accordingly.

   Nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention.

2. Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officer of any company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

   Explanation 1- For the purposes of this section,

   (i) "Company" means any body corporate and includes a firm or other association of individuals; and

   (ii) "Director", in relation to a firm, means a partner in the firm.

   Explanation 2- For the removal of doubts, it is hereby clarified that a company may be prosecuted, notwithstanding whether the prosecution or conviction of any legal juridical person shall be contingent on the prosecution or conviction of any individual.

Act to have overriding effect [Section 71]

The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

Continuation of proceedings in the event of death or insolvency [Section 72]

1. Where-

   (a) any property of a person has been attached under section 8 and no appeal against the order attaching such property has been preferred; or

   (b) any appeal has been preferred to the Appellate Tribunal, and-

      (i) in a case referred to in clause (a), such person dies or is adjudicated an insolvent before preferring an appeal to the Appellate Tribunal; or

      (ii) in a case referred to in clause (b), such person dies or is adjudicated an insolvent during the pendency of the appeal,

then, it shall be lawful for the legal representatives of such person or the official assignee or the official receiver, as the case may be, to prefer an appeal to the Appellate Tribunal or as the case may be, to continue the appeal before the Appellate Tribunal, in place of such person and the provisions of section 26 shall, so far as may be, apply, or continue to apply, to such appeal.

2. Where-

(a) after passing of a decision or order by the Appellate Tribunal, no appeal has been preferred to the High court under section 42; or

(b) any such appeal has been preferred to the High Court,-

then-

(i) in a case referred to in clause (a), the person entitled to file the appeal dies or is adjudicated an insolvent before preferring an appeal to the High Court, or

(ii) in a case referred to in clause (b), the person who had filed the appeal dies or is adjudicated an insolvent during the pendency of the appeal before the High Court,

then, it shall be lawful for the legal representatives of such person, or the official assignee or the official receiver, as the case may be, to prefer an appeal to the High Court or to continue the appeal before the High Court in place of such person and the provisions of section 42 shall, so far as may be, apply, or continue to apply, to such appeal.

3. The powers of the official assignee or the official receiver under sub-section (1) or sub-section (2) shall be exercised by him subject to the provisions of the Presidency-towns Insolvency Act, 1909 or the Provincial Insolvency Act, 1920, as the case may be.

11. CONCLUSION

Does money laundering mean siphoning of fund. No, not just siphoning of fund, it actually refers to a whole process or an entire system by which money is actually generated from serious crimes as listed above, but they are given such shape (by disguising its origin into a series of transactions) that it looks like it has originated from legitimate sources. The point to note is that the volume of money generated by above activities is also very huge. But the fact remains how does it effect us. The answer lies in observing the continuous increase in terrorist or militant or other criminal activities worldwide (wide spreading global network of terrorists and others who deal in above crimes) and we cannot be ignorant to the fact that such activities need huge funding and they generate large volume of money. To curb the criminal activities, one needs to follow and hit at this generation and utilization of revenue. PLMA, 2002 aims to achieve this. So, money laundering is simply giving shape to the financial structure required and generated from serious crimes as listed above. For example, a criminal may deposit all his money into a bank account or purchase a fixed deposit or even buy a property. But sudden appearance of such a transaction, invites the attraction of one and all. Hence he may resort to money laundering by making cash purchases from the market and then selling the goods in the legal manner and at the end create an impression that the money has come from the

sales and not from the criminal activities. So the money has been disguised by entering into a series of transactions and its origin now looks legitimate. India has followed the recommendations of Financial Action Task Force (FATF) and criminalized money laundering. FATF is an international government body. Financial Intelligence Unit of India (FIU_IND) was also set up at New Delhi with an objective to coordinate and strengthen the collection and sharing of financial intelligence through an effective national, regional and global network to combat money laundering and all the related crimes. The subject is a major issue of concern at the international level and all sectors of business across the globe, like insurance, retail, real-estate, stock –market, entertainment – just to name a few are getting flooded with money and more money and at this stage we can certainly doubt, that it might be a case of money – laundering. Hence the need, significance and scope of operation of Prevention of Money Laundering Act, 2002.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. The offences under the Prevention of Money Laundering Act, 2002 shall be:

   (a) Cognizable and Bailable

   (b) Non- cognizable and non - bailable

   (c) Cognizable and non-bailable

   (d) Non- cognizable and bailable

2. Mr. Ram gave two of his friends' cash amount of two lakh each in case of dire necessity for their business purposes. Later at the time of return, he asked both of them, in lieu of the same, to buy his product via credit card and online transfers in installments through next couple of months' time for which he issued bills to adjust the amount in his account books.

   Does this payment system through credit card and online transfer mode are covered under money laundering act?

   (a) No, payment are made through credit cards & online transfers hence all the transaction are genuine

   (b) Yes, money laundering transactions done via credit card and online payments comes under the Prevention of Money Act

   (c) No, it is not money laundering as none of Mr. Ram friends are benefiting from this transaction.

   (d) No, because the transactions are not done with shell companies.

Descriptive Questions

Question 1

Explain the meaning of the term "Money Laundering". Z, a known smuggler was caught in transfer of funds illegally exporting narcotic drugs from India to some countries in Africa. State the maximum punishment that can be awarded to him under Prevention of Money Laundering Act, 2002.

Question 2

Mr. Fraudulent has been arrested for a cognizable and non-bailable offence punishable for a term of imprisonment for more than three years under the Prevention of Money Laundering Act, 2002. Advise, as to how can he be released on bail in this case?

Question 3

The Adjudicating Authority appointed under the Prevention of Money Laundering Act, 2002 issued an order attaching certain properties of XYZ Limited alleged to be involved in money laundering for a specified period. The company aggrieved by the order of the Adjudicating Authority seeks your advice about the remedy that is available under the Act. Advise explaining the relevant provisions of the Prevention of Money Laundering Act, 2002.

ANSWERs/SUGGESTED

Answer to MCQs

1. **(c)** **Hint :** As per section 45 of the PMLA.

2. **(b)** **Hint :** In terms of clause (b) of sub – section (1) of section 2 "payment system" means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them. It includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations.

Answer to Descriptive Questions

1. **Money Laundering:** Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering. [Section 3 of the Prevention of Money Laundering Act, 2002]

   Paragraph 2 of Part A of the Schedule to the Prevention of Money Laundering Act, 2002, covers Offences under the Narcotic Drugs and Psychotropic Substances Act, 1985. Whereby, illegal import into India, export from India or transshipment of narcotic drugs and psychotropic substances (section 23) is covered under paragraph 2 of Part A.

   Punishment: Section 4 of the said Act provides for the punishment for Money-Laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than 3 years but which may extend to 7 years and shall also be liable to fine. But where the proceeds of crime involved in money-laundering relate to any offence specified under paragraph 2 of Part A of the Schedule, the maximum punishment may extend to 10 years instead of 7 years.

2. **Section 45** provides that the offences under the Act shall be cognizable and non-bailable. Notwithstanding anything contained in the Code of Criminal Procedure, 1973, no person accused of an offence under this Act shall be released on bail or on his own bond unless-

   (i) The Public Prosecutor has been given an opportunity to oppose the application for such release and

(ii) Where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

In case of any person who is under the age of 16 years or in case of a woman or in case of a sick or infirm person or is accused either on his own or along with other co-accused of money-laundering a sum of less than one crore rupees, may be released on bail, if the Special Court so directs.

3. Establishment of Appellate Tribunal

According to section 25 of the Prevention of Money Laundering Act, 2002, the Appellate Tribunal constituted under sub-section (1) of section 12 of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 shall be the Appellate Tribunal for hearing appeals against the orders of the Adjudicating Authority and the other authorities under this Act.

Appeals to Appellate Tribunal

Section 26 deals with the right and time frame to make an appeal to the Appellate Tribunal. The Director or any person aggrieved by an order made by the Adjudicating Authority under this Act may prefer an appeal to the Appellate Tribunal.

The appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the Adjudicating Authority is received and it shall be in such form and be accompanied by prescribed fees. The appeal shall be in such form and be accompanied by such fee as may be prescribed. The Appellate Tribunal may extend the period if it is satisfied that there was sufficient cause for not filing it within the period of 45 days.

The Appellate Tribunal may after giving the parties to the appeal an opportunity of being heard, pass such order as it thinks fit, confirming, modifying or setting aside the order appealed against.

Appeals to High Court

The Act also provides further appeal. According to Section 42 any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within 60 days from the date of communication of the order of the Appellate Tribunal.

In the light of the provisions of the Act explained above the company is advised to prefer an appeal to Appellate Tribunal in the first instance.

CHAPTER 4

THE FOREIGN CONTRIBUTION (REGULATION) ACT, 2010

LEARNING OUTCOMES

By the end of this Chapter, you will be able to-

- Know significant terminologies used in the Act.
- Understand how the law regulates the acceptance and utilization of foreign contribution
- Know of foreign hospitality made by individuals, associations or companies
- Identify the restrictions on acceptance and utilisation of foreign contribution or foreign hospitality
- Know basic requisite for the registration of persons to be regulated in this Act
- How the persons regulated under this Act manages the financial aspect with respect to the foreign contribution
- Identify the adjudicating authority, the provisions related to appeal and revision, and offences and penalties on contravention of the compliances.

1. INTRODUCTION

The Foreign Contribution (Regulation) Act, 2010, is an Act to consolidate the law to regulate the acceptance and utilisation of foreign contribution or foreign hospitality by certain individuals or associations or companies and to prohibit acceptance and utilisation of foreign contribution or foreign hospitality for any activities detrimental to the national interest and for matters connected therewith or incidental thereto.

The flow of foreign contribution to India is regulated under Foreign Contribution (Regulation) Act, 2010, Foreign Contribution (Regulation) Rules, 2011 and other notification / orders etc., issued thereunder from time to time.

Structure of the Act

The Foreign Contribution (Regulation) Act, 2010, comprises of nine chapters with 54 sections.

Chapter No.	Chapter Name
Chapter I	Preliminary (Section 1- 2)
Chapter II	Regulation of Foreign Contribution and Foreign Hospitality (Section 3 -10)
Chapter III	Registration (Section 11- 16)
Chapter IV	Accounts, Intimation, Audit and Disposal of Assets, etc. (Section 17- 22)
Chapter V	Inspection, Search and Seizure (section 23-27)
Chapter VI	Adjudication (Section 28-29)
Chapter VII	Appeal and Revision (Section 31- 32)
Chapter VIII	Offences and Penalties (Section 33- 41)
Chapter IX	Miscellaneous (Section 42- 54)

Extent, Application and Commencement of FCRA (Section 1)

As per Section 1(2) of FCRA, 2010, the provisions of the Act shall apply to:

- Whole of India
- Citizens of India outside India; and
- Associate Branches or subsidiaries, outside India, of companies or bodies corporate, registered or incorporated in India.

As per section 1(3) of the Act, the Central Government hereby appointed the 1st day of May, 2011 as the date on which the provisions of the said Act came into force.

2. IMPORTANT DEFINITIONS (SECTION 2)

In this Act, unless the context otherwise requires,—

"**Association"** means an association of individuals, whether incorporated or not, having an office in India and includes a society, whether registered under the Societies Registration Act, 1860 (21 of 1860), or not, and any other organisation, by whatever name called;

"**foreign company"** means any company or association or body of individuals incorporated outside India and includes :—

- a foreign company within the meaning of section 591 of the Companies Act, 1956 (Section 379 of the Companies Act, 2013)
- Company which is a subsidiary of a foreign company;
- the registered office or principal place of business of a foreign company referred to in sub-clause (*i*) or company referred to in sub-clause (*ii*) above;
- a multi-national corporation.

Explanation.—For the purposes of this sub-clause, a corporation incorporated in a foreign country or territory shall be deemed to be a multi-national corporation if such corporation,—

(a) has a subsidiary or a branch or a place of business in two or more countries or territories; or

(*b*) carries on business, or otherwise operates, in two or more countries or territories; **[Section 2(g)]**

"foreign contribution" means the donation, delivery or transfer made by any foreign source,—

(i) of any article, not being an article given to a person as a gift for his personal use, if the market value, in India, of such article, on the date of such gift, is not more than such sum as may be specified from time to time, by the Central Government by the rules made by it in this behalf; (This sum has been specified as ₹ 25,000/- as per the Rule 6A of the Foreign Contribution (Regulation) Amendment Rules, 2012)

(ii) any currency, whether Indian or foreign;

(iii) of any security as defined in the Securities Contracts (Regulation) Act, 1956 and includes any foreign security as defined in the Foreign Exchange Management Act, 1999 .

Explanation 1—A donation, delivery or transfer of any article, currency or foreign security referred to in this clause by any person who has received it from any foreign source, either directly or through one or more persons, shall also be deemed to be foreign contribution within the meaning of this clause.

Explanation 2—The interest accrued on the foreign contribution deposited in any bank referred to in section 17(1) or any other income derived from the foreign contribution or interest thereon shall also be deemed to be foreign contribution within the meaning of this clause.

Explanation 3—Any amount received, by any person from any foreign source in India, by way of fee (including fees charged by an educational institution in India from foreign student) or towards cost in lieu of goods or services rendered by such person in the ordinary course of his business, trade or commerce whether within India or outside India or any contribution received from an agent of a foreign source towards such fee or cost shall be excluded from the definition of foreign contribution within the meaning of this clause; **[Section 2(h)]**

Example: Whether earnings from foreign client(s) by a person in lieu of goods sold or a service rendered by it is treated as foreign contribution?

Answer: No. As per the above explanation 3, foreign contribution excludes earnings from foreign client(s) by a person in lieu of goods sold or services rendered by it as this is a transaction of commercial nature.

In terms of FCRA, 2010 **"person"** includes:

(i) an individual;

(ii) a Hindu undivided family;

(iii) an association;

(iv) a company registered under section 25 of the Companies Act, 1956 (now Section 8 of Companies Act, 2013). **[Section 2(m)]**

"foreign hospitality" means any offer, not being a purely casual one, made in cash or kind by a foreign source for providing a person with the costs of travel to any foreign country or territory or with free boarding, lodging, transport or medical treatment; **[Section 2(i)]**

"foreign source" includes,—

(i) the Government of any foreign country or territory and any agency of such Government;

(ii) any international agency, not being the United Nations or any of its specialized agencies, the World Bank, International Monetary Fund or such other agency as the Central Government may, by notification, specify in this behalf;

(iii) a foreign company;

(iv) a corporation, not being a foreign company, incorporated in a foreign country or territory;

(v) a multi-national corporation referred to in Section 2(g) sub-clause (iv) of FCRA, 2010;

(vi) a company within the meaning of the Companies Act, 1956, and more than one-half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following, namely:-

A. the Government of a foreign country or territory;

B. the citizens of a foreign country or territory;

C. corporations incorporated in a foreign country or territory;

D. trusts, societies or other associations of individuals (whether incorporated or not), formed or registered in a foreign country or territory;

E. Foreign company;

Provided that where the nominal value of share capital is within the limits specified for foreign investment under the Foreign Exchange Management Act, 1999, or the rules or regulations made thereunder, then, notwithstanding the nominal value of share capital of a company being more than one-half of such value at the time of making the contribution, such company shall not be a foreign source.

(vii) a trade union in any foreign country or territory, whether or not registered in such foreign country or territory;

(viii) a foreign trust or a foreign foundation, by whatever name called, or such trust or foundation mainly financed by a foreign country or territory;

(ix) a society, club or other association or individuals formed or registered outside India;

(x) a citizen of a foreign country;"

A few bodies/ organisations of the United Nations, World Bank and some other International agencies or multilateral organisations are exempted from this definition, and are not treated as foreign source. Hence, the funds received from them are not considered as foreign contribution. **[Section 2(j)]**

Example: Whether 100% subsidiary of foreign company in IT sector can give donation to trust who doesn't have registration under FCRA?

Answer: Yes, it can. As per proviso of Section 2(j)(vi) since the investment is within limits of FEMA, hence though may be 100% subsidiary of foreign company but still its not a foreign source.

"**political party**" means—

(i) an association or body of individual citizens of India—

(A) to be registered with the Election Commission of India as a political party under section 29A of the Representation of the People Act, 1951, or

(B) which has set up candidates for election to any Legislature, but is not so registered or deemed to be registered under the Election Symbols (Reservation and Allotment) Order, 1968;

(ii) a political party mentioned in column 2 of Table 1 and Table 2 to the notification of the Election Commission of India No. 56/J&K/02, dated the 8th August, 2002, as in force for the time being;**[Section 2(n)]**

"**relative**" has the meaning assigned to it in section 2(41) of the Companies Act, 1956 (Now section 2(77) of the Companies Act, 2013) **[Section 2(r)]**

3. REGULATION OF FOREIGN CONTRIBUTION AND FOREIGN HOSPITALITY

The provision related to the regulation of foreign contribution and foreign hospitality is given in chapter II of the Act. It covers section 3 to 10 of the Act. The chapter broadly focuses on whose foreign contribution can be accepted, on whom the provision contained under this chapter shall be applicable, restriction on acceptance of foreign hospitality and certain prohibitions.

(I) Prohibition to accept foreign contribution (Section 3)

(1) No foreign contribution shall be accepted by any:

(a) candidate for election;

(b) correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper;

(c) Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government;

(d) member of any Legislature;

(e) political party or office-bearer thereof;

(f) organisation of a political nature as may be specified under section 5(1) by the Central Government;

(g) association or company engaged in the production or broadcast of audio news or audio visual news or current affairs programmes through any electronic mode, or any other electronic form as defined in the Information Technology Act, 2000 or any other mode of mass communication;

(h) correspondent or columnist, cartoonist, editor, owner of the association or company referred to in clause (g).

Explanation.—In clause (*c*) and section 6, the expression "**corporation"** means a corporation owned or controlled by the Government and includes a Government company as defined in section 617 of the Companies Act, 1956 (Now section 2(45) of the Companies Act, 2013)

(2) Following other persons are also prohibited from accepting foreign contribution:

(a) **Person, resident in India, and citizen of India resident outside India**- shall not accept any foreign contribution, or acquire or agree to acquire any currency from a foreign source, on behalf of any political party, or any person referred to in sub-section (1) as stated above, or both.

(b) **Person, resident in India**- shall not deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to any person if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to any political party or any person referred to in sub-section (1), or both.

(c) **Citizen of India resident outside India**- shall not deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to—

(i) any political party or any person referred to in sub-section (1), or both; or

(ii) any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to a political party or to any person referred to in sub-section (1), or both.

(3) **Person receiving any currency, whether Indian or foreign, from a foreign source** on behalf of any person or class of persons (referred to in section 9) shall not deliver such currency—

(a) to any person other than a person for which it was received, or

(b) to any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to a person other than the person for which such currency was received.

(II) Persons to whom section 3 shall not apply (Section 4)

Nothing contained in section 3 shall apply to the acceptance, by any person specified in that section, of any foreign contribution where such contribution is accepted by him, subject to the provisions of section 10,—

(a) **by way of salary, wages or other remuneration** due to him or to any group of persons working under him, from any foreign source or by way of payment in the ordinary course of business transacted in India by such foreign source; or

(b) **by way of payment,** in the course of international trade or commerce, or in the ordinary course of business transacted by him outside India; or

(c) **as an agent of a foreign source** in relation to any transaction made by such foreign source with the Central Government or State Government; or

(d) **by way of a gift or presentation** made to him as a member of any Indian delegation, provided that such gift or present was accepted in accordance with the rules made by the Central Government with regard to the acceptance or retention of such gift or presentation; or

(e) **from his relative**; or

(f) **by way of remittance received**, in the ordinary course of business through any official channel, post office, or any authorised person in foreign exchange under the Foreign Exchange Management Act, 1999 (42 of 1999); or

(g) **by way of any scholarship, stipend or any payment** of like nature :

Provided that in case any foreign contribution received by any person specified under section 3, for any of the purposes other than those specified under this section, such contribution shall be deemed to have been accepted in contravention of the provisions of section 3.

Example: Whether foreign remittances received from a relative are to be treated as foreign contribution as per FCRA, 2010?

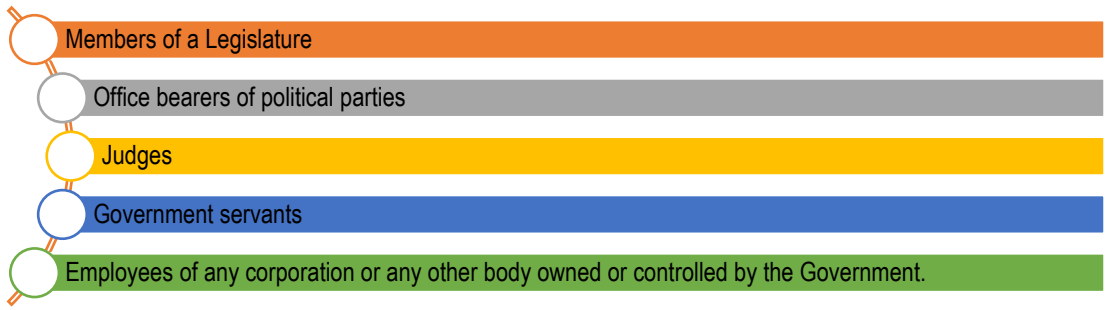
Answer: No. As per Section 4(e) of FCRA, 2010 and Rule 6 of FCRR, 2011, even the persons prohibited under section 3, i.e., persons not permitted to accept foreign contribution, are allowed to accept foreign contribution from their relatives. However, in terms of Rule 6 of FCRR, 2011, any person receiving foreign contribution in excess of one lakh rupees or equivalent thereto in a financial year from any of his relatives shall inform the Central Government [1]by uploading details electronically online in prescribed Form within thirty days from the date of receipt of such contribution.

Example: Whether donation given by Non-Resident Indians (NRIs) is treated as 'foreign contribution'?

Answer: Contributions made by a citizen of India living in another country (i.e., Non-Resident Indian), from his personal savings, through the normal banking channels, is not treated as foreign contribution. However, while accepting any donations from such NRI, it is advisable to obtain his passport details to ascertain that he/she is an Indian passport holder.

(III) Restriction on acceptance of foreign hospitality (Section 6)

As per Section 6 of the Act , following categories of persons require prior permission of the Central Government before accepting Foreign Hospitality, while visiting any country or territory outside India,:-



[1] Amended vide the Foreign Contribution (Regulation) Amendment Rules, 2019 notified on 7th March, 2019

Exception: Provided that it shall not be necessary to obtain any such permission for an emergent medical aid needed on account of sudden illness contracted during a visit outside India. But, where such foreign hospitality has been received, the person receiving such hospitality shall give an intimation to the Central Government as to the receipt of such hospitality within one month from the date of receipt of such hospitality, and the source from which, and the manner in which, such hospitality was received.

As per *Rule 7 of FCR, Rule 2011* foreign hospitality may be received by specified categories of persons in the following manner

(1) Any person belonging to any of the categories specified in section 6 who wishes to avail of foreign hospitality shall apply [2]electronically online to the Central Government in prescribed Form for prior permission to accept such foreign hospitality.

(2) Every application for acceptance of foreign hospitality shall be accompanied by an invitation letter from the host or the host country, as the case may be, and administrative clearance of the Ministry or department concerned in case of visits sponsored by a Ministry or department of the Government.

(3) The application for grant of permission to accept foreign hospitality must reach the appropriate authority ordinarily two weeks before the proposed date of onward journey.

(4) In case of emergent medical aid needed on account of sudden illness during a visit abroad, the acceptance of foreign hospitality shall be required to be intimated to the Central Government within sixty days of such receipt giving full details including the source, approximate value in Indian Rupees, and the purpose for which and the manner in which it was utilised.

However, no such intimation is required if the value of such hospitality in emergent medical aid is upto one lakh rupees or equivalent thereto.

Guidelines for consideration of proposals for acceptance of foreign hospitality under the Foreign Contribution (Regulation) Act, 2010: The provisions under the Act/Rules relating to 'foreign hospitality' and guidelines to be followed for consideration of proposals for acceptance of hospitality.

As per regulation 6 of the said guidelines the following cases need not be submitted to this Ministry for grant of permission to accept foreign hospitality:-

(i) Where the entire expenditure on the proposed foreign visit is being met by the Central/ State Government or any Central/State PSU etc.

(ii) Where the proposed foreign visit is being undertaken by a person in his/her personal capacity and the entire expenditure thereon is being met by the person concerned.

[2] Foreign Contribution (Regulation) Amendment Rules, 2019 vide Notification dated 7th March, 2019

(iii) Where the foreign hospitality is being provided by an Indian national living in a foreign country or territory.

(iv) Cases involving acceptance of an assignment on salary, fee or remuneration etc.

(v) Cases involving funding offered by an agency/organization mentioned in Annexure-2.

(vi) Cases involving visits undertaken by the Members of an Indian Parliamentary delegation under bilateral exchange.

(vii) Cases involving visits undertaken in pursuance of a bilateral agreement between the Government of India and the Government of the country concerned, approved by the Ministry of Finance (Department of Economics Affairs).

(viii) Cases involving long term/short term foreign training courses approved by the Ministry of Personnel, Training and Public Grievances.

(IV) Prohibition to transfer foreign contribution to other person (Section 7)

According to the section, person who—

(a) is registered and granted a certificate, or has obtained prior permission under this Act; and

(b) receives any foreign contribution,

shall not transfer such foreign contribution to any other person unless such other person is also registered and had been granted the certificate or obtained the prior permission under this Act:

However, that such person may transfer, with the prior approval of the Central Government, a part of such foreign contribution to any other person who has not been granted a certificate or obtained permission under this Act in accordance with the rules made by the Central Government.

Rule 24 of FCRR, 2011, prescribes the procedure for transferring foreign contribution to any unregistered person as under-

(1) **Limit on transfer of foreign contribution:** A person who has been granted a certificate of registration or prior permission under section 11 and intends to transfer part of the foreign contribution received by him to a person who has not been granted a certificate of registration or prior permission under the Act, may transfer such foreign contribution to an extent not exceeding ten per cent of the total value thereof and for this purpose, make an application to the Central Government in prescribed Form.

(2) **Declaration to be annexed:** Every application made under sub-rule (1) shall be accompanied by a declaration to the effect that-

(a) the amount proposed to be transferred during the financial year is less than ten per cent of the total value of the foreign contribution received by him during the financial year;

(b) the transferor shall not transfer any amount of foreign contribution until the Central Government approves such transfer.

(3) **Eligibility of recipient:** A person who has been granted a certificate of registration or prior permission under section 11 shall not be required to seek the prior approval of the Central Government for transferring the foreign contribution received by him to another person who has been granted a certificate of registration or prior permission under the Act provided that the recipient has not been proceeded against under any of the provisions of the Act.

(4) **Responsibility for proper utilisation of the foreign contribution:** Both the transferor and the recipient shall be responsible for ensuring proper utilisation of the foreign contribution so transferred and such transfer of foreign contribution shall be reflected in the returns in Form FC-6 to be submitted by both the transferor and the recipient."

(V) Restriction to utilize foreign contribution for administrative purpose (Section 8)

(1) Every person, who is registered and granted a certificate or given prior permission under this Act and receives any foreign contribution, shall—

(a) utilise such contribution for the purposes for which the contribution has been received:

Provided that any foreign contribution or any income arising out of it shall not be used for speculative business;

Provided further that the Central Government shall, by rules, specify the activities or business which shall be construed as speculative business for the purpose of this section;

Speculative activities have been defined in *Rule 4 of FCR, Rule 2011* as under:-

(i) any activity or investment that has an element of risk of appreciation or depreciation of the original investment, linked to marked forces, including investment in mutual funds or in shares;

(ii) participation in any scheme that promises high returns like investment in chits or land or similar assets not directly linked to the declared aims and objectives of the organization or association.

(b) not defray as far as possible such sum, not exceeding fifty per cent of such contribution, received in a financial year, to meet administrative expenses:

Provided that administrative expenses exceeding fifty per cent of such contribution may be defrayed with prior approval of the Central Government.

(2) The Central Government may prescribe the elements which shall be included in the administrative expenses and the manner in which the administrative expenses referred to in sub-section (1) shall be calculated.

(VI) Power of Central Government to prohibit receipt of foreign contribution, etc., in certain cases (Section 9)

The Central Government may—

(a) prohibit any person or organisation (not specified in section 3), from accepting any foreign contribution;

(b) require any person or class of persons, (not specified in section 6), to obtain prior permission of the Central Government before accepting any foreign hospitality;

(c) require any person or class of persons (not specified in section 11), to furnish intimation as to the amount of any foreign contribution received by such person or class of persons as the case may be, and the source from which and the manner in which such contribution was received and the purpose for which and the manner in which such foreign contribution was utilised;

(d) require any person or class of persons specified in that Section 11(1) to obtain prior permission of the Central Government before accepting any foreign contribution;

(e) require any person or class of persons, (not specified in section 6), to furnish intimation, as to the receipt of any foreign hospitality, the source from which and the manner in which such hospitality was received.

Exception: Above prohibition or requirement shall not be made unless the Central Government is satisfied that the acceptance of foreign contribution by such person or class of persons, as the case may be, or the acceptance of foreign hospitality by such person, is likely to affect prejudicially—

(i) the sovereignty and integrity of India; or

(ii) public interest; or

(iii) freedom or fairness of election to any Legislature; or

(iv) friendly relations with any foreign State; or

(v) harmony between religious, racial, social, linguistic or regional groups, castes or communities.

(VII) Power to prohibit payment of currency received in contravention of the Act (Section 10)

Where the Central Government is satisfied, after making such inquiry, that any person has in his custody or control any-

- article or
- currency or
- security,

whether Indian or foreign, which has been accepted by such person in contravention of any of the provisions of this Act, it may, by order in writing prohibit such person from-

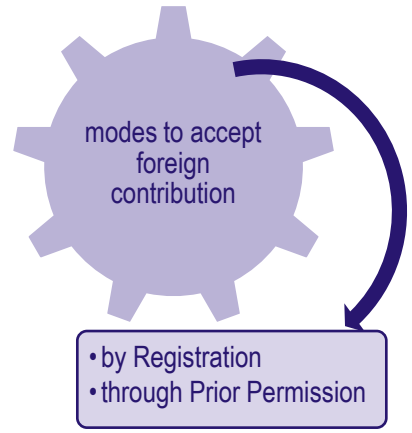
paying, delivering, transferring or otherwise dealing with, such article or currency or security.

A copy of such order shall be served upon the person so prohibited as per *Rule 8 of the FCR, Rule 2011*, and thereupon the provisions of section 7 of the Unlawful Activities (Prevention) Act, 1967 shall, apply to, or in relation to, such article or currency or security and references in the said sub-sections to moneys, securities or credits shall be taken as references to such article or currency or security.

4. REGISTRATION

The provisions related to registration of persons for acceptance of foreign contribution, grant of certificate, its suspension, cancellation and renewal are dealt in chapter III of the FCRA.

There are two modes to accept foreign contribution according to FCRA, 2010-



(I) Registration of certain persons with Central Government (Section 11)

(1) Person having a definite cultural, economic, educational, religious or social programme- shall not accept foreign contribution unless such person obtains a certificate of registration from the Central Government.

However, that-

- any association registered with the Central Government under section 6, or
- granted prior permission under that section of the Foreign Contribution (Regulation) Act, 1976, as it stood immediately before the commencement of this Act,

shall be deemed to have been registered or granted prior permission, as the case may be, under this Act and such registration shall be valid for a period of five years from the date on which this section comes into force.

(2) Acceptance of foreign contribution after obtaining prior permission of the Central Government: Every person may, if it is not registered with the Central Government, accept any foreign contribution only after obtaining the prior permission of the Central Government and such prior permission shall be valid for the specific purpose for which it is obtained and from the specific source

Further, if the person has been found guilty of violation of any of the provisions of this Act or the Foreign Contribution (Regulation) Act, 1976, the unutilised or unreceived amount of foreign contribution shall not be utilised or received, as the case may be, without the prior approval of the Central Government.

(3) The Central Government may, by notification in the Official Gazette, specify—

(i) the person or class of persons who shall obtain its prior permission before accepting the foreign contribution; or

(ii) the area or areas in which the foreign contribution shall be accepted and utilised with the prior permission of the Central Government; or

(iii) the purpose or purposes for which the foreign contribution shall be utilised with the prior permission of the Central Government; or

(iv) the source or sources from which the foreign contribution shall be accepted with the prior permission of the Central Government.

Example: Can a private limited company or a partnership firm get registration or prior permission under FCRA, 2010?

Answer: Yes, a private limited company too may seek prior permission/registration for receiving foreign funds in case they wish to do some charitable work at some point of time.

Example: Whether an individual or a Hindu Undivided Family (HUF) can be given registration or prior permission to accept foreign contribution in terms of section 11 of FCRA, 2010?

Answer: Yes. The definition of the 'person' in the Foreign Contribution (Regulation) Act, 2010 includes any individual and 'Hindu Undivided Family' among others. As such an Individual or an HUF is also eligible to apply for prior permission to accept foreign contribution.

Example: Whether organisations under Central/State Governments are required to obtain registration or prior permission under FCRA, 2010 for accepting foreign contribution?

Answer: Yes. However, all bodies constituted or established by or under a Central Act or a State Act requiring to have their accounts compulsorily audited by Comptroller & Auditor General of India are exempted from the operations of all the provisions of FCRA, 2010.

(II) Grant of certificate of registration (Section 12)

1. Conditions to be met for the grant of registration and prior permission

In terms of Sec.12 (4) of FCRA, 2010, the following shall be the conditions for the grant of registration and prior permission:

(a) The 'person' making an application for registration or grant of prior permission-

i. is not fictitious or benami;

ii. has not been prosecuted or convicted for indulging in activities aimed at conversion through inducement or force, either directly or indirectly, from one religious faith to another;

iii. has not been prosecuted or convicted for creating communal tension or disharmony in any specified district or any other part of the country;

iv. has not been found guilty of diversion or mis-utilisation of its funds;

v. is not engaged or likely to engage in propagation of sedition or advocate violent methods to achieve its ends;

vi. is not likely to use the foreign contribution for personal gains or divert it for undesirable purposes;

vii. has not contravened any of the provisions of this Act;

viii. has not been prohibited from accepting foreign contribution;

ix. the person being an individual, such individual has neither been convicted under any law for the time being in force nor any prosecution for any offence is pending against him.

x. the person being other than an individual, any of its directors or office bearers has neither been convicted under any law for the time being in force nor any prosecution for any offence is pending against him.

(b) the acceptance of foreign contribution by the association/ person is not likely to affect prejudicially -

i. the sovereignty and integrity of India;

ii. the security, strategic, scientific or economic interest of the State;

iii. the public interest;

iv. freedom or fairness of election to any Legislature;

v. friendly relation with any foreign State;

vi. harmony between religious, racial, social, linguistic, regional groups, castes or communities.

(c) the acceptance of foreign contribution-

i. shall not lead to incitement of an offence;

ii. shall not endanger the life or physical safety of any person.

(2) Procedure for grant of certificate of Registration

(1) An application by a person, referred to in section 11 for grant of certificate or giving prior permission, shall be made to the Central Government in such form and manner and along with such fee, as may be prescribed.

(2) On receipt of an application the Central Government shall, by an order, if the application is not in the prescribed form or does not contain any of the particulars specified in that form, reject the application.

(3) If on receipt of an application for grant of certificate or giving prior permission and after making such inquiry as the Central Government deems fit, it is of the opinion that the conditions specified in sub-section (4) are satisfied, it may, ordinarily within ninety days from the date of receipt of application, register such person and grant him a certificate or give him prior permission, as the case may be, subject to such terms and conditions as may be prescribed.

If that in case the Central Government does not grant, within the said period of ninety days, a certificate or give prior permission, it shall communicate the reasons therefor to the applicant.

And that a person shall not be eligible for grant of certificate or giving prior permission, if his certificate has been suspended and such suspension of certificate continues on the date of making application.

(4) Where the Central Government refuses the grant of certificate or does not give prior permission, it shall record in its order the reasons therefor and furnish a copy thereof to the applicant.

However, the Central Government may not communicate the reasons for refusal for grant of certificate or for not giving prior permission to the applicant under this section in cases where is no obligation to give any information or documents or records or papers under the Right to Information Act, 2005.

(5) The certificate granted shall be valid for a period of five years from the date of its issue and the prior permission shall be valid for the specific purpose or specific amount of foreign contribution proposed to be received, as the case may be.

(III) Suspension of certificate (Section 13)

(1) **Period of suspension of certificate:** Where the Central Government is satisfied that pending consideration of the question of cancelling the certificate on any of the grounds mentioned in sub- section 14(1), it is necessary so to do, it may, by order in writing, suspend the certificate for such period not exceeding one hundred and eighty days as may be specified in the order.

(2) **Effect of suspension:** Every person whose certificate has been suspended shall—

(a) not receive any foreign contribution during the period of suspension of certificate .

However, the Central Government, on an application made by such person, if it considers appropriate, allow receipt of any foreign contribution by such person on such terms and conditions as it may specify;

(b) Not utilise, in the prescribed manner, the foreign contribution in his custody without the prior approval of the Central Government.

Rule 14 of FCR, Rule 2011 defines the extent of amount that can be utilised in case of suspension of the certificate of registration. The unspent amount that can be utilised in case of suspension of a certificate of registration may be as under:—

(a) In case the certificate of registration is suspended under sub-section (1) of section 13 of the Act, up to **twenty-five per cent of the unutilised amount may be spent**, with the prior approval of the Central Government, for the declared aims and objects for which the foreign contribution was received.

(b) The **remaining seventy-five per cent of the unutilised foreign contribution** shall be utilised only after revocation of suspension of the certificate of registration.

(IV) Cancellation of certificate (Section 14)

(1) The Central Government may, by an order, cancel the certificate if —

(a) the **holder of the certificate has made a statement** in, or in relation to, the application for the grant of registration or renewal thereof, which is incorrect or false; or

(b) the **holder of the certificate has violated any of the terms and conditions of the certificate** or renewal thereof; or

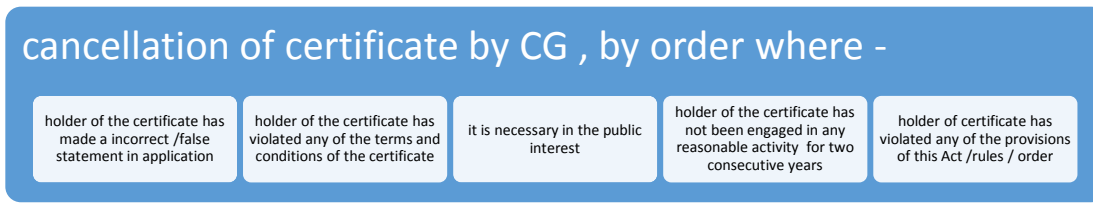
(c) in the opinion of the Central Government**, it is necessary in the public interest** to cancel the certificate; or

(d) the **holder of certificate has violated any of the provisions of this Act** or rules or order made thereunder; or

(e) if the **holder of the certificate has not been engaged in any reasonable activity** in its chosen field for the benefit of the society for two consecutive years or has become defunct.

(2) No order of cancellation of certificate under this section shall be made unless the person concerned has been **given a reasonable opportunity of being heard**.

(3) **Cooling period of 3 years:** Any person whose certificate has been cancelled under this section shall not be eligible for registration or grant of prior permission for a period of three years from the date of cancellation of such certificate.



(V) Management of foreign contribution of person whose certificate has been cancelled (Section 15)

(1) **Vesting of custody:** The foreign contribution and assets created out of the foreign contribution in the custody of every person whose certificate has been cancelled - shall vest in banking authority concerned till the Central Government issues further directions in the matter as per *Rule 15 of the FCR Rules, 2011*.

(2) **Role of Authority:** Such an authority may, if it considers necessary and in public interest- manage the activities of the person, as the Central Government may direct and such authority may utilise the foreign contribution or dispose of the assets created out of it in case adequate funds are not available for running such activity.

(3) **Return of vested FC & assets:** The authority shall- return the foreign contribution (FC) and the assets vested upon it to the person, if such person is subsequently registered under this Act.

(VI) Renewal of certificate (Section 16)

(1) **Period for applying for renewal of certificate:** Every person who has been granted a certificate, shall have such certificate **renewed within six months** before the expiry of the period of the certificate.

(2) **Filing of an application to CG:** The **application** for renewal of the certificate shall be **made to the Central Government** in such form and manner with such fee as may be prescribed.

(3) **Period for renewal of certificate** The Central Government shall renew the certificate, ordinarily within **ninety days** from the date of receipt of application for renewal of certificate subject to such terms and conditions as it may deem fit and grant a certificate of renewal for a period of **five years**.

However, in case the Central Government does not renew the certificate within the said period of ninety days, it shall communicate the reasons therefor to the applicant.

Further that the Central Government may refuse to renew the certificate in case where a person has violated any of the provisions of this Act or rules made thereunder.

Procedure for renewal of registration certificate - [3]*Rule 12 of FCR,Rule 2011* states that-

(1) Every certificate of registration issued to a person shall be liable to be renewed after the expiry of five years from the date of its issue on proper application.

(2) Every person shall apply to the Central Government electronically online in prescribed Form six months before the date of expiry of the certificate of registration, for its renewal.

(3) An application made for renewal of the certificate of registration shall be accompanied by a fee of ₹1500 (One Thousand Five Hundred rupees only).

(4) The fee for renewal of the certificate of registration shall be remitted by demand draft or banker's cheque in favour of the "Pay and Accounts Officer, Ministry of Home Affairs", payable at New Delhi or through online electronic payment gateway as specified by the Central Government.

(5) In case no application for renewal of registration is received or such application is not accompanied by the requisite fee, the validity of the certificate of registration of such person shall be deemed to have ceased from the date of completion of the period of five years from the date of the grant of registration.

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[3] Amended through the Foreign Contribution (Regulation) Amendment Rules, 2019 vide notification dated 7th March, 2019.

Example: A certificate of registration granted on the 1st January, 2012 shall be valid till the 31st December, 2016. A request for renewal of the registration certificate shall reach the Central Government, accompanied by the requisite fee, by the 30th June, 2016. If no application is received or is not accompanied by the renewal fee, the validity of the registration certificate issued on the 1st January 2012 shall be deemed to have lapsed with effect from the close of the day on 31st December, 2016.

(6) If the validity of the certificate of registration of a person has ceased in accordance with the provisions of these rules, a fresh request for the grant of a certificate of registration may be made by the person to the Central Government as per the provisions of rule 9.

(7) In case a person provides sufficient grounds, in writing, explaining the reasons for not submitting the certificate of registration for renewal within the stipulated time, his application may be accepted for consideration along with the requisite fee and with late fee of Rs.5000/- , but not later than one year after the expiry of the original certificate of registration.

5. ACCOUNTS, INTIMATION, AUDIT AND DISPOSAL OF ASSETS, ETC.

Provisions related to matters incidental to maintenance of accounts are dealt under chapter IV of the FCRA. It covers section 17 to 22 of the Act.

(I) Foreign contribution through scheduled bank (Section 17)

Every person who has been granted a certificate or given prior permission shall receive foreign contribution in a single account only through such one of the branches of a bank as he may specify in his application for grant of certificate. However, person may open one or more accounts in one or more banks for utilising the foreign contribution received by him. No funds other than foreign contribution shall be received or deposited in such account or accounts.

Every bank or authorised person in foreign exchange shall report to such authority as may be specified —

(a) prescribed amount of foreign remittance;

(b) the source and manner in which the foreign remittance was received; and

(c) other particulars, in such form and manner as may be prescribed.

According to *Rule 16 of FCR, Rule 2011,* the bank shall report to the Central Government within forty-eight hours any transaction in respect of receipt or utilisation of any foreign contribution by any person whether or not such person is registered or granted prior permission under the Act.

Example: Can foreign contribution be mixed with local receipts?

Answer: No. Foreign contribution cannot be deposited or utilised from the bank account being used for domestic funds.

(II) Intimation (Section 18)

Every person who has been granted a certificate or given prior approval shall give an intimation to the Central Government, and such other authority as may be specified by the Central Government –

- as to the amount of each foreign contribution received by it,
- the source from which, and
- the manner in which such foreign contribution was received, and the purposes for which, and the manner in which such foreign contribution was utilised by him.

Every person receiving foreign contribution shall submit a copy of a statement with the particulars of foreign contribution received duly certified by officer of the bank or authorised person in foreign exchange and furnish the same to the Central Government along with the intimation.

(III) Maintenance of accounts (Section 19)

Every person who has been granted a certificate or given prior approval under this Act shall maintain, in such form and manner as may be prescribed,—

(a) an account of any foreign contribution received by him; and

(b) a record as to the manner in which such contribution has been utilised by him.

Rule 11 of FCR, Rule 2011 states that every person who has been granted registration or prior permission under section 12 shall maintain a separate set of accounts and records, exclusively, for the foreign contribution received and utilised.

(IV) Audit of accounts (Section 20)

(1) Where any person who has been granted a certificate or given prior permission, fails to furnish any intimation under this Act ,or the intimation so furnished is not in accordance with law or if, after inspection of such intimation, the Central Government has any reasonable cause to believe that any provision of this Act has been, or is being, contravened, the Central Government may-

- by general or special order, authorise such Gazetted Officer, holding a Group A post under the Central Government or any other officer or authority or organisation, as it may think fit
- to audit any books of account kept or maintained by such person.

(2) Every such officer shall have the right to enter in or upon any premises at any reasonable hour, before sunset and after sunrise, for the purpose of auditing the said books of account.

(3) Any information obtained from such audit shall be kept confidential and shall not be disclosed except for the purposes of this Act.

(V) Disposal of assets created out of foreign contribution (Section 22)

Where any person who was permitted to accept foreign contribution under this Act-

(i) **ceases to exist or has become defunct** – in this case all the assets of such person shall be disposed of in accordance with the provisions contained in any law for the time being in force under which the person was registered or incorporated, and

(ii) **in the absence of any such law-** the Central Government may, having regard to the nature of assets created out of foreign contribution received under this Act, by notification, specify that all such assets shall be disposed of by such authority, in such manner and procedure as may be prescribed.

6. ADJUDICATION

The provisions related to adjudication is given under chapter VI &VII covering sections from 28-31 of the Act.

Confiscation of article or currency or security obtained in contravention of the Act (Section 28)

Any article or currency or security which is seized under the Act shall be liable to confiscation if such article or currency or security has been adjudged under section 29 to have been received or obtained in contravention of this Act.

Adjudication of confiscation (Section 29)

(1) Any confiscation referred to in section 28 may be adjudged—

(a) **without limit, by the Court of Session** within the local limits of whose jurisdiction the seizure was made; and

(b) subject to such limits as may be prescribed, by such officer, not below the rank of an Assistant Sessions Judge, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

As per *Rule 19 of FCR, Rule 2011* an officer above in clause(b), may adjudge confiscation in relation to any article or currency seized under section 25, if the value of such article or the amount of such currency seized does not exceed ₹ 10,00,000 (Ten lakh only).

(2) When an adjudication is concluded by the Court of Session or Assistant Sessions Judge, as the case may be, the Sessions Judge or Assistant Sessions Judge may make such order as he thinks fit for the disposal by confiscation or delivery of seized article or currency or security, as the case may be, to any person claiming to be entitled to possession thereof or otherwise, or which has been used for the commission of any offence under this Act.

Procedure for confiscation (Section 30)

No order of adjudication of confiscation shall be made unless a reasonable opportunity of making a representation against such confiscation has been given to the person from whom any article or currency or security has been seized.

Appeal (Section 31)

(1) Where any person is aggrieved by any order, may prefer an appeal.

Where an order is passed by-	Appeal to be made-
the Court of Session	to the High Court to which such Court is subordinate
OR	
any officer specified section 29(1)(b)	Court of Session within the local limits of whose jurisdiction such order of adjudication of confiscation was made
Appeal may be preferred within one month from the date of communication to such person of the order.	
However, the appellate court may, allow such appeal to be preferred within a further period of one month, but not thereafter.	

(2) Any organisation referred to in section 3(1)(f), or any person or association referred to in section 6 or section 9, aggrieved by an order made in pursuance of section 5 or by an order of the Central Government refusing to give permission under this Act, or by any order made by the Central Government section 12(2) or 12(4), or section 14(1), as the case may be, may,

- prefer an appeal against such order to the High Court within the local limits of whose jurisdiction the appellant ordinarily resides or carries on business or personally works for gain, or, where the appellant is an organisation or association, the principal office of such organisation or association is located-
- within sixty days from the date of such order.

Revision of orders by Central Government (Section 32)

(1) **Power to central Government-** The Central Government may either-

- of its own motion or
- on an application for revision by the person registered under this Act,

call for and examine the record of any proceeding under this Act in which any such order has been passed by it and may make such inquiry or cause such inquiry to be made and, subject to the provisions of this Act, may pass such order thereon as it thinks fit.

(2) **Restriction on entertainment of revision:** The Central Government shall not of its own motion revise any order under this section if the order has been made more than one year previously.

(3) **In the case of an application for revision under this section** -the application must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

Where if, the Central Government is satisfied that such person was prevented by sufficient cause from making the application within that period - may admit an application made after the expiry of that period.

7. OFFENCES AND PENALTIES

The provisions related to offences and Penalties are covered under sections 33 to 41 of the Act. This part prescribes types of offences committed and the penalties levied for the same.

Types of offence	Penalties levied
Any person who knowingly,— (a) gives false intimation under section 9(c) or section 18; or (b) seeks prior permission or registration by means of fraud, false representation or concealment of material fact,	shall, on conviction by a court, be liable to imprisonment for a term which may extend to six months or with fine or with both.
Any person, on whom any prohibitory order has been served under section 10, pays, delivers, transfers or otherwise deals with, any article or currency or security, whether Indian or foreign, in contravention of such prohibitory order.	• shall be punished with imprisonment for a term which may extend to three years, or with fine, or with both. • the court trying such contravention may also impose on the person convicted an additional fine equivalent to the market value of the article or the amount of the currency or security in respect of which the prohibitory order has been contravened by him or such part thereof as the court may deem fit.
Whoever accepts, or assists any person, political party or organisation in accepting, any foreign contribution or any currency or security from a foreign source, in contravention of any provision of this Act or any rule or order made thereunder	shall be punished with imprisonment for a term which may extend to five years, or with fine, or with both.

the court trying a person, who, in relation to any article or currency or security, whether Indian or foreign, does or omits to do any act which act or omission would render such article or currency or security liable to confiscation under this Act, may, in the event of the conviction of such person for the act or omission aforesaid	impose on such person a fine not exceeding five times the value of the article or currency or security or one thousand rupees, whichever is more, if such article or currency or security is not available for confiscation, and the fine so imposed shall be in addition to any other fine which may be imposed on such person under this Act.
Whoever fails to comply with any provision of this Act for which no separate penalty has been provided in this Act	shall be punished with imprisonment for a term which may extend to one year, or with fine or with both.
having been convicted of any offence under section 35 or section 37, insofar as such offence relates to the acceptance or utilisation of foreign contribution, is again convicted of such offence	shall not accept any foreign contribution for a period of five years from the date of the subsequent conviction.

Offences by companies

Where an offence under this Act or any rule or order made thereunder has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was 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.

However, such person shall not be liable to any punishment if he proves that the offence was committed –

- without his knowledge, or
- he had exercised all due diligence to prevent the commission of such offence.

Where an offence under this Act or any rule or order made thereunder 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 purposes of this section,—

(a) "**company**" means any body corporate and includes a firm, society, trade union or other association of individuals; and

(b) **"director",** in relation to a firm, society, trade union or other association of individuals, means a partner in the firm or a member of the governing body of such society, trade union or other association of individuals.

Bar on prosecution of offences under the Act.

No court shall take cognizance of any offence under this Act, except with the previous sanction of the Central Government or any officer authorised by that Government in this behalf.

Compounding of certain offences (Section 41)

- any offence punishable under this Act (whether committed by an individual or association or any officer or employee thereof), not being an offence punishable with imprisonment only, may, before the institution of any prosecution, be compounded by such officers or authorities and for such sums as the Central Government may, by notification in the Official Gazette, specify.
- Compounding of offences as stated above, shall not apply to an offence committed by an individual or association or its officer or other employee within a period of three years from the date on which a similar offence committed by it or him was compounded under this section.

  For the purposes of this section, any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence.
- Every officer or authority shall exercise the powers to compound an offence, subject to the direction, control and supervision of the Central Government.
- Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, against the offender in relation to whom the offence is so compounded.
- Every officer or authority while dealing with a proposal for the compounding of an offence for a default in compliance with any provision of this Act which requires by an individual or association or its officer or other employee to obtain permission or file or register with, or deliver or send to, the Central Government or any prescribed authority any return, account or other document, may-

  direct, by order, any individual or association or its officer or other employee to file or register with, such return, account or other document within such time as may be specified in the order.

8. MISCELLANEOUS

(I) Power to call of information or document and Investigation into cases under the Act (Sections 42 &43)

- Any inspecting officer, authorised by the Central Government may, during the course of any inspection of any account or record maintained by any political party, person, organisation or association in connection with the contravention of any provision of this Act,—

  (a) call for information from any person for the purpose of satisfying himself whether there has been any contravention of the provisions of this Act or rule or order made thereunder;

(b) require any person to produce or deliver any document or thing useful or relevant to such inspection;

(c) examine any person acquainted with the facts and circumstances of the case related to the inspection.

- **Investigation into cases under the Act** Any offence punishable under this Act may also be investigated into by such authority as the Central Government may specify in this behalf and the authority so specified shall have all the powers which an officer-in-charge of a police station has while making an investigation into a cognizable offence.

(II) Power of Central Government to give directions and delegation of powers (Sections 46 & 47)

- The Central Government may give such directions as it may deem necessary to any other authority or any person or class of persons regarding the carrying into execution of the provisions of this Act, except power to make rule under section 48.

(III) Power to make rules(Section 48)

The Central Government may, by notification, make rules for carrying out the provisions of this Act.

(IV) Power to exempt in certain cases (Section 50)

If the Central Government is of opinion that it is necessary or expedient in the interests of the general public so to do, it may-

- by order and subject to such conditions as may be specified in the order, exempt-
  - any person or
  - association or
  - organisation (not being a political party), or
  - any individual (not being a candidate for election)
- from the operation of all or any of the provisions of this Act and may, revoke or modify such order.

(V) Act not to apply to certain Government transactions (Section 51)

Nothing contained in this Act shall apply to any transaction between-

- the Government of India, and
- the Government of any foreign country or territory.

(VI) Application of other laws not barred (Section 52)

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. As per the FCRA, the restrictions on 'foreign contribution' are applicable if the foreign contribution is from 'foreign source'. Who among the following are excluded from the purview of foreign source in the Act-

   (a) United nations

   (b) World Bank

   (c) International monetary Fund

   (d) All of the above

2. Surya Ltd., incorporated and registered in New Delhi with a foreign shareholding more than 50% due to liberalisation in Foreign Direct Investment (FDI) policy.

   State the correct statement as to the status of the Surya Ltd.

   (a) Surya limited shall not be considered as foreign source because of its registration in India.

   (b) Surya Ltd would be 'foreign source' having foreign shareholding more than 50% of foreign company.

   (c) Surya Ltd would be 'foreign source' having foreign contribution through various international agencies.

   (d) Both (b) & (c)

3. An association was holding the certificate of registration making it eligible for acceptance of foreign contribution established for the betterment of poor children. Central Government later cancelled the certificate of the association for violation of the terms and conditions of certificate for being not engaged in chosen activity for the poor children. Such association again applied for the registration. State weather the association is eligible for registration-

   (a) Yes, it can apply freshly at any time

   (b) No, permanently becomes disqualified

   (c) yes, after 3 years from the date of cancellation of certificate

   (d) after reasonable opportunity of being heard, and on warning, same registration will be restored.

Descriptive Questions

Question 1

State under what circumstances Government can cancel the certificate of registration granted to a person under FCRA?

Question 2

X, is an association having registration to transfer the Foreign Contribution received by it to another organization? Is the valid act of X? If yes, then what is the process to do so? Is there any restriction on transfer of funds to other organisations?

Question 3

Can foreign contribution be received in and utilised from multiple Bank Accounts?

Question 4

Can capital assets purchased with the help of foreign contributions be acquired in the name of the Mr Ram, an office bearers of the association?

ANSWER/SUGGESTED

Answer to MCQs

1. **(d)** **Hint:** Foreign source includes Foreign Government, international agency (but not UN or its agencies, World Bank, IMF etc.), foreign company, multi-national corporation, company where more than 50% capital is held by foreigner or foreign company, foreign trust, foreign citizen etc. [section 2(1)(j) of FCRA, 2010.

2. **(b)** **Hints:** Many companies in India have foreign shareholding more than 50% due to liberalisation in Foreign Direct Investment (FDI) policy. These would be 'foreign source' as per section 2(1)(j)(vi) of FCRA. Receipt of donations/contributions directly or indirectly by persons and organisations from these companies are presently violative of the FCRA.

3. **(c)** **Hint:** As per section 14 of the FCRA, cooling period of 3 years is prescribed for registration of any person whose certificate has been cancelled by the Central Government.

Answer to Descriptive Questions

1. Yes. As per section 14 of the FCRA, Central Government may cancel the certificate, after carrying out an inquiry, on the following grounds –

   (a) the holder of the certificate has made an incorrect/false statement in the application for the grant of registration or renewal

   (b) the holder of the certificate has violated any of the terms and conditions of the certificate or renewal thereof

(c) in the opinion of the Central Government, it is necessary in the public interest to cancel the certificate

(d) the holder of the certificate has violated any of the provisions of this Act or rules or order made thereunder.

(e) if the holder of the certificate has not been engaged in any reasonable activity in its chosen field for the benefit of the society for two consecutive years or has become defunct.

In any person whose certificate has been cancelled under this section shall not be eligible for registration or grant of prior permission for a period of three years from the date of cancellation of such certificate.

2. Yes X can transfer the Foreign Contribution received by it to another organization as per section 7 of FCRA, 2010. According to the provision no person who –

- is registered and granted a certificate or has obtained prior permission under this Act; and
- receives any foreign contribution,

shall transfer such foreign contribution to any other person unless such other person is also registered and had been granted the certificate or obtained the prior permission under this Act:

Provided that such person may transfer, with the prior approval of the Central Government, a part of such foreign contribution to any other person who has not been granted a certificate or obtained permission under this Act in accordance with the rules made by the Central Government."

Restrictions on transfer: *Rule 24 of FCRR, 2011,* prescribes the procedure for transferring foreign contribution to any unregistered person as under:

(1) A person who has been granted a certificate of registration or prior permission under section 11 and intends to transfer part of the foreign contribution received by him to a person who has not been granted a certificate of registration or prior permission under the Act, may transfer such foreign contribution to an extent not exceeding ten per cent of the total value thereof and for this purpose, make an application to the Central Government in the prescribed Form.

(2) Every application made under sub-rule (1) shall be accompanied by a declaration to the effect that-

(a) the amount proposed to be transferred during the financial year is less than ten per cent of the total value of the foreign contribution received by him during the financial year;

(b) the transferor shall not transfer any amount of foreign contribution until the Central Government approves such transfer.

(3) A person who has been granted a certificate of registration or prior permission under section 11 shall not be required to seek the prior approval of the Central Government for transferring the foreign contribution received by him to another person who has been granted a certificate of registration or prior permission under the Act provided that the recipient has not been proceeded against under any of the provisions of the Act.

(4) Both the transferor and the recipient shall be responsible for ensuring proper utilisation of the foreign contribution so transferred and such transfer of foreign contribution shall be reflected in the returns in Form to be submitted by both the transferor and the recipient."

3. The foreign contribution should be received only in the exclusive single foreign contribution account of a Bank (also called designated FC account), as mentioned in the order for registration or prior permission granted and should be separately maintained by the associations. However, one or more accounts (called Utilization Account) in one or more banks may be opened by the association for 'utilising' the foreign contribution after it has been received in the designated FCRA bank account, provided that no funds other than that foreign contribution shall be received or deposited in such account or accounts and in all such cases, intimation is to be given online within 15 days of opening of such account.

4. No. Every asset purchased with foreign contribution should be acquired and possessed in the name of the association since an association has a separate legal entity distinct from its members.

CHAPTER 5

THE ARBITRATION AND CONCILIATION ACT, 1996

LEARNING OUTCOMES

By the end of this Chapter, you will be able to have an overview of following related concepts in relation to arbitration and conciliation:

- Meaning of the process of arbitration, different types of arbitration, and its difference with litigation;
- Arbitration agreement with basic characteristics and features and conditions for its enforcement.
- Arbitral tribunal and its constitution
- Basic requirements for an appointment of an arbitrator/arbitral tribunal, its removal and a replacement
- Meaning of Conciliation, basic characteristics of the process of Conciliation and role of Conciliators
- Know of the commencement process of Conciliation proceedings.

1. INTRODUCTION

The Arbitration and Conciliation Act, 1996 is an Act enacted to consolidate and amend the law relating to domestic arbitration, international commercial arbitration and enforcement of foreign arbitral awards as also to define the law relating to conciliation and for matters connected therewith or incidental thereto.

The said Act extends to the whole of India, except that Parts, I, III and IV shall extend to the State of Jammu and Kashmir only in so far as they relate to international commercial arbitration or, as the

case may be, international commercial conciliation. The expression "international commercial conciliation" shall have the same meaning as the expression "international commercial arbitration" in clause (f) of sub-section (1) of section 2, subject to the modification that for the word "arbitration" occurring therein, the word "conciliation" shall be substituted.

The Act came into enforcement on 22nd of August, 1996 vide Notification G.S.R. 375(E), dated 22nd August, 1996 by Central Government.

Need for the establishment of a unified legal framework: According to the Preamble of the Act the General Assembly of the United Nations has recommended that all countries shall give due consideration to the UNCITRAL Model Law on International Commercial Arbitration, and the UNCITRAL Conciliation Rules in 1980; in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice.

The General Assembly of the United Nations has recommended the use of the said Rules in cases where a dispute arises in the context of international commercial relations and the parties seek an amicable settlement of that dispute by recourse to conciliation; Said Model Law and Rules make significant contribution to the establishment of a unified legal framework for the fair and efficient settlement of disputes arising in international commercial relations;

The law respecting arbitration and conciliation have been constituted taking into account the aforesaid Model Law and Rules.

Importance of the Legislation: The Supreme Court of India has in the landmark decision "*Salem Advocate Bar Association, Tamil Nadu v. Union of India*" directed that all courts shall direct parties to alternative dispute resolution methods like arbitration, conciliation, judicial settlement or mediation.

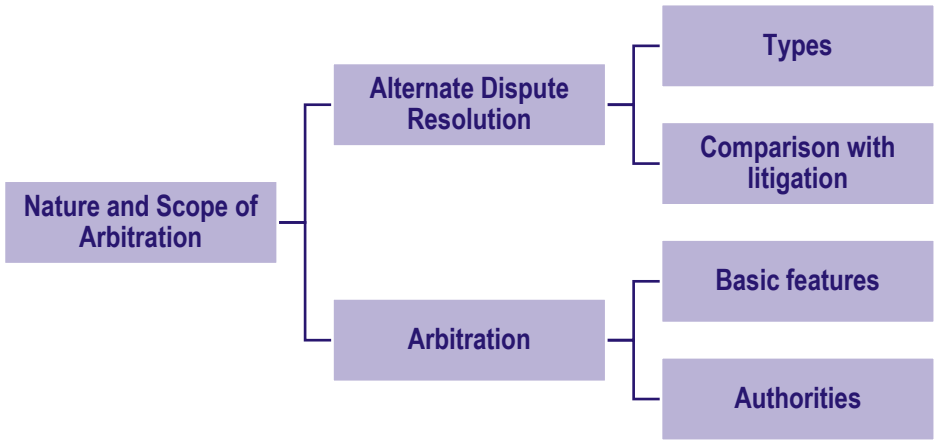
The High Court of Madras, India has pronounced a landmark judgment on 21/02/2012 in the matter, "*A.K. Balaji v. Government of India & others*", holding that foreign lawyers cannot be debarred to come to India and conduct arbitration proceedings in respect of disputes arising out of a contract relating to international commercial arbitration.

Structure of the Act: The Arbitration and Conciliation Act is divided into 4 Parts, Containing 88 Sections along with seven schedules. Part I contains ten chapters which deals with the Arbitration, Part II contains two chapters which deals with the enforcement of certain foreign awards, Part III deals with the conciliation and Part IV deals with the Supplementary provisions.

In the study material we shall be covering general provisions related to Arbitration, Arbitration agreement, Arbitral Tribunal and the commencement of Conciliation proceedings.

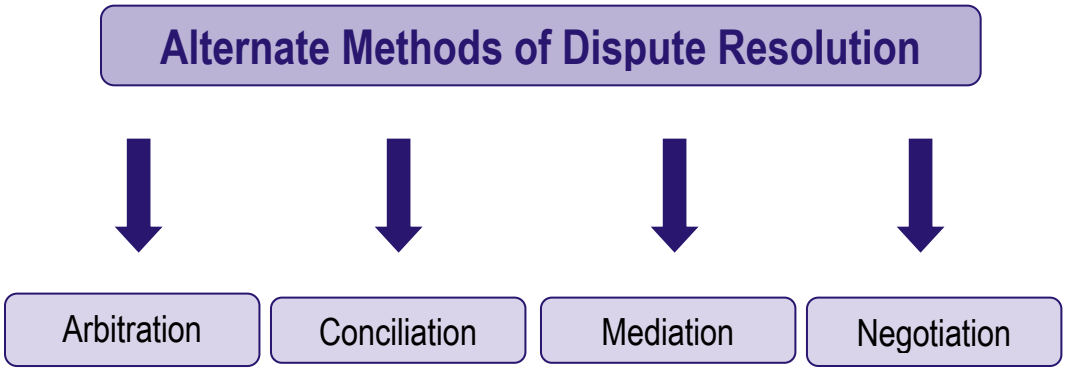
2. ARBITRATION – GENERAL PROVISIONS

Alternate methods of Dispute Resolution (ADR) were evolved to address some of major shortcomings of the court based adjudication system. One of the more utilised methods of ADR is arbitration.



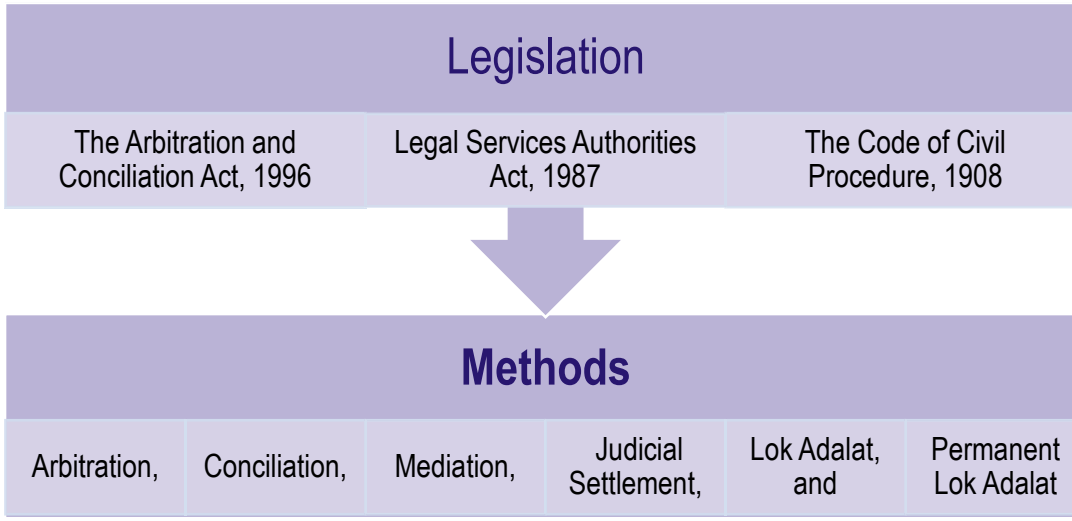
Alternate methods of dispute resolution

Alternate methods of dispute resolution (ADR) are used to resolve disputes outside the ordinary court system. In other words, these methods are an alternative to litigation. Two of the most common methods of ADR are arbitration and mediation. Other methods include conciliation, negotiation, case evaluation, neutral fact finding, ombudsperson, etc. All the methods differ from each other.



ADR methods enjoy significant advantages such as lower costs, greater flexibility of process, higher confidentiality, greater likelihood of settlement, choice of forum, choice of solutions. However these methods also suffer from few disadvantages, for example, requirement of cooperative behaviour of both parties, power imbalance between parties, lacks the possibility of interim measures, difficulty in enforcement of final outcome, to name a few.

Primary legislation dealing with alternate methods of dispute resolution: In India the primary legislations dealing with alternate methods of dispute resolution are -



Arbitration

One of the popular methods of alternate dispute resolution is arbitration. It could be understood as a method of dispute resolution involving one or more neutral third person selected by the disputing parties and whose decision is binding.[1] Thus arbitration has few defining features:

- It is a method of adjudication of disputes;
- by a neutral third person(s) selected by the parties; and
- who renders a final and binding decision

Relevant terms (Section 2)

"Arbitration" defined by the Arbitration and Conciliation Act, 1996 in section 2. According to which "arbitration" means any arbitration whether or not administered by permanent arbitral institution.

"Arbitral tribunal" means a sole arbitrator or a panel of arbitrators;

"**Arbitral award**" includes an interim award;

"International commercial arbitration" means an arbitration relating to disputes arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India and where at least one of the parties is—

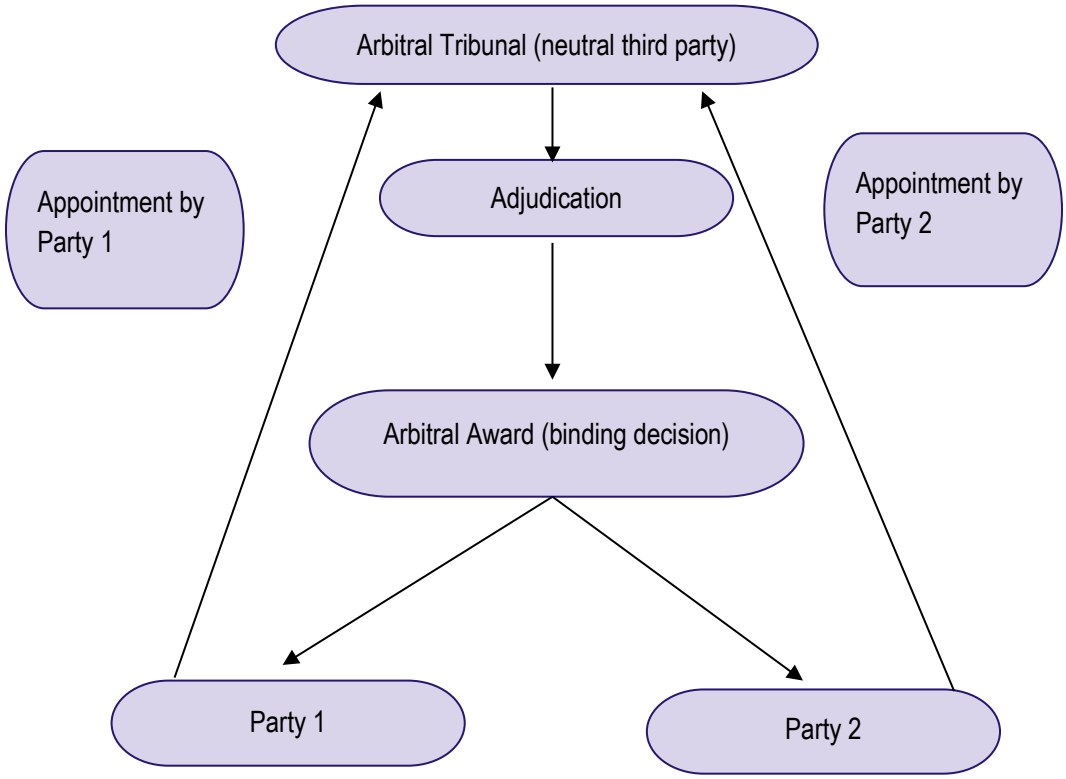
- an individual who is a national of, or habitually resident in, any country other than India; or
- a body corporate which is incorporated in any country other than India; or

[1] Black's law dictionary, 8th edition, Thomson West, 2004.

- an association or a body of individuals whose central management and control is exercised in any country other than India; or
- the Government of a foreign country;

"Party" means a party to an arbitration agreement.

Process of arbitration



Basic Features of Arbitration

(a) Arbitration agreement - no arbitration can happen without the consent of the parties. The consent is contained within an arbitration agreement. This agreement clearly specifies the desire of the parties to arbitrate their dispute. In other words they clearly note that in the event of a dispute between them they would not go to the court, instead they will proceed to arbitrate their dispute. This agreement takes the form of a binding contract.

As per section 7 of the Act, "arbitration agreement" means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract.

(b) **Arbitrator** - also known as the arbitral tribunal is similar to a judge of the court. The arbitrator decides the disputes between the parties. Just like the judge an arbitrator is also required to be completely neutral, impartial and not favour any party. Because the parties can choose the arbitrators, it inspires confidence in the arbitrators, the process and the decisions taken by the arbitrators. If however the arbitrators who are not independent then they could be removed by the court.

(c) **Seat of arbitration** - means the legal system which would supervise the arbitration to ensure that mandatory legal requirements are complied with. The courts of the seat would provide assistance through supportive measures. **For example** if India is the seat then Indian laws would apply and Indian courts would have the authority to provide supportive assistance such as issuance of interim measures, etc. It would also be the court which would hear challenges against the arbitral award.

(d) **Party autonomy and procedure** - arbitration also gives the parties the choice of applicable law especially if the arbitration is an international commercial arbitration. Additionally there is enormous flexibility to choose the type and kind of procedure that the parties want to adopt for the arbitration. These rules will deal with many things including what kind of hearing should be there for instance only written statements or oral arguments, etc.

(e) **Finality of outcome** - usually there is no appeal against an arbitral award. An arbitral award can only be set aside on very few grounds such as invalid arbitration agreement, parties' incapacity, independence and impartiality of an arbitrator, unfair procedure, etc.

(f) **Confidentiality** – an important feature of arbitration is that whatever that happens in arbitration remains private. It is only known to the parties and the arbitrators. All of them are prohibited with sharing with third parties who are not involved in arbitration, any document or information that is received during the course of arbitration. This is done to ensure that parties feel free to share all information during arbitration so that a proper solution can be arrived at.

(g) **Arbitral Awards** – an award is a decision by the arbitrator on the dispute that was submitted to it for adjudication.

(h) **Enforcement of arbitral awards** - it is much simpler to enforce an arbitral award in foreign nations than a judgment rendered by a court. Such enforcement happens under an international treaty.

Distinction between Litigation and Arbitration

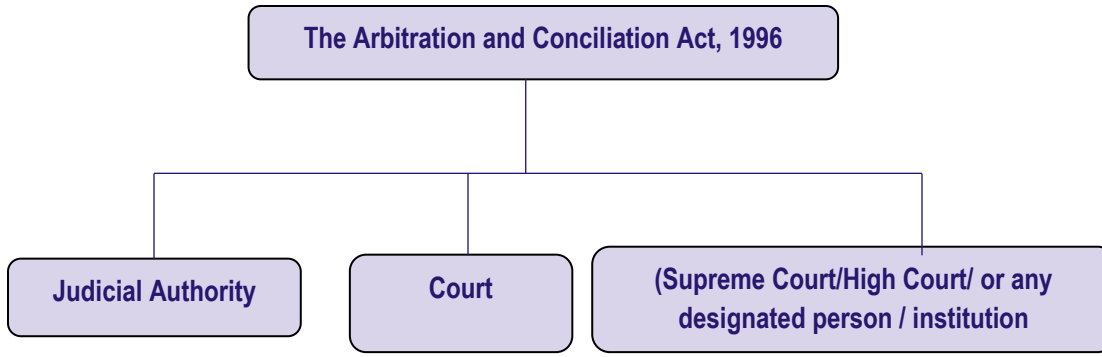
Litigation	Arbitration
Takes place in court	The place of arbitration is chosen by the parties.
A judge is assigned by the court. The litigants have no say on who will judge their disputes.	The arbitrator(s) is selected by the parties. Parties therefore are able to choose people with the appropriate expertise, educational qualifications, trade experience, etc., as arbitrators.
The procedure followed by the court is fixed and determined by the Rules of the court. In India it would be governed by the Code of Civil procedure and rules applicable to the particular court.	The parties have adequate flexibility to choose the procedures that would apply to their arbitration. They could either construct such procedures or adopt procedures of an arbitral institution.
The proceedings are generally open to public. In other words there is very little privacy and confidentiality.	Confidentiality is one of the most important characteristic of arbitration. In other words apart from the parties (including their lawyers) no other person is permitted to participate in the arbitral proceedings.
Court decisions are subject to numerous appeals.	Arbitral awards can be challenged on very limited grounds.
It is often difficult to enforce judgments of court of one country in a foreign country.	Enforcing an arbitral award in foreign nations is much easier and is governed by international treaties such as the Recognition and Enforcement of Foreign Arbitral Awards, 1958.

In India arbitration is governed by the Arbitration and Conciliation Act, 1996 (A&C Act, 1996) read with the Indian Contract Act, 1872. The two Acts together provide the legal framework governing and regulating arbitration in India. The A&C Act, 1996 is based on the UNCITRAL Model Law 1986,[2] and was recently amended vide the Arbitration and Conciliation (Amendment) Act, 2015.

Authorities under Act

Under the Arbitration and Conciliation Act 1996 there are three different authorities who are given different powers, functions, and duties to perform under the Act.

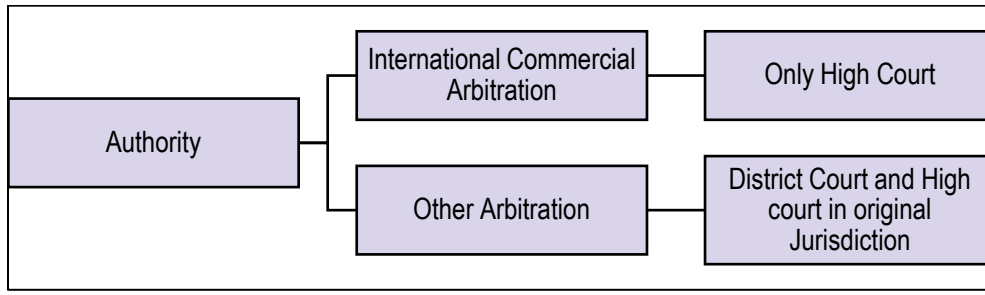
[2] UNCITRAL Model Law on International Commercial Arbitration (1985)



(a) **Judicial authority** – the term judicial authority is not defined in Act. The Supreme Court in SBP v. Patel Engineering[3] observed "A judicial authority as such is not defined in the Act. It would certainly include the court as defined in Section 2(e) of the Act and would also, in our opinion, include other courts and may even include a special tribunal like the Consumer Forum." Therefore it is a concept wider than courts as ordinarily understood and would include special tribunals and quasi judicial authorities. The functions performed would include reference to arbitration. Every court would be a judicial authority, but every judicial authority would not be a court.

(b) **Court [Section 2(1)(e)] –** There are two understandings of Court – Pre amendment and post 2015 amendment. Prior to the amendment, the term was held to be District Court and High Court exercising original jurisdiction and not other courts. This was confirmed in *Fountain Head Developers v Maria Arcangela Sequeria.*[4]

Post Amendment the understanding is now dependent on the type of arbitration – for international commercial arbitration the court would only be the High Court, and for all other arbitration it would be the District Court and High Court exercising original jurisdiction.



The Court performs many important functions. It is the primary judicial organ in respect of a particular arbitration in other words, it performs the Supervisory function as regards that arbitration. This supervisory function would include granting of interim measures, challenge to an arbitral tribunal, review of an award, and enforcement of awards, etc.

[3] (2005) 8 SCC 618 in para 19.

[4] AIR 2007 Bom 149

(c) **Supreme or High Court or any person or institution designated by such court (Section 11) –** Supreme Court and High court are entrusted with a specific task that of appointment of arbitrators upon request of a party. The Supreme Court would be the authority for appointing an arbitrator in case of international commercial arbitration, while High Court would be the authority for appointing an arbitrator in case of domestic arbitrator. The Act also authorizes any person or institution so designated by the Supreme and High Court to appoint the arbitrators.

Arbitration Agreement

Since arbitration is a private method of resolving dispute as opposed to litigation in a court system. At the heart of an arbitration lies an arbitration agreement.

Nature and Scope of Arbitration Agreement		
Definition and General Principles	**Requirement of valid arbitration agreement**	**Termination of Arbitration agreement**

Arbitration agreement: Definition and General Principles

Definition

Arbitration is a private method of dispute resolution. Under the Indian law every individual has the right to approach the court for resolution of his/her dispute that may involve infringement of right(s) vested upon that individual. This protection is so stringent that it cannot be contracted away. The Indian Contract Act, 1872 however notes an exception in favour of arbitration.[5]

Arbitration cannot happen without the parties consenting to submit their dispute to arbitration. Consent of the parties therefore is the most fundamental requirement for an arbitration to happen. The document which notes this consent is referred to as the arbitration agreement. In other words an arbitration agreement records the consent of the parties that in the event of a dispute between them that matter instead of being taken to court, will be submitted for resolution to arbitration. Arbitration agreement therefore is necessary to start arbitration.[6]

In India arbitration agreement is governed by the Arbitration and Conciliation Act, 1996 in particular sections 2(1)(b) and 7.

[5] Section 28, Indian Contract Act 1872 ''

[6] *SN Prasad, Hitek Industries (Bihar) Ltd v. Monnet Finance Ltd* (2011) 1 SC 320.

Section 2(1)(b) - In this Part, unless the context otherwise requires "arbitration agreement" means an agreement referred to in section 7.

Section 7 Arbitration Agreement -

(1) In this Part, "arbitration agreement" means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

(2) An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

(3) An arbitration agreement shall be in writing.

(4) An arbitration agreement is in writing if it is contained in –

a) a document signed by the parties;

b) An exchange of letters, telex, telegrams or other means of telecommunication including communication through electronic means which provide a record of the agreement; or

(5) The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to

The purpose of an arbitration agreement is to submit disputes to arbitration and the law defines an arbitration agreement on the basis of whether existing or future disputes would be submitted to arbitration. Thus the two basic types of arbitration agreement are:

(a) Arbitration clause - a clause contained within a principal contract. The parties undertake to submit disputes in relation to or in connection with the principal contract that may arise in future to arbitration.

(b) Submission agreement - an agreement to refer disputes that already exist to arbitration. Such an agreement is entered into after the disputes have arisen.

Example: In 2014, Company A, an automobile manufacturer entered into a joint venture agreement (JVA) with Company B the largest manufacturer of tyres for supply of all terrain tyres for its latest car. Both the companies are registered under the Companies Act 2013.

Scenario I - The JVA carries the following clause "Clause 56.1. All disputes shall be arbitrated in Mumbai." This would be an arbitration clause. It is contained in the principal contract (JVA) and no disputes have arisen till yet. It concerns future disputes that may arise.

Scenario II - The JVA does not have any clause relating to arbitration. Disputes arose between the parties concerning quality of tyres in 2016. To resolve this dispute, parties entered into an agreement

that noted "That all disputes including quality of tyres supplied by Company B to Company A shall be submitted to arbitration. The parties hereby agree to abide by the decision of the arbitrator. " Such an agreement that is made after the disputes have arisen would be called a submission agreement.

General Principles

1. **Arbitration agreement** is an agreement enforceable under the law. In other words it is a contract, and has to fulfill all requirements of a valid contract.

2. **Consent (consensus ad idem)**: parties have to clearly consent to arbitration. Words utilized by the parties should clearly indicate that all parties want to proceed to arbitration. Thus if words used are uncertain or ambiguous, then there can be no consensus ad idem, and in turn there can be no arbitration agreement.[7]

> Section 29 of the Indian Contract Act, 1872 clearly notes that 'agreements, meanings of which is not certain or capable of being made certain are void'

3. **Ouster of jurisdiction**: It is vital to understand that once the parties have agreed to arbitrate their matter, neither of the parties can unilaterally proceed to court to litigate that matter. Any party attempting to do that would be referred to arbitration, if the other party so requests.[8]

4. **Doctrine of separability**: the doctrine provides that an arbitration agreement even though contained in a contract is a separate agreement from the contract itself. In other words an arbitration agreement is an agreement independent of the main contract. It is done to ensure that the agreement to arbitrate would not be rendered invalid merely because the principal contract was invalid.[9] This is a legal fiction.

5. **Competency to rule on its jurisdiction**: The arbitral tribunal has the capacity to rule on its own jurisdiction even if involves a question of validity of the main contract. This allows the arbitral tribunal to determine the validity of the main contract without contradicting its own jurisdiction.

Requirements of a valid arbitration agreement

Requirements of an arbitration agreement can be gathered from two sources:

- statutory provisions, and
- Decided case laws.

1. **Writing** - unlike the possibility of an oral contract, arbitration agreement are required to be

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[7] *Dresser Rand SA v Bindal AgroChem Ltd* (2006) 1 SCC 751.

[8] Section 8, Arbitration and Conciliation Act, 1996.

[9] In the Arbitration and Conciliation Act, 1996, the doctrine of separability and competence-competence are noted in Section 16. The two doctrines were affirmed by the constitution bench of the Supreme Court of India in *SBP & Co v Patel Engineering Ltd* (AIR 2006 SC 450).

mandatorily in writing. There is however no requirement for the same to be in writing in one document. There is also no particular form or template for an arbitration agreement.

Example: C owns a shop in Chandni Chowk dealing in readymade clothes. D is a supplier of clothes to C. They have been doing business for many years. No separate written contract exists between them. However for each consignment D issues an individual invoice to C on the basis of which payment is made. Each invoice contains the following note "All disputes pertaining to this transaction if any will be subject to the Arbitration Rules & Regulations of Bharat Merchant Chamber". This is an arbitration agreement in writing.

Example: Vikram wants to start a Sweet and Confectionary Shop and contacts Ahuja Confectioners & Bakers for supply of cakes. The entire communication between the parties took place over email. One of the emails received by Vikram from Ahuja Bakers had, among other terms of service, the following condition "any disputes regarding quality or delivery shall be submitted to arbitration conducted under the aegis of Indian Confectionary Manufacturers Association. Please place your order if the above terms and conditions are agreeable to you." Vikram placed an order. The contract stood affirmed by reason of their conduct. This would be an arbitration agreement in writing contained in correspondence between the parties.

2. **Clarity of consent**: the intention to go to arbitration must be clear in other words there must be *consensus ad idem*. Utilization of vague words cannot be considered to be adequate. The intention has to be gathered from the wordings of the agreement. The words used should disclose a determination and obligation on the part of parties to go to arbitration and not merely contemplate the possibility of going for arbitration. If it is only a possibility then it is not an arbitration agreement.[10]

   Example: The parties had a contract with a clause "(16) that if during the continuance of the partnership or at any time afterwards any dispute touching the partnership arises between the partners, the same shall be mutually decided by the partners or shall be referred for arbitration if the parties so determine." This would not be an arbitration agreement, because of the need for parties to further agree whether or not to go for arbitration. The underlined portion clearly highlights the need for further agreement between the parties.

3. **Defined Legal relationship** - this term has been borrowed from the UNCITRAL Model Law. The statute does not define this term. The important idea here is that any dispute that arises from a legal relationship can be submitted to arbitration unless it is expressly or impliedly barred by a Statute.[11] Thus disputes concerning illegal activities cannot be submitted to arbitration.

4. **Final and binding award**: Parties to the arbitration agreement must agree that the determination of their substantive rights by a neutral third person acting as the arbitral tribunal would be final and binding upon them.

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[10] *Jagdish Chander v Ramesh Chander* (2007) 5 SCC 719.

[11] Arbitration and Conciliation Act 1996, Section 2(3) - This Part shall not affect any other Law for the time being in force by virtue of which certain disputes may not be submitted to arbitration.

Example: 'Any other questions, claim right, matter, thing, whatsoever, in any way arising out of or relating to the contract designs, drawings, specifications estimates, instructions, or orders, or those conditions or failure to execute the same whether arising during the progress of' the work, or after the completion, termination or abandonment thereof, the dispute shall, in the first place, be referred to the Chief Engineer who has jurisdiction over the work specified in the contract. The Chief Engineer shall within a period of ninety days from the date of being requested by the Contractor to do so, given written notice of his decision to the contractor. Chief Engineer's decision final.' Is this a valid arbitration agreement?

Answer: Since in the given case Chief Engineer is not a neutral party and has a Control over the work specified in the contract, so this is not a valid arbitration agreement.

5. **Specific words**: the mere use of words like 'arbitration' or 'arbitrator' in a clause will not make it an arbitration agreement. Usage of such words is not a necessary requirement.[12]

6. **Dispute**: there must be a present or a future dispute/difference in connection with some contemplated affairs that is proposed to be submitted to arbitration.

7. **Arbitrability**: the disputes submitted/ proposed to be submitted to arbitration must be arbitrable.[13] In other words that law must permit arbitration in that matter. There are certain disputes that the law retains exclusively for the court, and the same cannot be submitted for arbitration. The rationale is that given the nature of disputes, the courts are the only appropriate forum for adjudicating the matter.[14]

   For example criminal offences, matrimonial disputes, guardianship matters, testamentary matters, mortgage suit for sale of a mortgaged property, etc. cannot be arbitrated.

8. **Signature**: is only required when the arbitration agreement is contained in a contract i.e. in one set of documents. However no signature is required if the arbitration agreement is contained in correspondence or exchange of pleadings.

Arbitration agreement through reference

The Arbitration and Conciliation Act, 1996 envisages a possibility of an arbitration agreement coming into being through incorporation. In other words, parties to an agreement could agree to arbitrate by referring to another contract containing an arbitration agreement. The requirement is that the reference must leave no doubt in the mind of the reader that the parties indeed wanted to incorporate the arbitration agreement into the agreement between them.[15]

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[12]For relevant provision refer section 7(5) of the Arbitration and Conciliation Act 1996.

[13] Section 34(2)(b)(i) Arbitration and Conciliation Act 1996 - *'An arbitral award may be set aside by the Court only if (b) the Court finds that (i) the subject matter of the dispute is not capable of settlement by arbitration under the law for the time being in force.*'

[14] *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd* AIR 2011 SC 2507.

[15] Section 7(5) Arbitration and Conciliation Act 1996, and *MR Engineers & Contractors Pvt Ltd v. Som Dutt Builders Ltd* (2009) 7 SCC 696.

Example: In *Groupe Chimique Tunisien SA v. Southern Petrochemicals Industries Corpn Ltd 2006 (2) ArbLR 435 (SC)*, the respondent had placed an order of purchase of various quantities of phosphoric acid from the petitioner. The purchase order noted that the terms and conditions were to be as per the Fertilizer Association of India (FAI) Terms and Conditions for Sale and Purchase of Phosphoric Acid. Clause 15 of the terms provided for settlement of disputes by arbitration.

Is this a valid reference for an arbitration agreement to come into existence?

Answer: Yes. It was held by the Supreme Court of India that for a reference to constitute an arbitration agreement the contract should be writing and reference should be such as to make that arbitration clause a part of the contract. Both the conditions were held to be fulfilled in the present instance.

Termination of an arbitration agreement

Just the way parties can enter into an arbitration agreement, they can also terminate an arbitration agreement. Thus an arbitration agreement could be put to an end by:

1. **Mutual consent**: like any contract, the parties involved can jointly agree to put an end to a particular arbitration agreement.
2. **Termination of principal contract:** an arbitration agreement always operates in relation to a principal contract. If the principal contract is terminated through discharge or novation, the arbitration agreement terminates with the contract. However if the principal contract is breached, then the arbitration agreement survives because of the operation of the doctrine of separability.

   Example: Raj Air-Conditioning services (RACS) and Voltas Limited entered into a service agreement whereby RACS would provide annual maintenance services for all voltas commercial air conditioners in the NCR region. The contract provided that in the event of a dispute between the parties, the matter would be submitted to arbitration.

   Scenario 1: At the end of the third year, the Service Agreement was not renewed. The contract terminates, and along with it the arbitration agreement.

   Scenario 2: At the end of the second year, the two parties enter into a new contract, which replaces the existing service agreement between the parties. The new contract does not have an arbitration agreement. The arbitration agreement contained in the superseded service agreement does not survive.

   Scenario 3: Voltas raises a dispute with RACS as regards quality of services provided and terminates the agreement. Here, owing to separability doctrine, the arbitration agreement survives to allow parties to arbitrate their dispute.
3. **Death of parties**: under the Indian law, an arbitration agreement is not discharged by the death of any party. It shall be enforceable by or against the legal representatives of the deceased.[16]

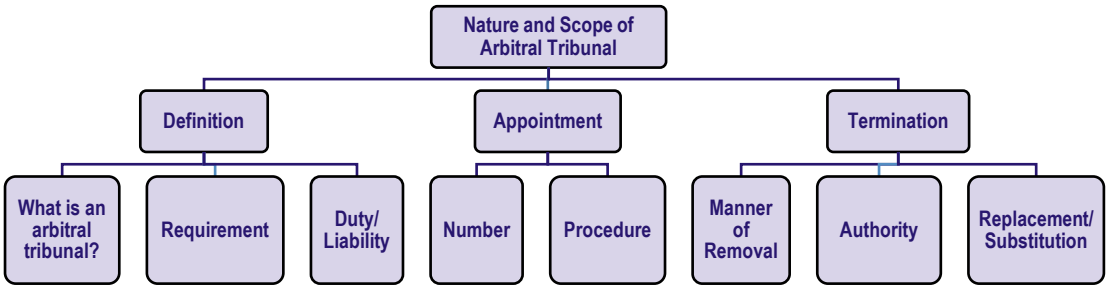
[16] Section 40, Arbitration and Conciliation Act, 1996.

As per section 2 of the Act, "legal representative" means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased, and, where a party acts in a representative character, the person on whom the estate devolves on the death of the party so acting;

4. **Operation of Law:** an arbitration agreement can be extinguished by the operation of law by virtue of which any right of action is extinguished.

3. ARBITRAL TRIBUNAL

A unique feature of arbitration is the ability to have the dispute adjudicated by a neutral, fair, unbiased and competent adjudicator.



Arbitral Tribunal

An arbitrator(s) or arbitral tribunal performs the function of a judge, in other words an arbitrator adjudicates/judges the dispute between the parties.[17] The terms arbitrator(s) or arbitral tribunal are interchangeable and refers to the same person or group of persons. Thus there could be one (sole) arbitrator or more than one arbitrator. Both would be referred to as arbitral tribunal.

A unique feature of arbitration unlike court based adjudication is that the parties get to select their arbitrators or delegate to an institution (like ICC, FICCI, ICADR, etc.) the power to appoint on their behalf. This is considered to be a key advantage as the parties can choose the person who will adjudicate their dispute as compared a court based system where they have no control over the judge. The point that an arbitrator adjudicates the matter, is important to understand. In other words, an arbitrator does not simply express an opinion based on materials given to the arbitrator. In fact that would be expert evaluation. Rather the arbitrator works like a judge, before whom the parties present their dispute, submit evidences, produce witnesses and then the arbitrator applies the law to the problem and decides in a judicial manner. Therefore even through a private adjudicator, the function is performed to standards applicable to public functionaries like judges.

[17] But this does not make the arbitral tribunal a court.

There are other important advantages to the ability of parties to choose their arbitrators. Parties have more confidence both in the arbitrators and their decisions. This is very important because unlike a court which has the ability to force parties to comply with its orders, success of arbitration depends on the cooperation of parties. Therefore the parties must trust the arbitrators to remain neutral and fair to all the parties involved in the arbitration. The quality of arbitrators would ultimately determine not only the overall quality of the arbitration process but also the outcome in the form of the arbitral awards.

In India, appointment and termination (removal) of arbitral tribunal is regulated by the Arbitration and Conciliation Act, 1996. The law prescribes various provisions for different possibilities that might arise in appointing or removal of arbitrators. The different authorities which have the power for appointment and removal are the District Court (Court), High Court and Supreme Court of India.

Who can be an arbitrator?

Any person capable of contracting, in theory can be an arbitrator. In our daily lives when we have a dispute with our family members or a neighbour, we take the dispute to an elder of the house or the society who decides the matter. The elder essentially acts as an arbitrator, and arbitrates the matter. Of course, arbitration as understood under law is a little more sophisticated than this setup, but it provides a basic idea of arbitration.

Since arbitration is a private arrangement, whereby when dispute arise it would be submitted to a private party instead of courts, the arbitrator can be anyone who is capable of contracting with the parties. Under the contract, a person agrees to act as arbitrator and adjudicate any disputes between the parties that is submitted to him by the parties.

Appointment of Arbitral Tribunal

An important principle of arbitration is the principle of party autonomy. Party autonomy means the 'freedom to choose' whether it is the procedure, the venue, the seat or the arbitrators. The parties have the right to choose the persons who would act as arbitrators in their dispute. However this right to choose is not absolute but instead is subject to certain limits that are provided under the applicable law.

There are two aspects to appointment, namely number of arbitrators, and the actual procedure of appointment.

Number of Arbitrators

The parties tend to have high level of freedom when deciding on the number of persons that can be chosen as arbitrators. There are many things that should be kept in mind at the time of appointment of arbitrators, for instance the fees of the arbitrators, complexity of the matter, time required for meetings, duration of sessions when oral arguments would be made, etc. A specific problem that arises when there is more than one arbitrator is the difficulty faced when coordinating the timings among the arbitrators. It becomes even more problematic as the number of arbitrators increase. At the same time there are advantages to having more than one arbitrator. More arbitrators results in greater discussions which can improve the quality of awards. It also brings greater expertise as arbitrators may be from different speciality and background.

Example: Party A and Party B entered into a contract for construction of apartments. The contract contained an arbitration agreement, whereby all disputes between the parties would be submitted for arbitration by an arbitral tribunal having three arbitrators. In such a situation, the arbitrators could all be from different discipline and having varying expertise. **For example** the arbitrators could be a lawyer, architect, interior designer, civil engineer, academic, government servant, etc. The parties therefore can choose almost anyone as arbitrator.

It is important to remember that even though a private process, arbitration and its outcome (arbitral award) require State support at different juncture but most importantly for enforcement. However the State will only extend its support for legal outcomes. Therefore it is important that the arbitrators are familiar with legal requirement especially under the Arbitration and Conciliation Act 1996 so as to ensure that the entire process and the outcome complies with all mandatory legal requirements.

The 1996 Act clearly provides that there can be any number of arbitrators so long as it is not even in number. In other words, parties can decide on any number of arbitrators so long as there are odd number of arbitrators. Ordinarily parties select one, but however if more than one is selected, it is usually three. The reason is obvious so that there can be a decision by majority. If there is even number of arbitrators, then there is a possibility that there might be a tie.

Example: If there are two arbitrators then it is possible that the two arbitrators may not agree, in which case there would be no decision.

Section 10, Number of arbitrators. – (1) The parties are free to determine the number of arbitrators, provided that such number shall not be an even number.

(2) Failing the determination referred to in sub-section (1), the arbitral tribunal shall consist of a sole arbitrator.

However in a rather interesting decision in *Narayan Prasad Lohia v. Nikunj Kumar Lohia*[18] the Supreme Court held that even number of arbitrators is an acceptable possibility. Among the many reasons put forward, the court observed that it was possible that the two arbitrators may not disagree, in which case there would be consensus and no disagreement. Also it was not correct to permit parties to proceed with the arbitration and raise objection only when the decision goes against them. Thus, after this decision, it seems that parties can choose 'even' number of arbitrators. However, in practice this rarely happens.

Procedure for appointment

Appointment procedure is also subject to party autonomy. In other words parties are given the freedom to make any procedure for appointing the arbitrators i.e. the parties can decide upon any procedure for choosing the arbitrators. It can be as simple as a toss of coin, or as complicated as they want.

[18] AIR 2002 SC 1139

The most common procedures are:

(a) The parties will jointly appoint.

(b) Each party will appoint one and the two arbitrators would appoint the rest.

(c) Appointment would be made by an unrelated person or institution, e.g. President of ICAI, President FICCI, etc.

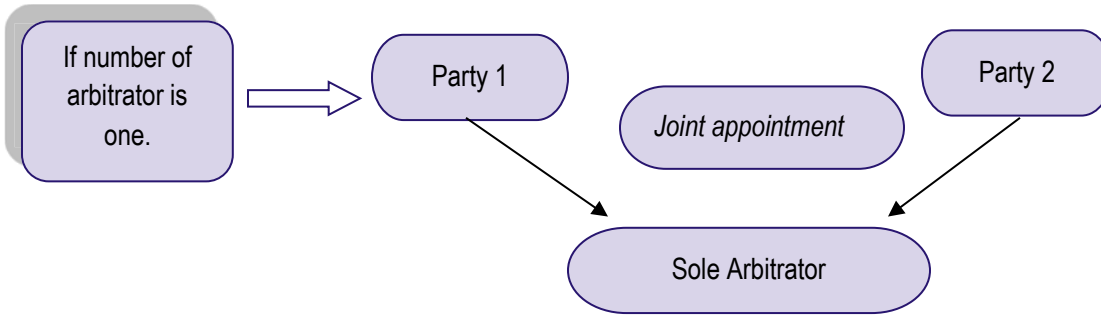
There may however be times when:

Scenario I - parties may not have decided upon an appointment procedure; or

Scenario II - parties may have decided upon a procedure and such a procedure requires further action, but a party / arbitrator / institution fails to act as required under the procedure.

To deal with both the scenarios the law, namely Section 11 of the Arbitration and Conciliation Act 1996,[19] provides alternate procedures.

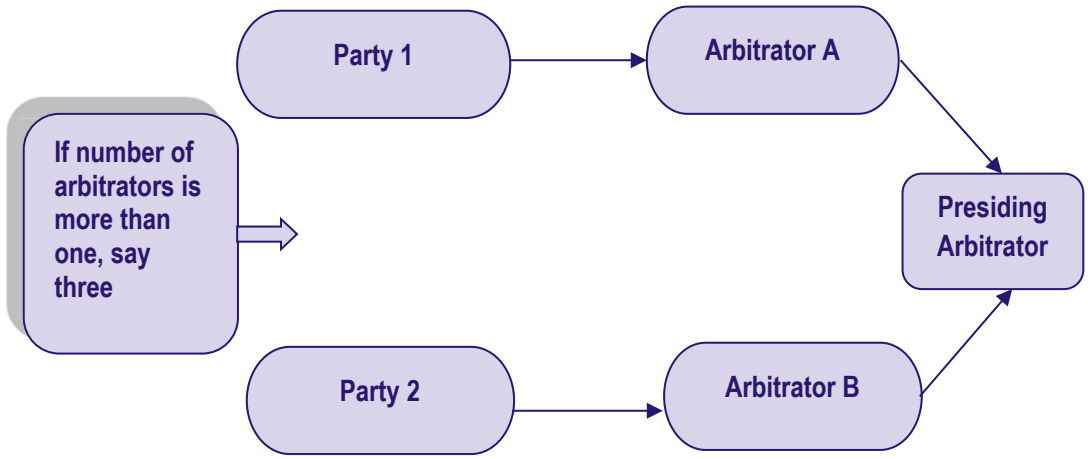
Scenario I



When an appointment is made jointly by both parties, both parties have to agree upon who the arbitrator would be. Usually one party writes to other party forwarding a list of names of potential arbitrators. If the other party approves one name from the list, then that individual would be the arbitrator. If not then the other party would propose new names to the first party. This would go on till both parties agree upon one name.

Example: When a joint appointment was required, Party 1 sent the following names to Party 2 - Sunil, Peter, Meenakshi, Iqbal, and Anil. None of them was acceptable to Party 2, which sent the following names to Party 1 –Akram, Shameek, Sebastian, Aarti, Debasish. From this list, Party 1 was agreeable for Shameek and informed Party 2. In this case Shameek would be the arbitrator and would be considered to be jointly appointed.

[19] Also important to the appointment is 'The Appointment of Arbitrators by the Chief Justice of India Scheme, 1996' vide Supreme Court of India Notification dated 29th January 1996, published in the Gazette of India, Extra., Pt III, Sec.1, dated 16th May 1996.



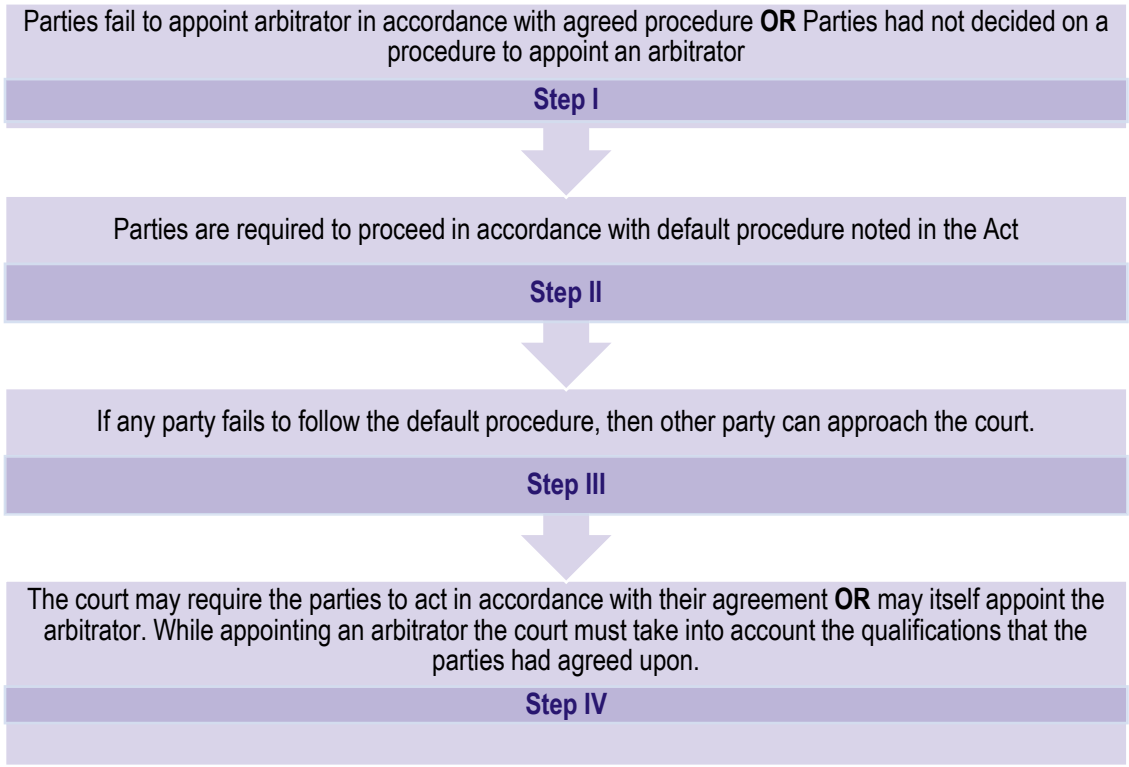
Example: When three arbitrators were to be appointed, Party 1 selected Sunil as their arbitrator, while Party 2 selected Iqbal as their arbitrator. The two arbitrators then jointly discussed the following names Shameek, Peter and Meenakshi out of which they selected Meenakshi as the third (presiding) arbitrator. Similarly where 5 arbitrators are to be appointed, every party will appoint two arbitrators and the four arbitrators will together appoint the presiding arbitrator.

Scenario II

There is also the possibility that although the parties had selected a procedure to appoint an arbitrator, a party, person or institution may not do what is required of them under the procedure. **For example** if according to the agreed procedure the appointment of the arbitrator(s) was to be made by the ICADR (The International Centre for Alternative Dispute Resolution) president, but such an appointment was not made, such a situation would fall under scenario II.

In such situations the parties would have to approach the authorities designated under the Arbitration and Conciliation Act 1996 for appointment of arbitrators. The designated authority is either the Supreme Court of India (for international commercial arbitration) or the High Court (for domestic arbitration). The law prescribes a detailed procedure for appointment of arbitrators, but what is important is that even when the court steps in it firstly requires parties to take action, and if that does not happen, only in the last instance it does step in to appoint arbitrators. A constitutional bench of the Supreme Court of India in *SBP & Co. v. Patel Engineering Ltd.*,[20] had observed that once the appointment had been made by the appointing authority, it could not be challenged before the arbitral tribunal or any other court.

[20] AIR 2006 SC 450. It is important to note that this case was rendered before the 2015 amendment to the Arbitration and Conciliation Act 1996. The appointing authority then were the Chief Justice (or Designate) of the Supreme Court of India for International Commercial Arbitration, and High Court for domestic arbitration.



Requirements of an arbitral tribunal

An arbitrator has to meet the following requirements:

(a) **The arbitrator could be of any nationality** – the arbitrator could be of any nationality. There is no requirement that the arbitrator should be of the nationality of one of the parties. This is relevant in international commercial arbitration, when the parties are from different countries. In such a situation an arbitrator who belongs to the nationality of one of the parties may be considered as biased. At the same time merely because the arbitrator is of the nationality of one of the parties, it would not automatically amount to presence of bias.

(b) **Capable of contracting** – The arbitrator should be capable of contracting. This is because arbitration is a private arrangement and requires consent of all involved i.e. parties and arbitrators. There is a contractual relation between the arbitrator and the parties, whereby the arbitrator renders a service of adjudication to parties for remuneration. Therefore all requirements of a contract as noted in the Indian Contract Act 1872 required to be fulfilled.

(c) **Lack of Bias** - An arbitrator should remain neutral, unbiased and should not favour any party in arbitration. In other words an arbitral tribunal should not be biased instead should remain at all times remain independent and impartial.

Section 12: Grounds for challenge. – (1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing any circumstances-

a. such as existence either direct or indirect of any past or present relationship with or interest in any of the parties or in relation to the subject matter in dispute, whether financial, business, professional or other kind, which is likely to give rise to justifiable doubts as to his independence or impartiality; and

b. which are likely to affect his ability to devote sufficient time to the arbitration and in particular his ability to complete the entire arbitration within a period of twelve months

Bias could take many forms, pecuniary bias, personal bias, bias as to subject matter, policy bias, etc. The Supreme Court of India in *Ranjit Thakur v. Union of India,*[21] held that the test of bias is whether a reasonable person, in possession of relevant information, would have thought that bias was likely and the matter was likely to be disposed in a particular way.

Independence – is presence of certain relationship between the arbitrator and a party such as previous employment, creditor, etc.

Impartiality – is the state of mind of the arbitrator i.e. by his / her behaviour the arbitrator gives an impression that they are favouring one party over the other. It can be understood as a pre-conceived notion to decide a case or an issue in a particular manner.

Example: Anil, who is a Chartered Accountant with his own independent practice, is the arbitrator in an arbitration between Tata Tea Inc., and Suzuki Ltd.

Situation I - Prior to starting his practice, Anil had worked for five years with Tata Tea Inc. In this situation the law would deem Anil to be lacking independence.

Situation II – During the proceedings before the arbitral tribunal, Anil would allow Tata Tea to take many liberties, for instance taking as much time for making oral arguments, cross examining the witnesses, for submitting documents, etc. Also the proceedings were adjourned (postponed) whenever so requested by Tata Tea. When Suzuki Motors wanted to take extra time they were not allowed. In few instances when they were permitted, they are asked to pay heavy cost to Tata Tea for delaying the proceedings. This would be a case where the arbitral tribunal clearly favours and is partial towards Tata Tea, and therefore lacks impartiality.

This requirement of previous employment does not operate in equal measure when the party involved is the Government. In such instances there is no automatic doubt where the arbitrator is a government employee and one of the party to the arbitration is the State.

[21] (1987) 4 SCC 611

At the end, it must be understood that even though there might be previous connection between the arbitrator and one of the parties, or the persons previous behaviour might have raised doubts as to their impartiality, it does not prevent parties from appointing that person as the arbitrator. In other words, parties have full autonomy to waive any of the objectionable grounds and make the appointment. However, once appointed the party that made/agreed to the appointment cannot raise a challenge on that very same ground, but they can raise a challenge on a new ground.

Example: Party A knew that Vikas had been an employee of Party B, yet goes ahead and appoints or agrees to the appointment of Vikas as arbitrator. Party A cannot later challenge Vikas on the ground that he had been an employee of Party B. It can however challenge him on other grounds, which had not been disclosed by Vikas.

This is so because the parties have all right to choose their arbitrator and the right to waive concerns. The law requires that all objectionable issues be brought to the notice of parties so that they can make an informed choice. Once such a choice has been made, the law respects and enforces that.

Some instances which would give rise to doubts as to presence of bias:

- arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party,
- the arbitrator currently represents the lawyer or law firm acting as counsel for one of the parties
- the arbitrator has given legal advice or provided an expert opinion on the dispute to a party or an affiliate of one of the parties
- a close family member of the arbitrator has a significant financial interest in one of the parties or an affiliate of one of the parties
- the arbitrator is a legal representative of an entity that is a party in the arbitration
- the arbitrator has a significant financial interest in one of the parties or the outcome of the case
- the arbitrator has previous involvement in the case

Duties and liabilities of arbitrator

An arbitrator once appointed is subject to certain duties. These duties emerge from combined reading of statute law and case laws.

a. **Conduct the arbitral proceedings without delay** – it is necessary that the arbitrator conducts the proceeding as expeditiously as possible. One of the advantages of arbitration is that there is a dedicated arbitrator to decide the matter. Longer proceedings would mean more cost to parties and delay in resolution. This does not mean that arbitrator should conduct the proceedings arbitrarily just to finish faster. He has to ensure that all legal requirements are met, and unnecessary delay is avoided.

b. **Remain at all times impartial i.e. treat both parties equally** – as noted above this is a crucial requirement. Impartiality maintains the sanctity and integrity of the process and the outcome. A biased outcome is no outcome, and would not be acceptable under law **(Section 18)**.

c. **Keep all matters concerning arbitration confidential** – a highlight of arbitration is that whatever happens in arbitration remains in arbitration. Confidentiality allows the parties to fully explore all aspects of the dispute so as to arrive at a more acceptable solution. This requirement of confidentiality extends to all including the arbitral tribunal, who is under a duty to not divulge any information that comes to their knowledge during the process the arbitration.

d. **Deliberation** – Arbitral tribunal should properly discuss all issues before issuing a decision or award. The award should be a reasoned award (Section 31). In other words, the arbitrators should discuss the matter with each other thoroughly and through a majority render the award. (Section 29)

e. **Avoid unilateral communication with one party** – This is necessary to ensure that no allegation of bias can be made against the arbitrator.

f. **Ensure all documents and communication received from one party is communicated to the other party** – the arbitral tribunal should ensure that all parties have copies of all communication and documents received from any party. This will ensure that all parties have the maximum opportunity to present its case.

g. **Ensure that the award and all other decisions comply with legal requirements** – unless the award complies with all the legal requirements the award would not be enforced. This would render the entire process futile.

h. **Ensure that he/she himself at all times comply with legal requirements associated with arbitrator** – This is of utmost importance, since non-compliance would mean that continuance of a person as arbitrator is liable to be challenged. One such requirement is that of duty to disclose grounds which may lead to an apprehension of bias.

Termination, Removal and substitution of arbitral tribunal

There is a possibility that the arbitrator that has been chosen by the parties or appointment made by the court may for different reasons become unsuitable. In such instances an arbitrator has to be removed and replaced by another arbitrator. There are clear processes for doing so. Removal of arbitrator may come about **in four instances**-

a. **When the arbitrator leaves voluntarily**

It is possible that the arbitrator for reasons which he may or may not disclose to the parties, decides to no longer act as the arbitrator. It is important to remember that being a private consent based arrangement an individual cannot be forced against their will to act or continue acting as an arbitrator.

b. When all parties involved in the arbitration agree that the arbitrator should be removed

At times all the parties involved may decide to no longer continue with a particular arbitrator. This could be for many reasons including that the parties realise that the arbitrator does not have the particular expertise they had desired. **For example** a person was appointed as arbitrator for his expertise as a civil engineer. However the parties during the arbitration found out that his experience was inadequate in construction projects involving large dams. The parties could through a unanimous decision, decide to have another person as arbitrator.

c. Operation of law

- **Arbitrator unable to continue -** assume for an instance where the arbitrator falls ill and is unable to, for a very long period of time, conduct any proceedings. Similarly there could be other issues, the arbitrator became busy with other matters, his own business or simply lost interest in the matter. These are factual inability. There may also be a possibility that law no longer permits the person to remain as an arbitrator. If any of the above happens, it would lead to long delays in arbitration which in turn would increase the expenses related to arbitration. Therefore in such situations, the law steps in and automatically terminates the arbitrators. If confusion remains as to whether arbitrator has indeed been terminated, then any party could proceed to the court which finally decides on the question of termination **(Section 14)**.

- **When the arbitration process ends.**

  The mandate of the arbitrator ends when the arbitration process ends. The process can end in multiple ways, for instance when final award has been made **(Section 32),** failure to make the award within 12 **months (Section 29A)** or when the parties decide to no longer continue with arbitration **(Section 25).**

d. When the court decides that the arbitrator should be removed.

In addition to all of the above, there may be a possibility, where none of the above is present **for example** the arbitrator is working without delay, parties are satisfied with their performance, etc., but still a party feels that the arbitrator should not continue, then it could, for reasons of bias approach the court to remove the arbitrator **(Sections 12 and 13).**

Before whom is the challenge to be raised?

It must be clearly understood that the first challenge must be raised before the arbitral tribunal itself. Only after that could the challenge be raised in front of the District Court (for domestic arbitration) and High Court (for international commercial arbitration). This is a very similar setup when compared to judiciary, where challenge against the judge is in the first instance heard by the judge himself and later by a higher court.

Once an arbitrator has been terminated, then what?

In such instances the law provides that a new arbitrator could be appointed keeping in mind the original method of appointment. If however that fails, then the parties are free to approach the Supreme Court of India (in international commercial arbitration) or High Court (for domestic arbitration) for appointment.

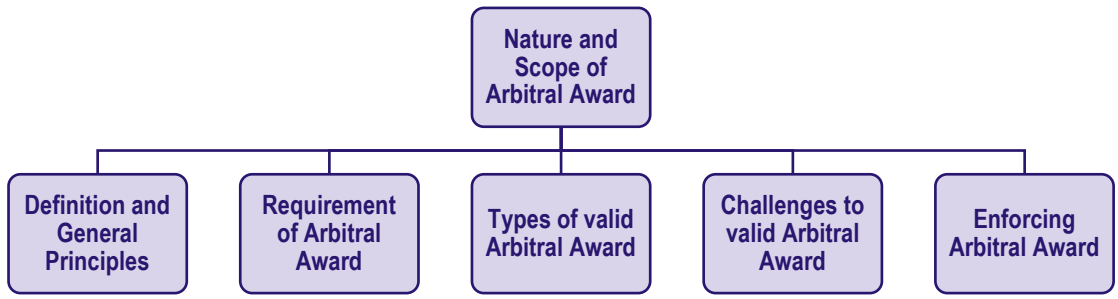
Example: Rahul was member of a three person arbitral tribunal to adjudicate a dispute between Dell Inc., Microsoft and Intel Corporation. Rahul was appointed by Microsoft. He had on an earlier occasion been associated as a software consultant with Microsoft. When the arbitration proceedings were ongoing on two occasions Rahul privately met with Microsoft lawyers and failed to inform either the other arbitrators or parties about the meeting or the contents of the meeting. It was also observed that Rahul adopted an unduly harsh attitude towards representatives of Dell and Intel, all the while remaining extremely friendly with Microsoft representatives and lawyers.

Here in this case, Rahul can be challenged on grounds of bias. His previous association and actions during the proceedings clearly point to his tendency to favour Microsoft above other parties.

Assume that Rahul was removed. A new arbitrator had to be appointed. In such a situation the original method, i.e. Microsoft making the appointment, would apply again. If however Microsoft fails to make an appointment, the other parties can approach the court to fill the vacancy.

4. ARBITRAL AWARD

An award is a conclusive determination as to the questions, issues or disputes that are put forward before the arbitral tribunal. The arbitral tribunal is constituted to hear the complete dispute between the parties, give reasonable opportunity to all parties to present their case and then based on the evidence submitted and applicable law deliver a final decision on the matter.



Definition

An arbitral award is similar to a judgment given by a court of law. In other words, an arbitral award is given by the arbitral tribunal as a decision on various issues in a matter which the parties had placed before the arbitral tribunal. The Arbitration and Conciliation Act 1996, does not clearly define

the idea of an arbitral award.[22] However the concept of an award could also be understood as a final determination of a particular issue or claim that had been submitted for arbitration. It represents a resolution of dispute between the parties.

General Principles

(a) **Who can challenge** – only a party to the arbitration agreement can challenge an arbitral award. A person who is not a party to the arbitration cannot raise a challenge against an arbitral award.

(b) **Authority** – an award can only be challenged before a court, which would include a district court and a High Court exercising original jurisdiction (for awards from domestic arbitration) and High Court (for awards from international commercial arbitration).

(c) **Timeline** – timeline refers to by when a challenge against arbitral award can be raised. The law notes an initial time period of three months from when the award is received by party, with a maximum extension of thirty more days by the court. In *Consolidated Engineering Enterprises v Principal Secretary (Irrigation Department)* 2008 (7) SCC 169.

Example: The award was rendered on 1st January 2017. Therefore, the award can be challenged by 31st March. This date could be extended by another 30 days on application to the court i.e. till 30th April 2017. There can be no further extensions.

(d) **Automatic stay** –According to the Act, there is no automatic stay on the enforcement. A party has to specifically request for a stay, and the court at the time of granting stay can impose conditions. (Section 36(2)&(3))

Types of arbitral award

Under the law there four types of award, namely:

Final Award – an award that is made in accordance with the requirements of the law (including signature, reason and delivery), and finally adjudicates on the issues submitted to arbitration, would be a final award.

Interim Award – there can be two types of interim awards, one which remains in force till the final award is rendered, and another is final as regards the matters it deals with. The latter is referred to as interim, because when it was rendered there were still other pending issues.

[22] Section 2(1)(c) - 'arbitral award' includes an interim award.

Settlement Award – during the arbitration process, the parties may choose to settle the matter instead of having it adjudicated by the arbitrator. In such a situation the arbitrator could assist the parties in arriving at the settlement. If a settlement is arrived at, and the arbitrator has no objection with it, then terms of the settlement could be made part of an award. This is referred to as a settlement award. **(Section 30)**

Additional Award – when a final award has been rendered, but it is later found out that certain claims that had been submitted to the arbitral tribunal were not resolved/adjudicated, the parties can request the arbitral tribunal to make an additional award covering the issues that had been left out. Such as request must be made within 30 days from the date of receipt of the final award. **[Section 33(4)]**

Example: Nagpur Metro Rail Corporation (NMRC) entered into a long term concession agreement with Nagpur Airport Metro Express Private Limited (NAMEPL) a subsidiary of Reliance Infrastructure to develop and operate the airport express metro project which included brining in rolling stock. NAMEPL was to run the metro services for 30 years. This agreement was entered into in 2008 and was terminated in 2012. The main disagreements were – (a) failure to fix civil structure defects, b) misrepresentation as to viability of the project including expected passenger, c) failure to transfer outstanding amounts, and d) failure to acquire land hampering development of further lines. All these according to NAMEPL led to delays in turn contributing to cost escalations. The matter was submitted to a three member arbitral tribunal for adjudication.

Scenario I – The arbitral tribunal gives an award dealing with all the four disagreements. It is one comprehensive award with reasons for all conclusions. This would be a final award as it conclusively deals with all the questions submitted to arbitration. There is nothing further left to be adjudicated.

Scenario II – The arbitral tribunal renders an award (Award no.1) which deals only with disagreements (a), (b) and (c). The arbitrators inform the parties that they will render another award dealing with disagreement (d). Award no.1 is an interim award.

Scenario III – The arbitral tribunal gave an award and informed the parties that this was the final award. However when the parties examined it they realised that the award only dealt with disagreement (a), (c) and (d). They bring it to the notice of the arbitral tribunal which gives another award dealing with disagreement (b). This latter award is an additional award.

Scenario IV – While the arbitral proceedings were going on the lawyers of both parties met for long discussions. They later informed the arbitral tribunal that the parties had settled the matter on all disagreements. They submitted the settlement agreement to the arbitral tribunal with the request that it be incorporated into an arbitral award. The arbitral tribunal after scrutinizing the agreement gave an award in which they included all the terms of the agreement. This would be a settlement award.

Requirements of an arbitral award

The Arbitration and Conciliation Act, 1996 prescribes certain requirements for an arbitral award. They can be categorized as necessary which means that the failure to adhere to these requirement would affect the validity of the award, and others which means failure to adhere to other requirements would have no affect on the validity of the award.

The necessary requirements are:

(a) **Must be a decision by the majority** – all decisions, including an award, must be made through majority. An award must also be complete concerning all issues that are submitted to the arbitral tribunal for adjudication.

(b) **Must be made in writing**, **signed and dated** – Section 31(1)(a) requires an award to be in writing and having the signature of majority of the members of the arbitral tribunal. It is not an award unless these two conditions are fulfilled. It is quite possible that a particular arbitrator may not agree with the contents of the award. Therefore the law only requires majority of the arbitrators to sign. The law however requires the award to note why the signature of an arbitrator was missing. Of equal importance is the date of the award which helps determining various timelines, for instance within how much time can an award be challenged before the court, etc.

(c) **Must be reasoned** – a mandatory requirement for an award is that it should be reasoned. Failure to state reasons would make the award invalid. The arbitral tribunal is required to reach a decision; it also has to show why it reached a particular decision. Presence of reason would show that the arbitrator had applied their minds to the matter, taken into consideration all materials put before them and only then arrived at a decision. In other words, the decision would not be an arbitrary decision. The only exception is when the parties have agreed that no reasons need be given for the award.

(d) **Must not be vague** – the arbitral award should be both certain and clearly note which party has to do what. In other words it must be clear about decision on each issue, what liabilities each party has and finally what relief has been awarded to parties. In other words it should not seem like a recommendation, must not be tentative, and must not leave a party with an option to either perform what is required or not. Vagueness should be avoided at all cost. Thus there should not be any doubt as to the content of the award.

Example: The award notes - "The Arbitral Tribunal finds that Sunil was required to deliver the goods to Anil at the rates which had been fixed in 2015 and not 2016. Owing to refusal to provide goods at the agreed rates, Anil was forced to find a different supplier. Anil, as a consequence suffered losses to the tune of 2 crores. Sunil's actions were clearly in violation of the agreement between them." It added the following lines:

Scenario I – Sunil should compensate Anil.

Scenario II - Sunil should pay Anil 2 crores, in two instalments.

Scenario III – Sunil should pay Anil 2 crores, within 2 weeks from the date of the award along with 10% interest. Failure to do so will attract additional 2% per day interest on the outstanding amount till the amount is finally paid. Payment should be done either through RTGS or through a demand draft.

In this instance only Scenario III is clear enough. Even Scenario II though seemingly clear, does not clearly specify by when it should be paid. Every award should clearly specify all these details.

(e) **Should be capable of being performed** – the award should be capable of being performed. The award must be realistic in what it suggests, and should not ask parties to do something that is not possible or illegal. An unenforceable award would be set aside.

(f) **Must not be illegal (against public policy)** - Under the law a particular award that is in violation of the public policy would be set aside. Public policy represents some of the most cherished and important principles and policies of the State. An award would be in violation of public policy if it is contrary to substantive provisions of law,

Other requirements:

Delivery – an award is ready to be delivered as soon as it is signed. An award that is signed should be delivered to the parties.

Challenging an Award

An arbitral award can be challenged on specific grounds only. These grounds are clearly noted in law. It is important to remember that a review is different from an appeal. In an appeal both questions relating to law and fact can be raised. However review can happen only on specific grounds and is not the same as an appeal. The grounds are noted under three different provisions of law:

A. under Section 13 – challenge of bias against the arbitral tribunal

The parties can challenge an arbitral tribunal on the ground that the arbitral tribunal is favouring or is biased in favour of one of the parties. Such a challenge should be first raised before the arbitral tribunal under Section 13. If the challenge is not accepted by the arbitral tribunal then the award rendered by that arbitral tribunal can be challenged.

B. under Section 16 – overstepping of jurisdiction by the arbitral tribunal

If during the arbitral tribunal one of the parties challenges the arbitral tribunal stating that the arbitral tribunal does not jurisdiction. The arbitral tribunal will decide on this challenge. If however the arbitral tribunal does not agree with the parties, the arbitral tribunal will render the award. That award can later be challenged by the parties for review.

C. under Section 34 – specific grounds for reviewing an award

There are seven grounds which can be divided into two categories – those that have to be specifically raised by a party and those which the court can look at its own motion.

The first set of grounds includes:

a. **Party is under some incapacity** – such an incapacity can be both contractual and personal incapacity, **example** that one of the party was a minor.

b. **Invalid arbitration agreement** – if the arbitration agreement is invalid then there can be no arbitration. This is because arbitration agreement forms the basis for any arbitration as it contain the consent of the parties that in the event there is dispute between them, the parties would not go to the court instead would submit it to arbitration.

c. **Party is not given proper notice about appointment of arbitrator or arbitral proceedings** – notice is crucial because it informs the parties as to the nature of the proceedings, and what is expected of each party. **For example** if the party is required to answer all allegations against it, then it should know that by the next date of hearing it is required to submit its response. Failure to provide adequate notice will have an adverse impact on the parties' ability to present its case.

d. **The award deals with disputes not submitted to arbitration** – it is possible that the parties do not submit all questions that is in dispute between them to arbitration. The arbitral tribunal derives its authority from the agreement between the parties. So if the parties have not agreed, an arbitral tribunal does not have any authority to adjudicate a particular dispute between the parties.

e. **Arbitral tribunal or procedure was not in accordance with necessary requirements under the law** – the law prescribes certain basic minimum requirements that all dispute resolution procedures must adhere to. One of the **simplest example** would be to treat both parties equally. An award that does adhere to such minimum requirement would be set aside.

Second set of grounds which the court can look at its own motion, includes:

(a) the subject matter of the dispute is not capable of settlement by arbitration (arbitrability).

(b) the award is in contravention of the public policy of India.

Consequence of challenge

There are four major outcomes when an award is challenged before the court.

(a) **Set aside** – the court reviewing the award could set aside an award on grounds noted above. Once an award has been set aside that award has no legal consequence. It is no longer an award and has no legal sanctity. It is nothing more than a document and has no legal value.

(b) **Confirm** – the reviewing court also confirm the complete award. Confirming an award means that the court is of the opinion that there is nothing legally wrong with the award i.e. it fulfils all the requirements noted in law.

(c) **Modify –** the court the power to modify the award so that it may not be set aside.

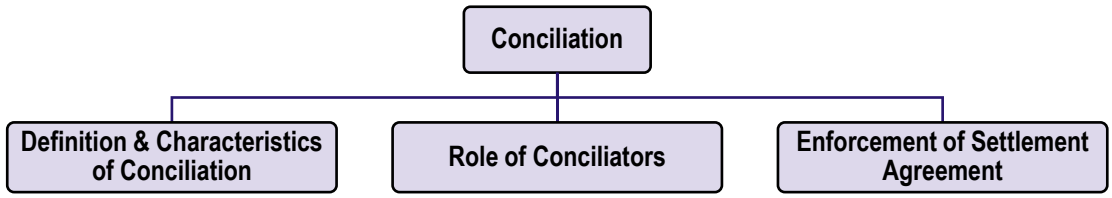
(d) **Remit back to the arbitral tribunal -** the court may instead of setting aside the award, send the matter back to the arbitral tribunal to rectify some defect, which if not corrected would lead to setting aside of the award.

Enforcement

Where the time for making an application to set aside an award has expired, or when such application was made but it was rejected then the award can be enforced. Enforcement of an arbitral award shall happen under the Code of Civil Procedure 1908 in the same manner as if it were a decree of the court.. The award can be put for enforcement right after it has been rendered without waiting for challenge proceedings to conclude.

5. CONCILIATION

Arbitration is one of the many ADR methods utilised to resolve dispute outside of the court system. However Arbitration remains adversarial in nature. It mimics the court system, and therefore like a court adjudicates a matter. This however means that the parties remain as adversaries, with one party having won and the other losing the contest. This win-loss creates a feeling of bitterness, and often tends to destroy relations. In order to avoid these consequences of arbitration, other methods of ADR are adopted.



Definition

There is no single definition of Conciliation. It is an alternative method of dispute resolution. It can be understood as a process of getting the parties to come to an agreement about a common problem / dispute through confidential discussion and dialogue. In its operation it is very similar to mediation and like mediation it is voluntary, flexible and completely at parties initiative.

Characteristics

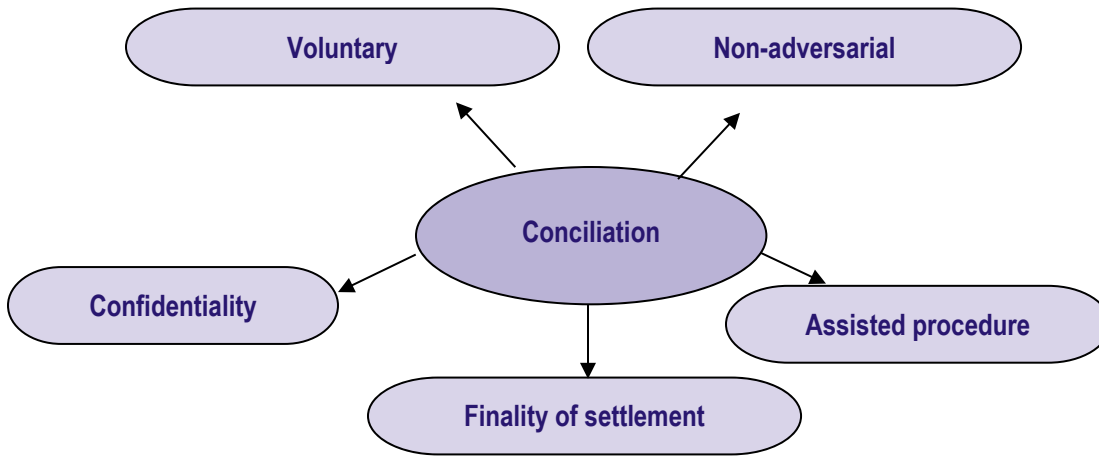
(a) **Voluntary** – the process of conciliation is voluntary which implies that all parties have to agree to have their disputes conciliated. Unless all the parties involved in the dispute agree, the matter cannot be conciliated. No party can be forced to conciliate matter or attend conciliation proceedings. If a party is forced, then the outcome of such conciliation would not be binding on that party. Thus party autonomy and consent are an important aspect of conciliation. This was also held by the Supreme Court of India in the case of *Afcons Infrastructure Ltd. v. Cherian Varkey Construction Co. (P) Ltd.*, JT 2010 (7) SC 616

(b) **Non Adversarial** – unlike arbitration or court based adjudication the parties don't compete against each other to prove themselves as correct and others as wrong. Parties don't behave as adversaries, who can only win by defeating the other party. Instead of focusing on win-lose, the attempt is to find a solution to the problem that best suits all the parties involved, in such a manner that no party is made worse off.

(c) **Assisted procedure** – the conciliation proceedings can be crafted in a manner which most suits the parties' convenience. At all times to assist the parties in arriving at a solution the conciliator(s) are present. They, along with the parties, craft a procedure for sharing of information among the parties so as to reach an amicable settlement.

(d) **Finality of settlement** – the outcome i.e. settlement as an end result of the conciliation process is final and binding between the parties.

(e) **Confidentiality** – all aspects of the conciliation process are confidential. In other words, the conciliator(s) and the parties cannot disclose to persons not party to conciliation, any matter relating to the conciliation proceedings. Thus confidentiality primarily operates to cover the process and its participants. It prevents leak of information. However within the process information received by the conciliator from one party must be disclosed to the other party, unless the party giving the information has specifically requested that it be kept confidential. Even the agreement arrived at by the parties is covered under the broad spectrum of confidentiality. This is important because it assures the parties that any information they share would remain private and would not be used against them in an adversarial process.



Conciliation in India

In India conciliation is governed by the Arbitration and Conciliation Act, 1996 and by Section 89 of the Code of Civil Procedure 1908. Any dispute arising out of a legal relationship, whether contractual or not, can be conciliated. Thus only those disputes which are not prohibited by law from being conciliated can be submitted to conciliation. The law provides for number of conciliators, and provides for a process using which conciliation would be conducted.

a. **Number of Conciliator –** the number of conciliators depends upon the parties, but with a maximum of three conciliators. In other words, number of conciliators can range from one to three**. (Section 63)**

b. **Appointment of Conciliators –** conciliator appointments are subject to party consent, in other words, the conciliators are appointed by the parties. The law also permits parties to request an institution or some other person to recommend a conciliator. This allows parties to approach institutions that provide professional conciliation services, such as the ICADR. While appointment it must be ensured that independent and impartial conciliators are selected. **(Section 64)**

c. **Procedure of Conciliation** – once the conciliators have been appointed both parties are required to submit their statements in writing, supply documents and other evidence to the conciliator. The conciliator then provides a copy of the statements, documents and other evidence of one party to the other party. The conciliator is then required to encourage and assist parties to engage in discussions based on the information to arrive at a settlement. **(Section 65)**

d. **Bar on judicial or arbitral proceedings -** when the conciliation proceedings are ongoing parties cannot start arbitration proceedings or approach a court regarding the same dispute which is part of conciliation proceedings. The exception to this rule is that when it concerns preserving its right, the party can approach a court or initiate arbitration. **(Section 77)**

Example: Prakash and Rumi are business partners. Their partnership firm (Fruits & Flowers) are dealers in fresh fruits and exotic flowers. Their clientele include various high end hotels, marriage venues and other institutions in and around Delhi. They have standing orders from many for daily supply of flowers, both exotic and otherwise. One of their regular clients is Orion Decorators in Gurgaon, which specialises in flower decorations. Over the years it has built a name for itself in the business of flower decorations at marriage venues. Fruits & Flowers and Orion Decorators have had business dealings for many years.

In 2016 Fruits & Flowers was sold by Prakash and Rumi to Sanjay. One of the first things that Sanjay did after taking over was to drastically increase price for exotic flowers. One of the clients that was most hit was Orion Decorators, because they had already taken several orders based on previous pricings of Fruits & Flowers. The increased pricing meant that Orion Decorators would incur substantial loss. Being the peak of marriage season, Orion Decorators requested Fruits & Flowers to honour their long standing business relation and provide flowers at earlier prices. Sanjay refused outright but agreed to have the matter conciliated. The conciliation proceedings started next day. Sanjay however refused to provide flowers unless the higher rate was paid.

In this scenario what could Orion Decorators have done to ensure they continued to receive exotic flowers required by them to fulfil their orders?

Under Section 77 of the Arbitration and Conciliation Act 1996, even though approach to court is prohibited during the conciliation proceedings, as an exception a party could approach the court to

protect its rights. Orion Decorators could approach the court for interim measures, whereby till the conclusion of conciliation proceedings it could request the court to direct Sanjay to continue providing flowers at the lower rate. The court would have the power to grant the requested measure of protection on such conditions as it deems appropriate.

Conciliation *versus* Mediation

Even though mediation and conciliation have fundamentally the same philosophy and similar processes there are subtle differences between the two, namely:

Mediation	Conciliation
Mediator plays a facilitative role and attempts to guide the parties towards a solution. Thus the solution should come from the parties themselves.	The Conciliator plays a more proactive role. He acts a facilitator, evaluator and intervener. In other words, he can also along with the parties suggest solutions.
The outcome is an agreement between the parties.	The outcome is a settlement agreement.
The agreement reached by the parties is a contract enforceable by law.	The settlement agreement reached between the parties has the same status as an arbitral award on agreed terms. In other words it is executable as a decree of the civil court.
Mediation is governed by Section 89 of the Code of Civil Procedure, 1908.	Conciliation is governed by Part III of the Arbitration and Conciliation Act, 1996.
Mediation is governed by confidentiality. However confidentiality in mediation is often based on trust.	Conciliation is bound by confidentially. Extent of confidentiality is defined by the law. Breach of confidentially could be fatal to the entire process.
If the agreement is breached, the parties would have to proceed in the usual process adopted for breach of contract.	The settlement agreement is enforced as an arbitral award. Breach of the settlement agreement, would be the same as breach of an arbitral award. The Arbitration and Conciliation Act 1996 provides mechanisms for enforcing arbitral award and recourse in instances the award is not followed.

The Supreme Court of India in *Salem Advocate Bar Association v. UOI* AIR 2005 SC 3353 held that conciliation is a bigger concept than mediation, and the conciliator plays a much greater and more involved role than a mediator.

Settlement Agreement

a. **Initial steps -** attempt of conciliation is to resolve the dispute and arrive at a settlement. This settlement could be based on suggestions made by the Conciliator(s) **[Section 67(4)]**, or the parties **[Section 72].** When it appears to the conciliator that a settlement is possible, he should identify possible terms of settlement and submit them to the parties for their observations and suggestions. The parties may also make suggestions as to contents of the agreement.

b. **Agreement** – if the parties reach a settlement, then it has to be written down as an agreement. This agreement is known as settlement agreement (at times it is also referred to as Memorandum of Conciliation). It can be made by the parties or by the Conciliator on behalf of the parties. However the conciliator is required to authenticate the agreement without which the agreement would have no legal sanctity. This was also upheld by the Supreme Court of India in *Mysore Cements Ltd. v. Svedala Barmac Ltd.*, (2003) 10 SCC 375.

c. **Enforcement** - the settlement agreement has the same status as that of an arbitral award. An arbitral award is final and binding on the parties and persons claiming under them. The award can be challenged before a court, and once the time for challenge has lapsed, or if the challenge had been made but was unsuccessful, then it could be enforced under the Code of Civil Procedure 1908.

Confidentiality – The conciliation proceedings and its outcome are subject to stringent confidentiality requirements.

a. Both the conciliator and the parties are required to keep all matter relating to the proceedings and the settlement agreement confidential. The only exception is when disclosure becomes necessary for purposes of implementation and enforcement of the settlement agreement.

b. The Conciliator cannot act as an arbitrator or representative of any of the party in arbitral or judicial proceedings in respect of the dispute that was subject of conciliation proceedings.

c. None of the views expressed, suggestions made, admissions by parties, or proposals made could be relied upon or introduced as evidence in arbitral or judicial proceedings, irrespective of whether or not those proceedings relate to dispute that was the subject of arbitral or judicial proceedings.

Breach of confidentiality would vitiate the arbitral or judicial proceedings they are attempted to be utilised in.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. Mr. Komal and Mr. Rajesh, entered into arbitration agreement for the disputes that arise, if any in their business transactions. Due to certain fault on the part of Mr. Rajesh, the dispute came before the arbitration for settlement. In the meantime, Mr. Komal dies. Mr. Rajesh shed of their liabilities on the plea that arbitration agreement has come to end with the death of the other party. Decide the affirmative statement in the given situation-

   (a) Arbitration agreement get terminated due to death of the party.

   (b) It shall be remain enforceable by or against the legal representatives of the deceased.

   (c) Since it is a private law between the parties, it will be terminated with the death of the party.

   (d) Both (a) & (c)

2. Mr. A. Mr. B and Mr. C are partners in XYZ partnership firm. The firm made an agreement in writing to refer a dispute between them in business to an arbitrator. Inspite of this agreement Mr. B files a suit against Mr. A and Mr. C relating to the dispute in a magisterial court. Examine on the admission of the suit filed by Mr. B in the court in the light of the Arbitration and Conciliation Act, 1996.

   (a) Yes it can be admitted by the Magisterial court , as the said court has jurisdiction over the matter and it overpowers arbitration agreement

   (b) Yes it can be admitted by the Magisterial court, only in the case of challenge to the arbitral award in appeal

   (c) Yes, it can be admitted by the court, if Mr. A and Mr. C mutually agrees.

   (d) No it cannot be admitted by the court, as the jurisdiction of court is ousted because of existence of a valid arbitration agreement

3. Mr. X wants to start a bakery and so he contacts Mr. Y Confectioners & Bakers for supply of cakes and biscuits. The communication between the parties were over email. On e-mail, there was a term of service between the parties containing that "any disputes regarding quality or delivery shall be submitted to arbitration conducted under the guidance of Indian Confectionary Manufacturers Association. Please place your order if the above terms and conditions are agreeable to you." X placed an order. State which statement is correct with respect to the arbitration agreement made between X and Y:

   (a) It is not valid agreement, as the terms of service is not contained in same document of agreement

   (b) It is not valid, as the agreement is not laid down in particular format / formally.

(c) It is not valid, as communication over email of the term of services is not proper.

(d) It is valid arbitration agreement in writing contained in correspondence between the parties over email.

Descriptive Questions

Question 1

In 2016, Company Amar, food processor manufacturing unit entered into a joint venture agreement with Company USHA, the largest manufacturer of Food processors for supply of parts of mixer & grinder for manufacturing its latest model. Both the companies are registered under the Companies Act 2013. Agreement carries the term that all disputes shall be arbitrated in Mumbai. State the type of arbitration agreement made between them.

What will happen if the agreement does not have any clause relating to arbitration? Disputes arose between them concerning quality of material supplied in 2017.

Question 2

How important are the ideas of independence and impartiality in arbitration?

(a) Is the arbitrator required to disclose anything to the parties?

(b) Is membership of the same sports club as one of the parties problematic?

Question 3

Can an arbitrator resign on their own account? Do they have to give reasons for their resignation? Could an award be challenged on the ground that the arbitrator had resigned without giving any proper justifications?

Question 4

Mr. X wants to start a bakery and so he contacts Mr. Y Confectioners & Bakers for supply of cakes and biscuits. The communication between the parties were over email. On e-mail, there was a term of service between the parties containing that "any disputes regarding quality or delivery shall be submitted to arbitration conducted under the guidance of Indian Confectionary Manufacturers Association. Please place your order if the above terms and conditions are agreeable to you." X placed an order. State the legal position as the validity of the arbitration agreement.

ANSWER/SUGGESTED

Answer to MCQs

1. (c) **Hint:** As per section 40 of the Arbitration and Conciliation Act,1 996, an arbitration agreement shall not be discharged by the death of any party thereto either as respects the deceased or as respects any other party, but shall in such event be enforceable by or against the legal representative of the deceased.

2. **(d)** **Hint:** The jurisdiction of court is ousted as a valid arbitration agreement exists. As per Section 8, if there is an arbitration agreement between the parties, the dispute shall not be submitted to the court, but instead shall be submitted to arbitration.

3. **(d)** **Hint:** As per the arbitration and Conciliation Act, an agreement must be in writing. There is however no requirement for the same to be in writing in one document. There is also no particular form or template for an arbitration agreement. The communication over email of the term of services is a proper valid agreement and the same have been stood affirmed by reason of their conduct. This would be an arbitration agreement in writing contained in correspondence between the parties.

Answer to Descriptive Questions

1. There are two basic types of arbitration agreement are:

   (a) **Arbitration clause** - a clause contained within a principal contract. The parties undertake to submit disputes in relation to or in connection with the principal contract that may arise in future to arbitration.

   (b) **Submission agreement** - an agreement to refer disputes that already exist to arbitration. Such an agreement is entered into after the disputes have arisen.

   In first case, the agreement already carries the term that all disputes shall be arbitrated in Mumbai at the time of entering into joint venture agreement. This would be an arbitration clause as it is contained in the principal contract (JVA) and no disputes have arisen till yet. It concerns future disputes that may arise.

   In the second case, the Principal contract (JVA) does not have any term relating to arbitration. Disputes arose between the parties concerning quality of supplied goods in 2017. To resolve this dispute, parties later entered into an agreement "That all disputes including quality of goods supplied by Company USHA to Company Amar shall be submitted to arbitration. The parties hereby agree to abide by the decision of the arbitrator." Such an agreement that is made after the disputes have arisen would be called a submission agreement.

2. **(a)** The arbitrator are under a duty of disclose any relations with parties or their lawyer that might give rise to justifiable doubts as to their independence and impartiality.

   (b) Such an association is too remote to count as a relation that might lead to doubts of bias.

3. An arbitrator can resign when they want, without giving reasons for their resignation. This action does not affect the validity either of the arbitration proceedings or the arbitral award.

4. As per the arbitration and Conciliation Act, an agreement must be in writing There is however no requirement for the same to be in writing in one document. There is also no particular form or template for an arbitration agreement. The communication over email of the term of services is a proper valid agreement and the same have been stood affirmed by reason of their conduct. This would be an arbitration agreement in writing contained in correspondence between the parties.

CHAPTER 6

THE INSOLVENCY AND BANKRUPTCY CODE, 2016

LEARNING OUTCOMES

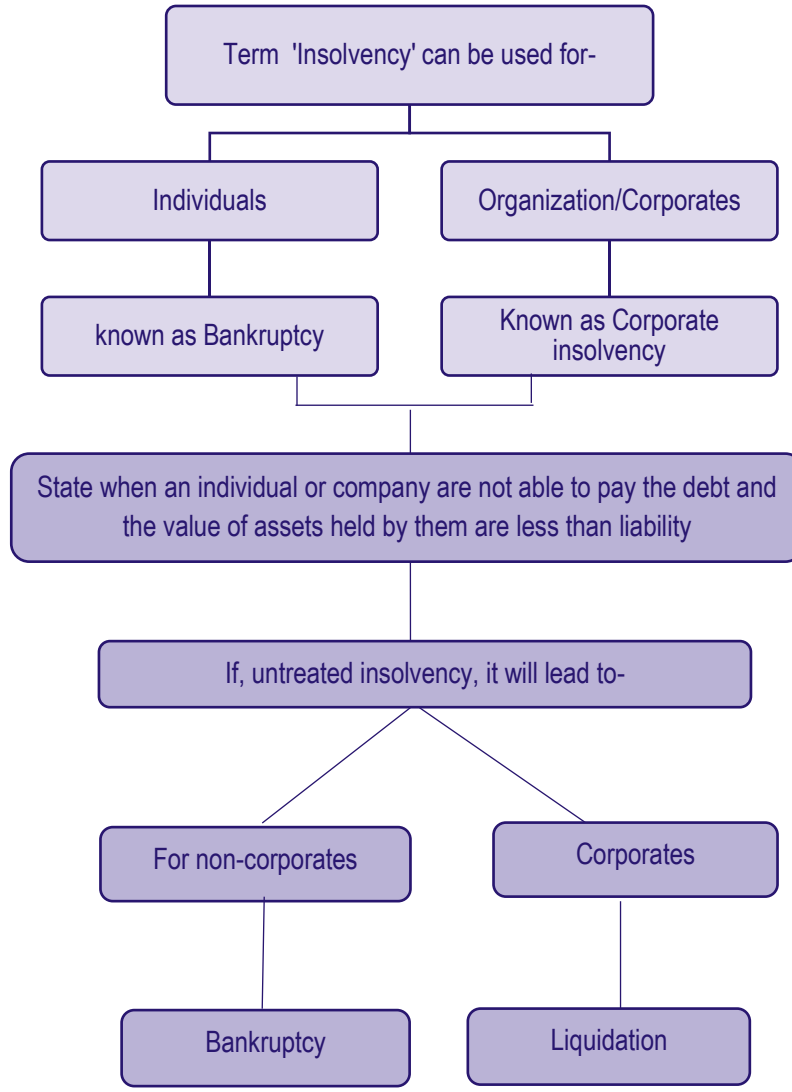
By the end of this Chapter, you will be able to:

- ❑ Know the concepts of Insolvency and Bankruptcy.
- ❑ To have understanding of important terminologies used in the Code.
- ❑ Identify the structure and applicability of the Code.
- ❑ Understand the manner and process of Corporate Insolvency Resolution Process & Fast track resolution corporate process
- ❑ Know the process of Voluntary liquidation of corporate person.

1. INTRODUCTION

Concept of Insolvency and Bankruptcy

- The term insolvency is used for both individuals and organizations. For individuals, it is known as bankruptcy and for corporate it is called corporate insolvency. Both refer to a situation when an individual or company are not able to pay the debt in present or near future and the value of assets held by them are less than liability.
- Insolvency in this Code is regarded as a "state" where assets are insufficient to meet the liabilities. If untreated, insolvency will lead to bankruptcy for non-corporates and liquidation of corporates.



- While insolvency is a situation which arises due to inability to pay off the debts due to insufficient assets, bankruptcy is a situation wherein application is made to an authority declaring insolvency and seeking to be declared as bankrupt, which will continue until discharge.
- From the above it is evident that insolvency is a state and bankruptcy is a conclusion. A bankrupt would be a conclusive insolvent whereas all insolvencies will not lead to bankruptcies. Typically insolvency situations have two options – resolution and recovery or liquidation

Relationship between Bankruptcy, Insolvency & Liquidation

Bankruptcy is a legal proceeding involving a person or business that is unable to repay outstanding debts. The bankruptcy process begins with a petition filed by the debtor, or by the creditors. All of

the debtor's assets are measured and evaluated, and the assets may be used to repay a portion of outstanding debt.

In lucid language, if any person or entity is unable to pay off the debts, it owes, to their creditor, on time or as and when they became due and payable, then such person or entity is regarded as "insolvent".

Liquidation is the winding up of a corporation or incorporated entity. There are many entities that can initiate proceedings to cause the Liquidation, those being:-

- The Regulatory Bodies;
- The Directors of a Company;
- The Shareholders of a Company; and
- An Unpaid Creditor of a Company

In nut shell, **insolvency** is common to both bankruptcy and liquidation. Not being able to pay debts as and when they became due and payable are the leading cause of Liquidations and is the only way that can cause a natural person to become a bankrupt.

Insolvency and Bankruptcy Code

The Code seeks to provide an effective legal framework for timely resolution of insolvency and bankruptcy which would support development of credit markets and encourage entrepreneurship, and facilitate more investments leading to higher economic growth and development.

Features of the Insolvency and Bankruptcy Code:

The Insolvency and Bankruptcy Code, 2016 has following distinguishing features:-

(i) **Comprehensive Law:** Insolvency Code is a comprehensive law which envisages and regulates the process of insolvency and bankruptcy of all persons including corporates, partnerships, LLP's and individuals.

(ii) **No Multiplicity of Laws:** The Code has withered away the multiple laws covering the recovery of debts and insolvency and liquidation process and presents singular platform for all the reliefs relating to recovery of debts and insolvency.

(iii) **Low Time Resolution**: The Code provides a low time resolution and defines fixed time frames for insolvency resolution of companies and individuals. The process is mandated to be completed within 180 days, extendable to maximum of 90 days. Further, for a speedier process there is provision for fast-track resolution of corporate insolvency within 90 days. If insolvency cannot be resolved, the assets of the borrowers may be sold to repay creditors.

(iv) **One Window Clearance:** It has been drafted to provide one window clearance to the applicant whereby he gets the appropriate relief at the same authority unlike the earlier position of law where in case the company is not able to revive the procedure for winding

up and liquidation has to be initiated under separate laws governed by separate authorities.

(v) **One Chain of Authority:** There is one chain of authority under the Code. It does not even allow the civil courts to interfere with the application pending before the adjudicating authority, thereby reducing the multiplicity of litigations. The National Company Law Tribunal (NCLT) will adjudicate insolvency resolution for companies. The Debt Recovery Tribunal (DRT) will adjudicate insolvency resolution for individuals.

(vi) **Priority to the interests of workman and employees:** The Code also protects the interests of workman and employees. It excludes dues payable to workmen under provident fund, pension fund and gratuity fund from the debtor's assets during liquidation.

(vii) **New Regulatory Authority:** It provides for constitution of a new regulatory authority 'Insolvency and Bankruptcy Board of India' to regulate professionals, agencies and information utilities engaged in resolution of insolvencies of companies, partnership firms and individuals. The Board has already been established and started functioning.

Objectives of the Code

The Insolvency and Bankruptcy Code, 2016 is intended to strike the right balance of interests of all stakeholders of the business enterprise so that the corporates and other business entities enjoy availability of credit and at the same time the creditor do not have to bear the losses on account of default. The purpose of enactment of the Insolvency and Bankruptcy Code, 2016 is as follows:

(a) To consolidate and amend the laws relating to re-organization and insolvency resolution of corporate persons, partnership firms and individuals.

(b) To fix time periods for execution of the law in a time bound manner.

(c) To maximize the value of assets of interested persons.

(d) To promote entrepreneurship

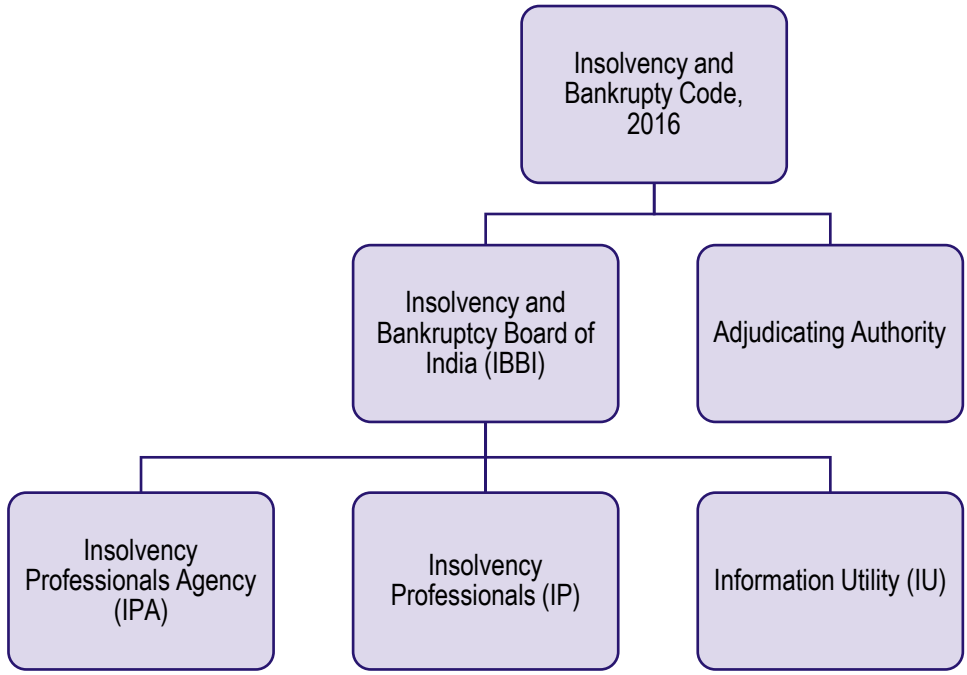
(e) To increase availability of credit.

(f) To balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues.

(g) To establish an Insolvency and Bankruptcy Board of India as a regulatory body for insolvency and bankruptcy law.

Regulatory Mechanism

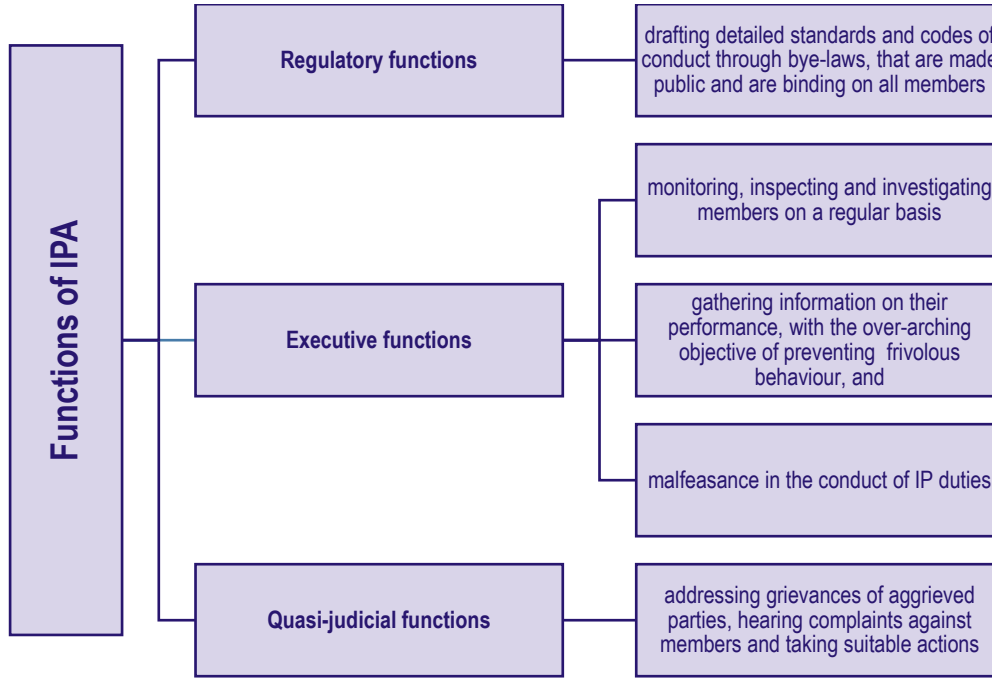
The Insolvency and Bankruptcy Code, 2016 provides a new regulatory mechanism with an institutional set-up comprising of following five pillars:-



1. **Insolvency and Bankruptcy Board of India-**The Code provides for establishment of a Regulator who will oversee these entities and to perform legislative, executive and quasi-judicial functions with respect to the Insolvency Professionals, Insolvency Professional Agencies and Information Utilities. The Insolvency and Bankruptcy Board of India was established on October 1, 2016. The head office of the Board is located at New Delhi.

   The Board is a body corporate, having perpetual succession and a common seal, with power, subject to the provisions of this Code, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued.

2. **Insolvency Professional Agencies (IPA)-**The Code provides for establishment of insolvency professionals agencies to enroll and regulate insolvency professionals as its members in accordance with the Insolvency and Bankruptcy Code 2016 and read with regulations. IPA will perform three key functions:



3. **Insolvency Professionals:** The Code provides for insolvency professionals as intermediaries who would play a key role in the efficient working of the bankruptcy process. The role of the IP encompasses a wide range of functions, which include adhering to procedure of the law, as well as accounting and finance related functions. He shall have the power and responsibility to monitor and manage the operations and assets of the enterprise.

In the resolution process, the insolvency professional verifies the claims of the creditors, constitutes a creditors committee, runs the debtor's business during the moratorium period and helps the creditors in reaching a consensus for a revival plan. In liquidation, the insolvency professional acts as a liquidator and bankruptcy trustee.

An Insolvency Professional if appointed as a Resolution Professional shall act as a as a neutral trustee of the assets of the organization.

Every insolvency professional shall abide by the following code of conduct:—

- to take reasonable care and diligence while performing his duties;
- to comply with all requirements and terms and conditions specified in the bye-laws of the insolvency professional agency of which he is a member;
- to allow the insolvency professional agency to inspect his records;
- to submit a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member; and

- to perform his functions in such manner and subject to such conditions as may be specified.

4. **Information Utilities** – The Code envisages creation of information utility to collect, collate, authenticate and disseminate financial information of debtors in centralized electronic databases, at all times.

The Code requires creditors to provide financial information of debtors to multiple utilities on an ongoing basis. Such information would be available to creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings. The purpose of this is to remove information asymmetry and dependency on the debtor's management for critical information that is needed to swiftly resolve insolvency.

Obligations of Information Utility:

An information utility shall provide such services as may be specified including core services to any person if such person complies with the terms and conditions as may be specified by regulations.

For the purposes of providing core services to any person, every information utility shall—

(a) create and store financial information in a universally accessible format;

(b) accept electronic submissions of financial information from persons who are under obligations to submit financial information

(c) accept, in specified form and manner, electronic submissions of financial information from persons who intend to submit such information;

(d) meet such minimum service quality standards as may be specified by regulations;

(e) get the information received from various persons authenticated by all concerned parties before storing such information;

(f) provide access to the financial information stored by it to any person who intends to access such information in such manner as may be specified by regulations;

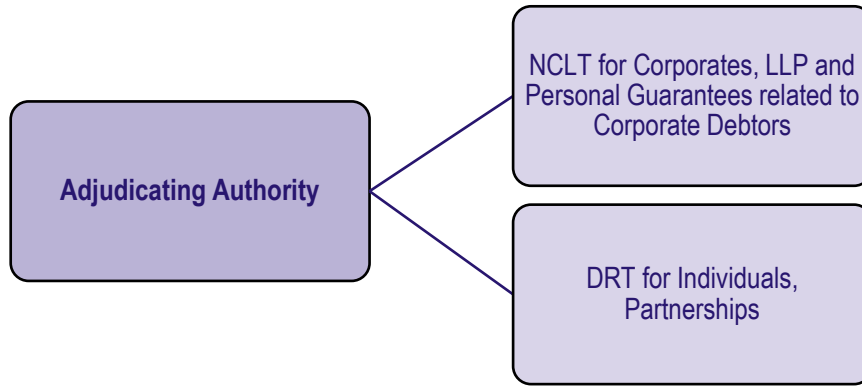
(g) publish such statistical information as may be specified by regulations;

(h) have inter-operatability with other information utilities.

5. **Adjudicating Authority-**The Adjudicating Authority for corporate insolvency and liquidation is the National Company Law Tribunal (NCLT). Appeals against NCLT orders shall lie with National Company Law Appellate Tribunal (NCLAT) and thereafter to the Supreme Court of India.

The Code has created one chain of authority for adjudication under the Code. Civil Courts have been prohibited to interfere in the matters related with application pending before the Adjudicating Authority. No injunction shall be granted by any Court, Tribunal or Authority in respect of any action taken by the NCLT.

For individuals and other persons, the Adjudicating Authority is the Debt Recovery Tribunal (DRT), appeals lie to the Debt Recovery Appellate Tribunal (DRAT) and thereafter to the Supreme Court.



Example : XY & Co., a firm applied to NCLT to be declared insolvent as the firm is not able to pay off debts to his creditors in present and in coming future. State whether the act of the firm is valid as to the filing of application in terms of jurisdiction.

Answer: No, as per the Code, individual & firms in relation to Insolvency matters shall apply to the DRT not to NCLT. Here there is violation of jurisdiction in relation to adjudicating authority.

Structure of the Code

The Code is structured into 5 parts comprising of 255 sections and 11 Schedules. Each part deals with a distinct aspect of the insolvency resolution process. Part II, Chapters I and II are of particular significance for the students from examinations perspective and are discussed in detail hereunder :

Part	Part Content	Chapters and Sections	Chapter / Contents
I	Preliminary	(1-3)	1. Short title, extent & Commencement 2. Application 3. Definitions
II	Insolvency Resolutions and Liquidation for Corporate Persons	I–VII (4–77)	1. Preliminary (Application & Definitions) 2. Corporate Insolvency Resolution Process 3. Liquidation Process 4. Fast Track Corporate Insolvency Resolution Process 5. Voluntary Liquidation of Corporate Persons 6. Adjudicating Authority for Corporate Persons 7. Offences & Penalties

Part	Part Content	Chapters and Sections	Chapter / Contents
III	Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms	I – VII (78-187)	1. Preliminary (Application & Definitions) 2. Fresh Start Process 3. Insolvency Resolution Process 4. Bankruptcy Order for Individuals & Partnership Firms 5. Administration & Distribution of the Estate of the Bankrupt 6. Adjudicating Authority 7. Offences & Penalties
IV	Regulation of Insolvency Professionals, Agencies and Information Utilities	I – VII (188–223)	1. The Insolvency and Bankruptcy Board of India 2. Powers & Functions of the Board 3. Insolvency Professional Agencies 4. Insolvency Professionals 5. Information Utilities 6. Inspection & Investigation 7. Finance, Accounts & Audit
V	Miscellaneous	(224 – 255)	Miscellaneous

Extent and Commencement of the Code:

As per section 1 of the Insolvency and Bankruptcy Code, it extends to the whole of India except Part III (Insolvency Resolution and Bankruptcy for Individuals and Partnership Firm) which excludes the state of Jammu and Kashmir.

This Code came into an enforcement on 28th May 2016, however, the Central Government appointed different dates for different provisions of this Code and any reference in any such provision to the commencement of this Code shall be construed as a reference to the commencement of that provision.

Significant amendments: The Code has been first amended by the Insolvency and Bankruptcy (Amendment) Ordinance, 2017, passed on November 23, 2017.This Ordinance became an Act on January 18, 2018. It was known as the Insolvency and Bankruptcy Code (Amendment) Act, 2018. It was made applicable from November 23, 2017.

The second amendment was made vide the **Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018, on June 6, 2018**. Further, the said ordinance, in the form of the Insolvency and Bankruptcy (Second Amendment) Bill received the assent of the President on the 17th August, 2018 and thus the **Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** was promulgated.

Applicability of the Code

The provisions of the Code shall apply for insolvency, liquidation, voluntary liquidation or bankruptcy of the following entities:-

(a) Any company incorporated under the Companies Act, 2013 or under any previous law.

(b) Any other company governed by any special act for the time being in force, except in so far as the said provision is inconsistent with the provisions of such Special Act.

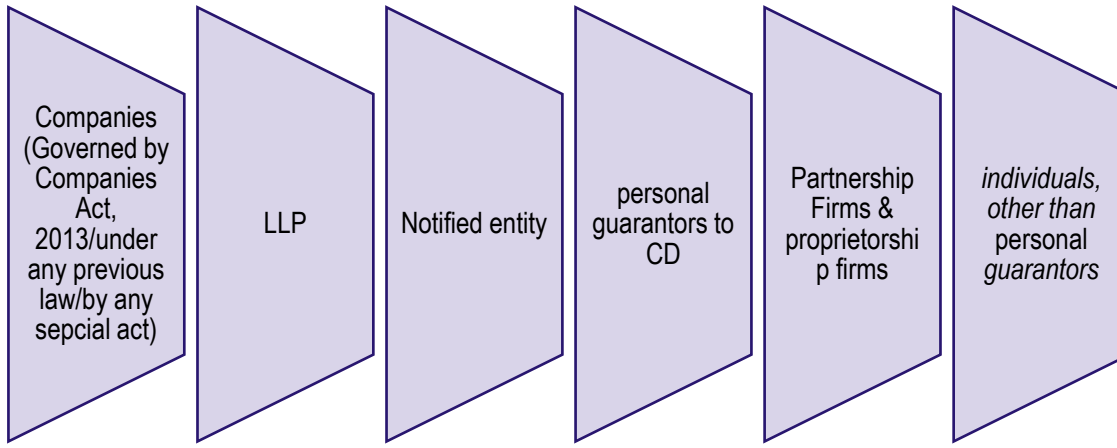
(c) Any Limited Liability Partnership under the LLP Act 2008.

(d) Any other body incorporated under any law for the time being in force, as the Central Government may by notification specify in this behalf.

(e) personal guarantors to corporate debtors;

(f) partnership firms and proprietorship firms; and

(g) individuals, other than persons referred to in clause (e),



Non-applicability of the Code: The Code is not applicable to corporates in finance sector. Section 3(7) of Insolvency & Bankruptcy Code, 2016 states that "Corporate person" shall not include any financial service provider.

Thus, the Code does not cover Bank, Financial Institutions, Insurance Company, Asset Reconstruction Company, Mutual Funds, Collective Investment Schemes or Pension Funds.

However, NBFC is engaged in various activities and hence NBFC is not ipso facto excluded from definition of 'corporate person' under section 3(7) of Insolvency Code. NBFC can be a 'corporate debtor' *[Jindal Saxena Financial Services v. Mayfair Capital (2018)]*

"Financial service provider" means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator [section 3(17)].

However, section 227 of the Code, which was notified on 1-5-2018 provided that, Central Government can notify financial service providers for purpose of insolvency and liquidation proceedings, which may be conducted under the Insolvency & Bankruptcy Code, in consultation with appropriate financial sector regulator.

2. IMPORTANT DEFINITIONS [SECTIONS 3 AND 5]

(1) **Claim** means a right to payment or right to remedy for breach of contract if such breach gives rise to a right to payment whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured. [Section 3(6)]

(2) **Corporate Person** means

(a) a company as defined under section 2(20) of the Companies Act, 2013;

(b) a Limited Liability Partnership as defined in 2(1)(n) of Limited Liability Act, 2008; or,

(c) any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider. [Section 3(7)]

(3) **Corporate Debtor** means a corporate person who owes a debt to any person. [Section 3(8)]

(4) **Creditor** means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decree holder. [Section 3(10)]

(5) **Debt** means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt. [Section 3(11)]

(6) **Default** means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be. [Section 3(12)]

(7) **Financial information,** in relation to a person, means one or more of the following categories of information, namely:—

(a) records of the debt of the person;

(b) records of liabilities when the person is solvent;

(c) records of assets of person over which security interest has been created;

(d) records, if any, of instances of default by the person against any debt;

(e) records of the balance sheet and cash-flow statements of the person; and

(f) such other information as may be specified. [Section 3(13)]

(8) A **person** includes:-

- an individual

- a Hindu Undivided Family
- a company
- a trust
- a partnership
- A limited liability partnership, and
- any other entity established under a Statute.

And includes a person resident outside India [Section 3(23)]

(9) **Secured creditor** means a creditor in favour of whom security interest is created; [Section 3(30)]

(10) **Security Interest** means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person. [Section 3(31)]. Provided that security interest shall not include a performance guarantee;

(11) A **transaction** includes an agreement or arrangement in writing for transfer of assets, or funds, goods or services, from or to the corporate debtor. [Section 3(33)]

(12) **Transfer** includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien. In case of property- transfer of property means transfer of any property. [Section 3(34)]

(13) **Transfer of property** means transfer of any property and includes a transfer of any interest in the property and creation of any charge upon such property; [Section 3(35)]

(14) **Adjudicating Authority,** for the purposes of this Part II (Insolvency Resolution and Liquidation for corporate persons), means National Company Law Tribunal constituted under section 408 of the Companies Act, 2013 [Section 5(1)]

(15) **Corporate applicant** means—

(a) corporate debtor; or

(b) a member or partner of the corporate debtor who is authorised to make an application for the corporate insolvency resolution process under the constitutional document of the corporate debtor; or

(c) an individual who is in charge of managing the operations and resources of the corporate debtor; or

(d) a person who has the control and supervision over the financial affairs of the corporate debtor; [Section 5(5)]

(16) **"Corporate Guarantor"** means a corporate person who is the surety in a contract of guarantee to a corporate debtor; [Section 5(5A)]

(17) **Dispute** includes a suit or arbitration proceedings relating to—

(a) the existence of the amount of debt;

(b) the quality of goods or service; or

(c) the breach of a representation or warranty; [Section 5(6)]

(18) **Financial creditor** means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to;[section 5(7)]

(19) **Financial debt** means a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money and includes—

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;

(c) Any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;

(e) receivables sold or discounted other than any receivables sold on non-recourse basis;

(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing.

[*Explanation*.—For the purposes of this sub-clause,—

(i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and

(ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);]

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

(h) Any counter-indemnity obligation in respect of a guarantee, indemnity, bond,

documentary letter of credit or any other instrument issued by a bank or financial institution;

(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause; [Section 5(8)]

(20) **Financial position,** in relation to any person, means the financial information of a person as on a certain date; [Section 5(9)]

(21) **Information memorandum** means a memorandum prepared by resolution professional under section 29(1); [Section 5(10)]

(22) **Initiation date** means the date on which a financial creditor, corporate applicant or operational creditor, as the case may be, makes an application to the Adjudicating Authority for initiating corporate insolvency resolution process; [Section 5(11)]

Provided that where the interim resolution professional is not appointed in the order admitting application under section 7, 9 or section 10, the insolvency commencement date shall be the date on which such interim resolution professional is appointed by the Adjudicating Authority;

(23) **Insolvency commencement date** means the date of admission of an application for initiating corporate insolvency resolution process by the Adjudicating Authority under sections 7, 9 or section 10, as the case may be;[Section 5(12)]

Provided that where the interim resolution professional is not appointed in the order admitting application under section 7, 9 or section 10, the insolvency commencement date shall be the date on which such interim resolution professional is appointed by the Adjudicating Authority;

(24) **Insolvency resolution process period** means the period of one hundred and eighty days beginning from the insolvency commencement date and ending on one hundred and eightieth day;[Section 5(14)]

(25) **Liquidation commencement date** means the date on which proceedings for liquidation commence in accordance with section 33 or section 59, as the case may be; [Section 5(17)]

(26) **Liquidator** means an insolvency professional appointed as a liquidator in accordance with the provisions of Chapter III or Chapter V of this Part, as the case may be. [Section 5(18)]

(27) **Operational creditor** means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred;[Section 5(20)]

(28) **Operational debt** means a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority; [Section 5(21)]

(29) **Related party,** in relation to a corporate debtor, means—

(a) **a director or partner or a relative** of a director or partner of the corporate debtor

(b) **a key managerial personnel or a relative** of a key managerial personnel of the corporate debtor;

(c) **a limited liability partnership or a partnership firm** in which a director, partner, or manager of the corporate debtor or his relative is a partner;

(d) **a private company** in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent. of its share capital;

(e) **a public company** in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent. of its paid-up share capital;

(f) **any body corporate** whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

(g) **any limited liability partnership or a partnership firm** whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

(h) **any person** on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;

(i) **a body corporate which is a holding, subsidiary or an associate company** of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;

(j) **any person who controls** more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement;

(k) **any person in whom the corporate debtor controls** more than twenty per cent. of voting rights on account of ownership or a voting agreement;

(l) **any person who can control the composition** of the board of directors or corresponding governing body of the corporate debtor;

(m) **any person who is associated with the corporate debtor** on account of—

(i) participation in policy making processes of the corporate debtor; or

(ii) having more than two directors in common between the corporate debtor and such person; or

(iii) interchange of managerial personnel between the corporate debtor and such person;

(iv) provision of essential technical information to, or from, the corporate debtor; [Section 5(24)]

(30) **"Related party",** in relation to an individual, means—

(a) a person who is a relative of the individual or a relative of the spouse of the individual;

(b) a partner of a limited liability partnership, or a limited liability partnership or a partnership firm, in which the individual is a partner;

(c) a person who is a trustee of a trust in which the beneficiary of the trust includes the individual, or the terms of the trust confers a power on the trustee which may be exercised for the benefit of the individual;

(d) a private company in which the individual is a director and holds along with his relatives, more than two per cent of its share capital;

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

(f) a body corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of the individual;

(g) a limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, act on the advice, directions or instructions of the individual;

(h) a person on whose advice, directions or instructions, the individual is accustomed to act;

(i) a company, where the individual or the individual along with its related party, own more than fifty per cent of the share capital of the company or controls the appointment of the board of directors of the company.

Explanation—For the purposes of this clause,—

(a) "relative", with reference to any person, means anyone who is related to another, in the following manner, namely:—

(i) members of a Hindu Undivided Family,

(ii) husband,

(iii) wife,

(iv) father,

(v) mother,

(vi) son,

(vii) daughter,

(viii) son's daughter and son,

(ix) daughter's daughter and son,

(x) grandson's daughter and son,

(xi) granddaughter's daughter and son,

(xii) brother,

(xiii) sister,

(xiv) brother's son and daughter,

(xv) sister's son and daughter,

(xvi) father's father and mother,

(xvii) mother's father and mother,

(xviii) father's brother and sister,

(xix) mother's brother and sister, and

(b) wherever the relation is that of a son, daughter, sister or brother, their spouses shall also be included; [Section 5(24A)]

(31) **Resolution applicant** means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25; [Section 5(25)]

(32) **Resolution plan** means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II; [Section 5(26)]

(33) **Resolution professional,** for the purposes of this Part, means an insolvency professional appointed to conduct the corporate insolvency resolution process and includes an interim resolution professional; [Section 5(27)]

(34) **Voting share** means the share of the voting rights of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor. [Section 5(28)]

3. CORPORATE INSOLVENCY RESOLUTION PROCESS [SECTIONS 4, 6-32]

Provisions related to Insolvency Resolution and Liquidation process for Corporate Persons are covered in Part II of the Code.

Corporate Insolvency Resolution is a process during which financial creditors assess whether the debtor's business is viable to continue and the options for its rescue and revival, if any. If the insolvency resolution process fails or financial creditors decide that the business of debtor cannot

be carried on in a profitable manner and it should be wound up, the debtor will undergo liquidation process and the assets of the debtor shall be realized and distributed by the liquidator.

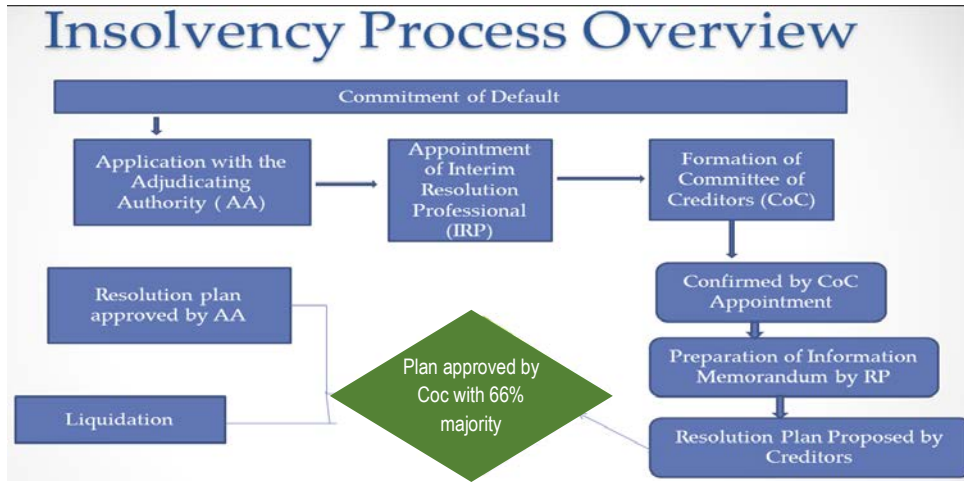
The Insolvency Resolution Process provides a collective mechanism to lenders to deal with the overall distressed position of a corporate debtor. This is a significant departure from the existing legal framework under which the primary onus to initiate a re-organization process lies with the debtor, and lenders may pursue distinct actions for recovery, security enforcement and debt restructuring.

The Code creates time-bound processes for insolvency resolution of companies and individuals. These processes will be completed within 180 days, extendable by 90 days. It also provides for fast-track resolution of corporate insolvency within 90 days. If insolvency cannot be resolved, the company goes into liquidation under which, the assets of the borrowers may be sold to repay creditors.

i. Process Flow

A comprehensive process that covers the gamut of insolvency resolution framework for Corporates and includes processes relating to:-

- Filing of application before NCLT
- Adjudication: Admission or Rejection of application
- Moratorium and Public Announcement
- Appointment of Interim Resolution Professional
- Formation of the Committee of Creditors
- Preparation and approval of the Resolution Plan
- Consequences of non-submission of the Resolution Plan



ii. Application to National Company Law Tribunal

Commitment of Default

The process of insolvency is triggered by occurrence of default. Default occurs when a whole or any part of the amount of debt has become due and payable and is not paid by the debtor. The provisions relating to the insolvency and liquidation of corporate debtors shall be applicable only when the amount of the default is one lakh rupees or more. However, the Central Government may, by notification, specify the minimum amount of default of higher value which shall not be more than one crore rupees. [Section 4]

Filing of application before NCLT

The corporate insolvency process may be initiated against any defaulting corporate debtor by making an application for corporate insolvency resolution. The application may be made by:-

(a) Financial creditor

(b) Operational creditor

(c) Corporate debtor

(A) Filling of an application by a financial creditor: A financial creditor either itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government, may file an application before the Adjudicating Authority (National Company Law Tribunal) for initiating corporate insolvency resolution process against a corporate debtor who commits a default in payment of its dues.

Vide Notification S.O.1091(E) dated 27th February, 2019, the Central government hereby notifies following persons who may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority, on behalf of the Financial Creditor:-

(i) a guardian;

(ii) an executor or administrator of an estate of a financial creditor;

(iii) a trustee (including a debenture trustee); and

(iv) a person duly authorized by the Board of Directors of a Company.

- **Evidence in support of default and name of the Interim resolution professional by financial creditor:** The Financial Creditor shall along with the application give following evidence in support of the default committed by the corporate debtor-

  (a) record of the default recorded with the information utility or such other record or evidence of default as may be specified;

  (b) the name of the resolution professional proposed to act as an interim resolution professional; and

  (c) any other information as may be specified by the Board.

(B) Filling of an application by an operational creditor: An operational creditor shall on the occurrence of default, shall:

- first send a demand notice and a copy of invoice to the corporate debtor.
- The corporate debtor shall within a period of ten days of receipt of demand notice or copy of invoice intimate to the operational creditor about the existence of a dispute, if there is any and record of pendency of any suit or arbitration proceedings.
- He shall also provide the details of payment of unpaid operational debt in case the debt has or is being paid.
- After the expiry of ten days, if the operational creditor does not receive his payment or the confirmation of a dispute that existed even before the demand notice was sent, he may file an application before the Adjudicating Authority for initiating a corporate insolvency resolution process.
- The operational creditor shall, along with the application furnish—
  - (a) a copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor;
  - (b) an affidavit to the effect that there is no notice given by the corporate debtor relating to a dispute of the unpaid operational debt;
  - (c) a copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available;
  - (d) a copy of any record with information utility confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available; and
  - (e) any other proof confirming that there is no payment of an unpaid operational debt by the corporate debtor or such other information, as may be prescribed.
- An operational creditor initiating a corporate insolvency resolution process under this section, may propose a resolution professional to act as an interim resolution professional.

(C) Filing of an application by corporate applicant: Where a corporate debtor has committed a default, a corporate applicant thereof may file an application for initiating corporate insolvency resolution process with the Adjudicating Authority. The corporate applicant shall along with the application furnish the particulars related to the information relating to books of account and other documents, the name of a resolution professional proposed to be appointed as interim resolution professional, and the special resolution passed by shareholders of the corporate debtor or the resolution passed by at least three-fourth of the total number of partners of the corporate debtor, as the case may be, approving filing of the application.

Persons not entitled to initiate insolvency process:

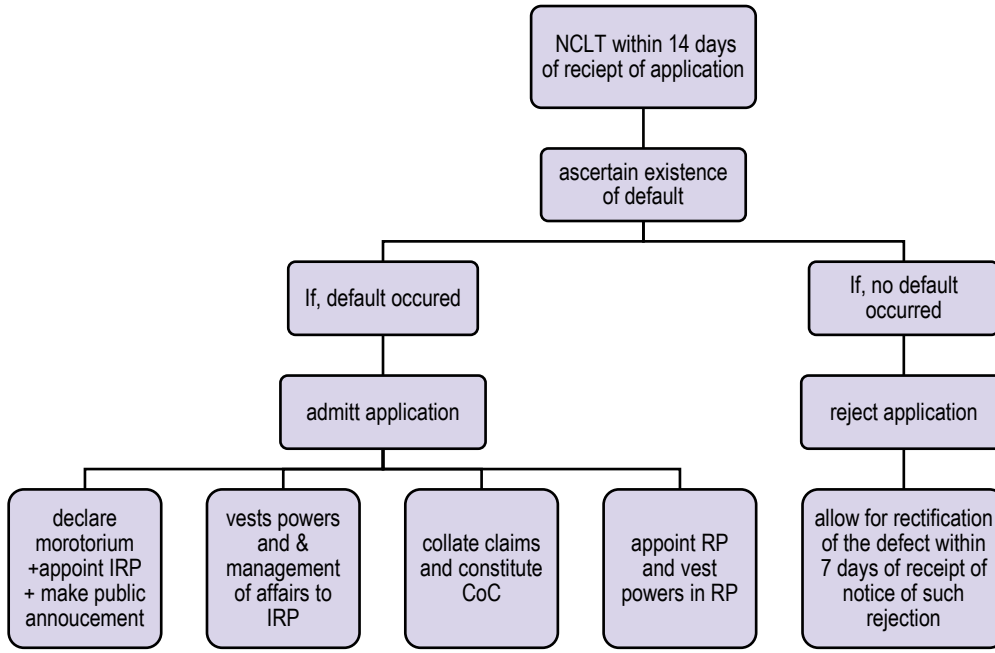
persons	In the following circumstances	Can/cannot Initiate Insolvency process
Corporate debtor, who	• already undergoing an insolvency resolution process • having completed corporate insolvency resolution process 12 months preceding the date of making of the application • who has violated any of the terms of resolution plan which was approved 12 months before the date of making of an application; • in respect of whom a liquidation order has been made	• Cannot initiate Insolvency process
financial creditor, who	has violated any of the terms of resolution plan which was approved 12 months before the date of making of an application;	Cannot initiate Insolvency process

Here, a corporate debtor includes a corporate applicant in respect of such corporate debtor. [Section 11]

iii. Adjudication: Admission or Rejection of Application

The Adjudicating Authority may either accept or reject the application within fourteen days of receipt of application. However, applicant should be allowed to rectify the defect within seven days of receipt of notice of such rejection.

The insolvency resolution process shall commence from the date of admission of application by the Adjudicating Authority. It is referred to as the Corporate Insolvency Resolution Date.



iv. Moratorium

With the admission of an insolvency application and commencement of Corporate Insolvency Resolution process, the Adjudicating authority will declare moratorium period during which no action can be taken against the company or the assets of the company to keep the Company as a going concern.

A calm period for 180 days is declared, during which all suits and legal proceedings etc. against the Corporate Debtor are held in abeyance to give time to the entity to resolve its status. It is called the Moratorium Period. [Section 14]

Section 14 of the Code provides that the following acts shall be prohibited during the moratorium period:-

(a) The institution of suits or continuation of any pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;

(b) Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

(c) Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFAESI Act, 2002

(d) The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor. [Section 14]

Exemptions: The following act shall not be prohibited during moratorium:

(1) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.

(2) such transaction as may be notified by the Central Government in consultation with any financial regulator;

(3) a surety in a contract of guarantee to a corporate debtor.

Date of effect of order: The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process.

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under section 31(1) or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.

Example: After commencement of Corporate Insolvency Resolution, NCLT declared Moratorium against the corporate debtor. Within a month of declaration, corporate debtor disposed of his property. State validity of the act of corporate debtor.

Answer: As per section 14 of the Code, any transaction/disposal/ of any assets of Corporate Debtor during the moratorium period which is 180 days from date of commencement of corporate insolvency resolution, is prohibited. So such an act of corporate debtor is not valid.

v. Appointment, Term and Powers of Interim Resolution Professional (IRP)

Interim Resolution Professional is the Insolvency Professional appointed by Adjudicating Authority to manage the affairs of Corporate Debtor from the date of such appointment till the date of appointment of Resolution Professional (the other Insolvency Professional) by Committee of Creditors.

Appointment of IRP: Adjudicating authority shall appoint an Interim Resolution Professional within 14 days from the commencement date. Section16 of the Code lays down the procedure for appointment of an Interim Resolution Professional.

In case of application filed by FC and CD: Where the application for corporate insolvency resolution process is made by a financial creditor(FC) or the corporate debtor (CD), the resolution professional as proposed in the application shall be appointed as the interim resolution professional, if no disciplinary proceedings are pending against him.

In case of application filed by OC: Where the application for corporate insolvency resolution process is made by an operational creditor with the following situations:

(a) **Where no proposal for an interim resolution professional is made:** The Adjudicating Authority shall make a reference to the Board for the recommendation of an insolvency professional who may act as an interim resolution professional.

The Board shall recommend the name of an insolvency professional to the Adjudicating

Authority against whom no disciplinary proceedings are pending, within ten days of the receipt of a reference from the Adjudicating Authority.

(b) **Where a proposal for an interim resolution professional is made:** the proposed resolution professional shall be appointed as the interim resolution professional, if no disciplinary proceedings are pending against him.

Period of appointment of IRP: The term of the interim resolution professional shall continue from his appointment till the date of appointment of the resolution professional by CoC in first meeting of CoC under section 22 of the Insolvency & Bankruptcy Code, 2016.

Insolvency Professional shall make a public announcement of initiation of corporate insolvency resolution process in Form A immediately within three days from the date of his appointment as an Interim Resolution professional.

Powers of IRP: As per Section 17 of the Code, the interim resolution professional shall have following powers:-

(a) **Management of Affairs:** The management of the affairs of the corporate debtor shall vest in the interim resolution professional from the date of his appointment.

(b) **Exercise of Power of BoD/ partners**: The powers of the board of directors or the partners of the corporate debtor, as the case may be, shall stand suspended and be exercised by the interim resolution professional.

(c) **Reporting of officers/managers:** The officers and managers of the corporate debtor shall report to the interim resolution professional and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional.

(d) **Instructions to financial institutions:** The financial institutions maintaining accounts of the corporate debtor shall act on the instructions of the interim resolution professional in relation to such accounts and furnish all information relating to the corporate debtor available with them to the interim resolution professional.

Duties of IRP: As per section 18 of the IBC, Interim Resolution professional shall perform the following duties:

1. Collect all information relating to the assets, finances and operations of the corporate debtor.
2. receive and collate all the claims submitted by creditors.
3. Constitute a committee of creditors.
4. Monitor the assets of the corporate debtor.
5. File information collected with the information utility.
6. Take control and custody of any asset over which the corporate debtor has ownership rights.
7. To perform such other duties as may be specified by the Board.

For the purposes of this section, the term "assets" shall not include the following, namely:—

(a) assets owned by a third party in possession of the corporate debtor held under trust or under contractual arrangements including bailment;

(b) assets of any Indian or foreign subsidiary of the corporate debtor; and

(c) such other assets as may be notified by the Central Government in consultation with any financial sector regulator.

vi Appointment of Resolution Professional (RP)

As per section 22 of the Code, the first meeting of the committee of creditors shall be held within seven days of the constitution of the committee of creditors.

Committee of Creditors in its first Meeting by majority (not less than 66% of voting shares) appoint Interim Resolution Professional or any other Insolvency Professional to act as Resolution Professional. In case CoC resolved to appoint any other Insolvency Professional to act as an RP, it shall file an application before the Adjudicating Authority for the appointment of the proposed Resolution Professional.

If the Board does not confirm the name of the proposed resolution professional within ten days of the receipt of the name of the proposed resolution professional, the Adjudicating Authority shall direct the interim resolution professional to continue as the resolution professional until such time as the Board confirms the Appointment of the proposed resolution professional.

Duties of a resolution professional: It shall be the duty of the Resolution Professional to preserve and protect the assets of the corporate debtor including the continued business operations of the corporate debtor. (section 25)

Powers of a resolution professional: Section 25(2) of the Code states that the Resolution Professional so appointed can take following actions:

1. Take custody and control of all the assets of the corporate debtor.
2. Represent and act on behalf of the corporate debtor with third parties.
3. Raise interim finances subject to the approval of the committee of creditors.
4. Appoint accountants, legal or other professionals.
5. Maintain an updated list of claims.
6. Convene and attend all meetings of the committee of creditors.
7. Prepare the information memorandum.
8. Invite prospective lenders, investors, and any other persons to put forwarder solution plans.
9. present all resolution plans at the meetings of the committee of creditors.
10. file application for avoidance of transactions.

Eligibility of an insolvency Professional to be appointed as a Resolution Professional

As per Regulation 3 of Insolvency and Bankruptcy (Insolvency Resolution process for corporate persons) Regulation, 2016, an insolvency professional shall be eligible for appointment as a resolution professional for a corporate insolvency process if he and all partners and directors of the insolvency professional entity of which he is partner or director are independent of the corporate debtor:-

(a) He is eligible to be appointed as an independent director on the board of the corporate debtor under section 149 of the Companies Act, 2013, where the corporate debtor is a company.

(b) He is not a related party of the corporate debtor.

(c) He is not an employee or proprietor or a partner of a firm of auditors or secretarial auditors **in practice** or cost auditors of the corporate debtor in the last three financial years.

(d) He is not an employee or proprietor or a partner of a legal or consulting firm that has or had any transaction with the corporate debtor amounting to five per cent or more of the gross turnover of such firm in the last three financial years.

Fees of Resolution Professional

As per Section 5(13) of the Code, the fees payable to any person acting as a resolution professional and any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern shall be included in the insolvency resolution process costs. It shall have priority over other costs in the event of winding up of the corporate debtor.

Replacement of Resolution Professional

- If a debtor or a creditor is of the opinion that the resolution professional appointed is required to be replaced, he may apply to the Adjudicating Authority for replacement of such professional.
- The Adjudicating Authority within seven days of receipt of the application may make reference to the Board for Replacement of Resolution Professional.
- As per Section 27 of the Code, The committee of creditors may, at a meeting, by a vote of sixty-six per cent of voting shares, resolve to replace the resolution professional appointed under section 22 with another resolution professional, subject to a written consent from the proposed resolution professional in the specified form.
- The Committee of Creditors shall forward the name of the new proposed Insolvency Professional to the Adjudicating Authority, and
- After the confirmation of the proposed insolvency resolution professional by the Board he shall be appointed in the same manner as laid down in Section 16 which deals with the Appointment of IRP.

Example: Mr. Z was continuing as Interim resolution professional (IRP) in XY company. The committee of creditors by majority vote of financial creditors proposed to appoint Mr. Final as Resolution professional (RP) of the XY & Co. The said proposal was confirmed by the Board after the 10 days. State whether Mr. Final is appointed as Resolution professional.

Answer: No, as per the Code, if Board does not confirm the proposed name as RP within 10 days of receipt of proposal, the Adjudicating authority shall direct IRP to continue as RP for such time as the Board would have confirmed for the appointment of Proposed RP.

vii Public Announcement

Insolvency Professional shall make a public announcement of initiation of corporate insolvency resolution process in Form A immediately within three days from the date of his appointment as an Interim Resolution professional.

As per Section 15 of the Code, public announcement shall include the following:-

(a) name and address of the corporate debtor under the CIRP;

(b) name of the authority with which the corporate debtor is incorporated / registered;

(c) the last date for submission of claims, as may be specified;

(d) details of the interim resolution professional vested with the management of the corporate debtor and be responsible for receiving claims;`

(e) penalties for false or misleading claims; and

(f) the date on which the CIRP shall close, which shall be the one hundred and eightieth day from the date of the admission of the application under sections 7, 9 or section 10, as the case may be.

The expenses of public announcement shall be borne by the applicant which may be reimbursed by the Committee of Creditors, to the extent it ratifies them.

viii Committee of Creditors

After the collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, the interim resolution professional shall constitute a committee of creditors.

The composition of the committee shall be as follows:-

1. **Where Financial Creditors exist:** The Committee of creditors shall comprise of all financial creditors of a corporate debtor. The Resolution Professional shall identify the financial creditors and constitutes a creditors committee. The resolution professional shall conduct all the meetings of the Committee of Creditors.

After the constitution of committee of creditors, the interim resolution professional is required to file a report certifying the constitution of the committee to the Adjudicating Authority. The

report shall be filed on or before the expiry of thirty days from the date of appointment of the interim resolution professional.

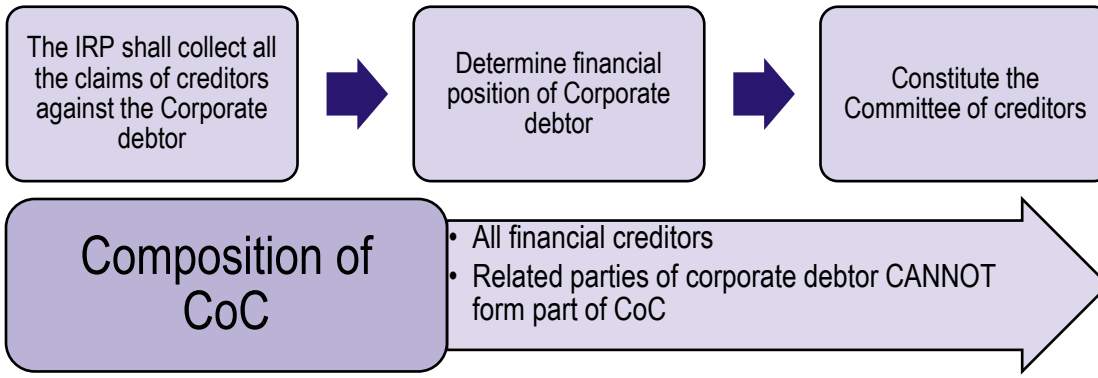
2. **Where Financial Creditors don't exist:** As per Regulation 16 of the Insolvency and Bankruptcy (Insolvency Resolution) Regulations, 2016, where the corporate debtor has no financial debt or where all financial creditors are related parties of the corporate debtor, the committee shall be formed comprising of following members:-

   (a) 18 largest operational creditors by value.

   (b) 1 representative elected by all workmen

   (c) 1 representative elected by all employees.

Where the number of operational creditors is less than 18, the committee shall include all such operational creditors.



Exception: Provided that a financial creditor or the authorised representative of the financial creditor referred to in section 21 (6) or section 21(6A) or section 24(5), if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors:

Provided further that the first proviso shall not apply to a financial creditor, regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares, prior to the insolvency commencement date.

Where a person is both FC and OC: Where any person is a financial creditor (FC) as well as an operational creditor(OC),—

(a) such person shall be a financial creditor to the extent of the financial debt owed by the corporate debtor, and shall be included in the committee of creditors, with voting share proportionate to the extent of financial debts owed to such creditor;

(b) such person shall be considered to be an operational creditor to the extent of the operational debt owed by the corporate debtor to such creditor.

In case of Joint financial creditors: Where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the committee of creditors and their voting share shall be determined on the basis of the financial debts owed to them.

Where the terms of the **financial debt extended as part of a consortium arrangement** or syndicated facility provide for a single trustee or agent to act for all financial creditors, each financial creditor may-

(a) authorise the trustee or agent to act on his behalf in the committee of creditors to the extent of his voting share;

(b) represent himself in the committee of creditors to the extent of his voting share;

(c) appoint an insolvency professional (other than the resolution professional) at his own cost to represent himself in the committee of creditors to the extent of his voting share; or

(d) exercise his right to vote to the extent of his voting share with one or more financial creditors jointly or severally. [Section 21(6)]

Nature of the financial debt in case of joint financial creditors: Section 21(6A) provides that where a financial debt—

(a) **is in the form of securities or deposits** and the terms of the financial debt provide for appointment of a trustee or agent to act as authorised representative for all the financial creditors, such trustee or agent shall act on behalf of such financial creditors;

(b) **is owed to a class of creditors** exceeding the number as may be specified, other than the creditors covered under section 21(6)(a), the interim resolution professional shall make an application to the Adjudicating Authority along with the list of all financial creditors, containing the name of an insolvency professional, other than the interim resolution professional, to act as their authorised representative who shall be appointed by the Adjudicating Authority prior to the first meeting of the committee of creditors;

(c) **is represented by a guardian, executor or administrator**, such person shall act as authorised representative on behalf of such financial creditors, and such authorised representative under clause (a) or clause (b) or clause (c) shall attend the meetings of the committee of creditors, and vote on behalf of each financial creditor to the extent of his voting share.

Remuneration to these authorised representatives: Section 21(6B) provides of the remuneration payable to the authorised representative—

(i) under clauses (a) and (c) of sub-section (6A), if any, shall be as per the terms of the financial debt or the relevant documentation; and

(ii) under clause (b) of sub-section (6A) shall be as specified which shall form part of the insolvency resolution process costs.

Voting in the Meeting

The Board may specify the manner of voting and the determining of the voting share in respect of financial debts covered under sub-sections (6) and (6A). All the decisions of the committee of creditors shall be taken by vote of **minimum fifty one percent of the voting share of the financial creditors.** The voting share is determined based on the value of the debt of the creditor in proportion to the total debt.

Where a corporate debtor does not have any financial creditors, the committee of creditors shall be constituted and comprise of such persons to exercise such functions in such manner as may be specified by the Board.

Conduct of Meeting of committee of creditors : All meetings of the committee of creditors shall be conducted by the resolution professional.

Notice of the Meeting: The resolution professional shall give notice of each meeting of the committee of creditors to:-

(a) Members of Committee of creditors, including the authorised representatives referred to in sub-sections (6) and (6A) of section 21 and sub-section (5).

(b) Members of the suspended Board of Directors or the partners of the corporate persons, as the case may be;

(c) Operational creditors or their representatives if the amount of their aggregate dues is not less than ten per cent. of the debt.

The directors, partners and operational creditor /one representative of operational creditors do not have right to vote in the meeting of Committee of Creditors, however, they may attend the meetings of Committee of Creditors.

Any creditor who is a member of the committee of creditors may appoint an insolvency professional other than the resolution professional to represent such creditor in a meeting of the committee of creditors:

Further, as defined in section 5(24) of the Code, a Related Party to whom a Corporate Debtor owes a financial debt shall not have any right of Representation, Participation or Voting in a meeting of the Committee of Creditors.

Quorum for the Meeting

- A meeting of committee of creditors shall quorate if members of the **committee of creditors representing at least thirty three percent of the voting rights are present** either in person or by video/audio means.
- If the **requisite quorum for committee of creditors is not fulfilled** the meeting cannot be held and the meeting shall automatically stand adjourned at the same time and place on the next day.

- The adjourned meeting shall quorate with the members of the committee attending the meeting.

Example: Committee of creditors approved the resolution plan with respect to the management of affairs of the company by more than 50% of voting share of the financial creditors. State whether decision given on the resolution plan is binding on the corporate debtors and all its creditors?

Answer: As per the Code, the resolution plan shall be approved by the committee of creditors by vote of not less than 51% of voting share of the financial creditors. Therefore Resolution plan here was passed by majority, and so was binding on the corporate debtors and all its creditors.

ix Resolution Plan (Section 22- 31)

A resolution plan is a proposal agreed to by the Debtors and Creditors of an entity in a collective mechanism to propose a time bound solution to resolve the situation of insolvency.

Formulation of Resolution Plan (Section 28)

- The Resolution Professional shall prepare an Information Memorandum which shall contain information for preparing resolution plan.
- Resolution Professional shall provide access of the following to a Resolution applicant in order to prepare the Resolution Plan:
  - Financial position of corporate debtor
  - Information required by applicant for resolution plan
  - Other matters pertaining to corporate debtor
- Resolution Professional shall examine the Resolution Plan and submit the same to Committee of Creditors for its approval.

Persons not eligible to be resolution applicant. [Section 29A] - A person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person—

(a) is an undischarged insolvent;

(b) is a wilful defaulter in accordance with the guidelines of the Reserve Bank of India

(c) at the time of submission of the resolution plan has an account, or an account of a corporate debtor under the management /control of such person / of whom such person is a promoter, classified as non-performing asset and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor.

Provided further that nothing in this clause shall apply to a resolution applicant where such applicant is a financial entity and is not a related party to the corporate debtor.

(d) has been convicted for any offence punishable with imprisonment –

(i) for two years or more under any Act specified under the Twelfth Schedule; or

(ii) for seven years or more under any law for the time being in force:

Provided that this clause shall not apply to a person after the expiry of a period of two years from the date of his release from imprisonment:

Provided further that this clause shall not apply in relation to a connected person.

(e) is disqualified to act as a director under the Companies Act, 2013 .Provided that this clause shall not apply in relation to a connected person .

(f) is prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities markets;

(g) has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the Adjudicating Authority.

Provided that this clause shall not apply if a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place prior to the acquisition of the corporate debtor by the resolution applicant pursuant to a resolution plan approved or pursuant to a scheme or plan approved by a financial sector regulator or a court, and such resolution applicant has not otherwise contributed to the preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction.

(h) has executed a guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under this Code and such guarantee has been invoked by the creditor and remains unpaid in full or part];

(i) is subject to any disability, corresponding to clauses (a) to (h), under any law in a jurisdiction outside India; or

(j) has a connected person not eligible under clauses (a) to (i).

Submission of Resolution Plan

- A resolution applicant may submit a resolution plan along with an affidavit stating that he is eligible under section 29A to the resolution professional prepared on the basis of the information memorandum.
- The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan –

(a) provides for the payment of insolvency resolution process costs in a manner in priority to the payment of other debts of the corporate debtor

(b) provides for the payment of the debts of operational creditors

(c) provides for the management of the affairs of the Corporate debtor after approval of the resolution plan

(d) implementation and supervision of the resolution plan;

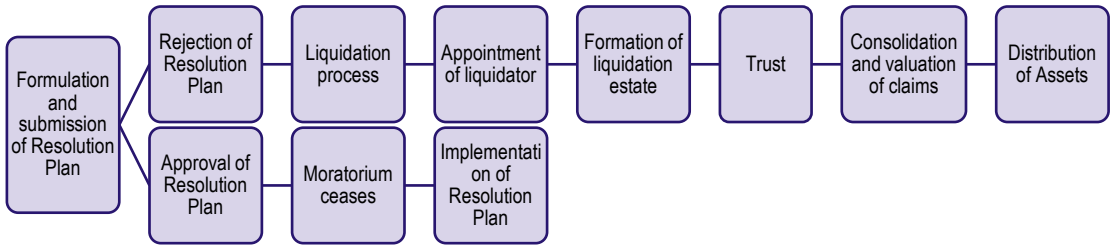
(e) does not contravene any of the provisions of the law. For this, if any approval of shareholders is required under the Companies Act, 2013 or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law.

(f) conforms to such other requirements as may be specified by the Board.

- The resolution professional shall present to the committee of creditors for its approval such resolution plans.
- The committee of creditors may approve a resolution plan by a vote of not less than 66% per cent of voting share of the financial creditors.
- The resolution applicant may attend the meeting of the committee of creditors in which the resolution plan of the applicant is considered. However, he shall not have a right to vote at the meeting of the committee of creditors unless such resolution applicant is also a financial creditor.
- The resolution professional shall submit the resolution plan as approved by the committee of creditors to the Adjudicating Authority.

x Procedure after submission of resolution plan

If the Adjudicating Authority is satisfied that the resolution plan as approved by the committee of creditors meets the requirements specified in section 30, it shall by order approve the resolution plan which shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. Where the Adjudicating Authority is satisfied that the resolution plan does not confirm to the requirements, it may, by an order, reject the resolution plan.



The resolution applicant shall, pursuant to the resolution plan approved under sub-section (1), obtain the necessary approval required under any law for the time being in force within a period of one year from the date of approval of the resolution plan by the Adjudicating Authority or within such period as provided for in such law, whichever is later. Provided, that where the resolution plan contains a provision for combination, as referred to in section 5 of the Competition Act, 2002, the resolution applicant shall obtain the approval of the Competition Commission of India under that Act prior to the approval of such resolution plan by the committee of creditors.

Appeal against Approval of Resolution Plan

As per Section 61(3) of the Code, an appeal against an order of Adjudicating Authority for approving the resolution plan may be filed on the following grounds:-

(a) The approved resolution plan is in contravention of the provisions of any law for the time being in force.

(b) There has been material irregularity in exercise of the powers by the resolution professional during the corporate insolvency resolution period.

(c) The debts owed to operational creditors of the corporate debtor have not been provided for in the resolution plan in the manner specified by the Board.

(d) The insolvency resolution process costs have not been provided for repayment in priority to all other debts.

(e) The resolution plan does not comply with any other criteria specified by the Board.

xi. Consequences of non-submission of a Resolution Plan

The corporate insolvency resolution process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate such process. The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if a resolution passed at a meeting of the committee of creditors by a vote of 66 per cent of the voting shares.

On receipt of an application, if the Adjudicating Authority is satisfied that the corporate insolvency resolution process cannot be completed within one hundred and eighty days, it may by order extend the duration by such further period, but not exceeding ninety days. It shall not be granted more than once.

Therefore, when the Resolution Plan is not filed within 180 days of the Commencement date or such other extended period the Adjudicating Authority may pass orders for the liquidation of the corporate debtor.

xii. Withdrawal of application admitted under section 7, 9 or 10.

The Adjudicating Authority may allow the withdrawal of application admitted under section 7 or section 9 or section 10, on an application made by the applicant with the approval of ninety per cent voting share of the committee of creditors, in such manner as may be specified. [Section 12A]

xiii. Order of Liquidation

As per Section 33 of the Code, the Adjudicating Authority may order for liquidation of the Corporate Debtor in the following cases:-

a) Where before the expiry of the Insolvency Resolution Process or within 180 days of the initiation of Insolvency Resolution or the fast track corporate insolvency resolution process under section 56, the Adjudicating Authority does not receive the Resolution Plan.

b) If the Committee of Creditors before the expiry of the resolution process intimate the Adjudicating Authority of their decision approved by not less than sixty-six per cent of the voting share that they have passed an order for liquidation of the Corporate Debtor.

c) Where the resolution plan approved by the Adjudicating Authority is contravened by the concerned corporate debtor, any person other than the corporate debtor, whose interests are prejudicially affected by such contravention, may make an application to the Adjudicating Authority for a liquidation order

Once the Adjudicating Authority passes an order of liquidation, a moratorium is imposed on the pending legal proceedings against the corporate debtor, and the assets of the debtor (including the proceeds of liquidation) vest in the liquidation estate.

xiv. Appointment of liquidator: Where the Adjudicating Authority passes an order for liquidation of the corporate debtor, the resolution professional appointed for the corporate insolvency resolution process under shall, subject to submission of a written consent by the resolution professional to the Adjudicatory Authority in specified form, act as the liquidator for the purposes of liquidation unless replaced by the Adjudicating Authority. On his appointment, all powers of the board of directors, key managerial personnel and the partners of the corporate debtor, shall cease to have effect and shall be vested in the liquidator. [Section 34]

Eligibility for appointment of Liquidator: To be a Liquidator person should be independent of the Corporate Debtor.

A person is considered independent of Corporate Debtor if he:-

- Is eligible to be appointed an as Independent Director on the board of the corporate debtor.
- Is not related party of the Corporate Debtor.
- Not has been employee or proprietor or a partner of a firm of auditors of legal firm.

Powers of the liquidators: As per section 35, here are some of the important powers:

(a) To verify all the claims of the creditors.

(b) To take all the assets, property, effects and actionable claims of the Corporate Debtor into his custody.

(c) To evaluate the assets and property of the Corporate Debtor.

(d) To carry out the business of Corporate Debtor for its beneficiary liquidation.

(e) To make the Progress Report of the Corporate Debtor.

Liquidation estate: As per section 36 of the Code, for the purposes of liquidation, the liquidator shall form an estate of the assets, which will be called the liquidation estate in relation to the corporate debtor.

Liquidation estate shall comprise all liquidation estate assets which shall include the following :—

(a) any assets over which the corporate debtor has ownership rights, including shares held in any subsidiary of the corporate debtor;

(b) assets that may or may not be in possession of the corporate debtor

(c) tangible assets,

(d) intangible assets;

(e) assets subject to the determination of ownership by the court or authority;

(f) any assets or their value recovered through proceedings for avoidance of transactions;

(g) any asset of the corporate debtor in respect of which a secured creditor has relinquished security interest;

(h) any other property belonging to or vested in the corporate debtor at the insolvency commencement date; and

(i) all proceeds of liquidation as and when they are realised

Exemptions from inclusion in the liquidation estate assets: The following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation:—

(a) assets owned by a third party which are in possession of the corporate debtor, including—

  (i) assets held in trust for any third party;

  (ii) bailment contracts;

  (iii) all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund;

  (iv) other contractual arrangements which do not stipulate transfer of title but only use of the assets; and

(v) such other assets as may be notified by the Central Government in consultation with any financial sector regulator;

(b) assets in security collateral held by financial services providers;

(c) personal assets of any shareholder or partner of a corporate debtor except that such assets are not held on account of avoidance transactions that may be avoided;

(d) assets of any Indian or foreign subsidiary of the corporate debtor; or

(e) any other assets as may be specified by the Board, including assets which could be subject to set-off on account of mutual dealings between the corporate debtor and any creditor.

xv. Consolidation of claim

The Code has significantly changed the priority waterfall for distribution of liquidation proceeds. As per the section 38 of the Code, the liquidator shall receive or collect the claims of creditors within a period of thirty days from the date of the commencement of the liquidation process.

A financial creditor may submit a claim to the liquidator by providing a record of such claim with an information utility. Where the claim is not recorded in the information utility, the financial creditor may submit the claim as an operational creditor in the prescribed form along with supporting documents.

Where a creditor is partly a financial creditor and partly an operational creditor shall submit claims to the liquidator to the extent of his financial debt and to the extent of his operational debt. A creditor may withdraw or vary his claim within fourteen days of its submission.

The liquidator may, after verification of claims under section 39, either admit or reject the claim, in whole or in part. And shall communicate his decision of admission or rejection of claims to the creditor and corporate debtor within seven days of such admission or rejection of claims

xvi Preferential transactions, undervalued transactions, Transaction defrauding creditors & Extortionate credit transactions

Preferential transactions: As per section 43 of the Code, where the liquidator or the resolution professional, is of the opinion that the corporate debtor has at a relevant time given a preference in such transactions (as given below), to any persons as specified below, he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44 of The Code.

Types of preferential Transactions: A corporate debtor shall be deemed to have given a preference, if—

(a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and

(b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53.

Exceptions: Following preference shall not include the following transfers—

(a) transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee;

(b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that —

(i) such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property; and

(ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property.

Provided that any transfer made in pursuance of the order of a court shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

"new value" means money or its worth in goods, services, or new credit, or release by the transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the liquidator or the resolution professional under this Code, including proceeds of such property, but does not include a financial debt or operational debt substituted for existing financial debt or operational debt.

Persons to whom preference share is deemed to be made: A preference shall be deemed to be given at a relevant time, if—

(a) It is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date; or

(b) a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date.

Avoidance of undervalued transactions: As per section 45 of the Code, if the liquidator or the resolution professional, on an examination of the transactions of the corporate debtor determines that certain transactions were made during the relevant period under section 46, which were undervalued, he shall make an application to the Adjudicating Authority to declare such transactions as void and reverse the effect of such transaction in accordance with this Chapter.

A transaction shall be considered undervalued where the corporate debtor —

(a) makes a gift to a person; or

(b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor,

and such transaction has not taken place in the ordinary course of business of the corporate debtor.

Relevant period for avoidable transactions.

Section 46 provides that in an application for avoiding a transaction at undervalue, the liquidator or the resolution professional, shall demonstrate that—

(i) such transaction was made with any person within the period of one year preceding the insolvency commencement date; or

(ii) such transaction was made with a related party within the period of two years preceding the insolvency commencement date.

Where an undervalued transaction has taken place and the liquidator or the resolution professional has not reported it to the Adjudicating Authority, a creditor, member or a partner of a corporate debtor, may make an application to the Adjudicating Authority to declare such transactions void and reverse their effect.

Order passed by AA: The Adjudicating Authority, after examination of the application is satisfied that—

(*a*) undervalued transactions had occurred; and

(*b*) liquidator or the resolution professional, after having sufficient information or opportunity to avail information of such transactions did not report such transaction to the Adjudicating Authority.

Adjudicating Authority shall pass an order—

(*a*) restoring the position as it existed before such transactions and reversing the effects thereof in the manner as laid down in section 45 and section 48;

(*b*) requiring the Board to initiate disciplinary proceedings against the liquidator or the resolution professional as the case may be.

Transactions defrauding creditors: As per section 49 of the Code, where the corporate debtor has entered into an undervalued transaction and the Adjudicating Authority is satisfied that such transaction was deliberately entered into by such corporate debtor, there the Adjudicating Authority shall make an order—

(i) restoring the position as it existed before such transaction as if the transaction had not been entered into; and (ii) protecting the interests of persons who are victims of such transactions:

Provided that an order under this section—

(a) shall not affect any interest in property which was acquired from a person other than the corporate debtor and was acquired in good faith, for value and without notice of the relevant circumstances, or affect any interest deriving from such an interest, and

(b) shall not require a person who received a benefit from the transaction in good faith, for value and without notice of the relevant circumstances to pay any sum unless he was a party to the transaction.

Extortionate credit transactions: Section 50 of the Code specifies that where the corporate debtor has been a party to an extortionate credit transaction involving the receipt of financial or operational debt during the period within two years preceding the insolvency commencement date, the liquidator or the resolution professional, may make an application for avoidance of such transaction (as board may specify) to the Adjudicating Authority if the terms of such transaction required exorbitant payments to be made by the corporate debtor.

xvii. Secured creditor in liquidation proceedings: A secured creditor who seeks to realize its security interest under section 52 of the Bankruptcy & Insolvency Code, 2016 shall intimate the liquidator of the price at which he proposes to realize its secured asset.

A secured creditor may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realised and to the secured creditor and apply the proceeds to recover the debts due to it.

If in the course of realising a secured asset, any secured creditor faces resistance from the corporate debtor or any person connected therewith in taking possession of, selling or otherwise disposing off the security, the secured creditor may make an application to the Adjudicating Authority to facilitate the secured creditor to realise such security interest in accordance with law for the time being in force.

The Adjudicating Authority, on the receipt of an application from a secured creditor, may pass such order as may be necessary to permit a secured creditor to realise security interest in accordance with law for the time being in force.

Where the enforcement of the security interest, yields an amount by way of proceeds in excess of the debts due to the secured creditor, the secured creditor shall—

(a) account to the liquidator for such surplus; and

(b) tender to the liquidator any surplus funds received from the enforcement of such secured assets.

The amount of insolvency resolution process costs, due from secured creditors who realise their security interests in the manner provided in this section, shall be deducted from the proceeds of any realisation by such secured creditors, and they shall transfer such amounts to the liquidator to be included in the liquidation estate.

Where the proceeds of the realisation of the secured assets are not adequate to repay debts owed to the secured creditor, the unpaid debts of such secured creditor shall be paid by the liquidator in the manner specified in section 53(1)(e).

xviii. Distribution of assets: According to Section 53, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority:

(a) the insolvency resolution process costs and the liquidation costs;

(b) the following debts which shall rank equally between and among the following :

(i) workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and

(ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;

(c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;

(d) financial debts owed to unsecured creditors;

(e) the following dues shall rank equally between and among the following :—

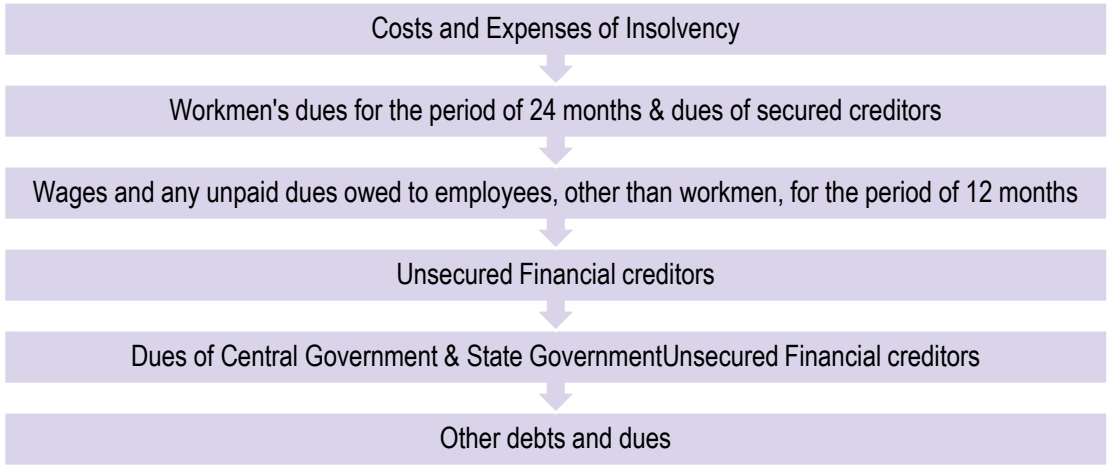
(i) any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;

(ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;

(f) any remaining debts and dues;

(g) preference shareholders, if any; and

(h) equity shareholders or partners, as the case may be.



Priority of claim

The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients, and the proceeds to the relevant recipient shall be distributed after such deduction.

xix. Application for dissolution of corporate debtor on liquidation: According to section 54 of the Code, where the assets of the corporate debtor have been completely liquidated, the liquidator shall make an application to the Adjudicating Authority for the dissolution of such corporate debtor.

The Adjudicating Authority shall on application, order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly.

A copy of an order shall within seven days from the date of such order, be forwarded to the authority with which the corporate debtor is registered.

4. FAST TRACK INSOLVENCY RESOLUTION FOR CORPORATE PERSONS

The Code introduced a speedy process for corporate insolvency resolution. It is termed as fast track corporate insolvency resolution process for small corporates.

Applicability of the provisions– An application for fast track corporate insolvency resolution process may be made in respect of the following corporate debtors :

(*a*) a corporate debtor with assets and income below a level as may be notified by the Central Government; or

(*b*) a corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government; or

(*c*) such other category of corporate persons as may be notified by the Central Government. [Section 55(2)]

Vide notification no. SO 1911(E) dated 14-6-2017, the Central Government prescribed the following class of corporate debtors on whom the provisions pertaining to the fast track corporate insolvency resolution process are applicable –

(a) small company under section 2(85) of Companies Act

(b) a start-up (other than partnership firm) as defined by Ministry of Commerce and Industry notification No. GSR 501(E) dated 23-5-2017

(c) an unlisted company with total assets not exceeding ₹ one crore as per financial statement immediately preceding the financial year - SO 1911(E) dated 14-6-2017.

Time period for completion of fast track corporate insolvency resolution process.

Period for CIRP: According to section 56 of the Code, the fast track corporate in solvency resolution process shall be completed within a period of ninety days from the insolvency commencement date.

Extension of period: The resolution professional shall file an application to the Adjudicating Authority to extend the period of the fast track corporate insolvency resolution process beyond ninety

days if instructed to do so by a resolution passed at a meeting of the committee of creditors and supported by a vote of seventy five per cent of the voting share.

Limitation on extension of time period: On receipt of an application, if the Adjudicating Authority is satisfied that the subject matter of the case is such that fast track corporate insolvency resolution process cannot be completed within a period of ninety days, it may, by order, extend the duration of such process beyond the said period of ninety days by such further period, as it thinks fit, but not exceeding forty-five days:

Number of extension: Provided that any extension of the fast track corporate insolvency resolution process under this section shall not be granted more than once.

Manner of initiating fast track corporate insolvency resolution process

Section 57 of the Code specifies, an application for fast track corporate insolvency resolution process may be filed by a creditor or corporate debtor as the case may be, alongwith-—

(a) the proof of the existence of default as evidenced by records available with an information utility or such other means as may be specified by the Board; and

(b) such other information as may be specified by the Board to establish that the corporate debtor is eligible for fast track corporate insolvency resolution process.

The process for conducting a corporate insolvency resolution process, shall apply mutatis mutandis to fast track corporate insolvency resolution process.

5. VOLUNTARY LIQUIDATION OF CORPORATE PERSONS [SECTION 59]

Voluntary liquidation by corporates with no default: A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under section 59(1) of Bankruptcy & Insolvency Code, 2016.

Company can also liquidate voluntarily if fixed period or event was specified in Articles of company for its dissolution.

The voluntary liquidation of a corporate person shall be allowed such conditions and procedural requirements as may be specified by the Board (IBBI).

Procedure of voluntary liquidation: Company should first prepare declaration from majority of the directors of the company verified by an affidavit stating that—

(i) they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and

(ii) the company is not being liquidated to defraud any person under section 59(3)(a).

Documentations: The declaration shall be accompanied with the following documents, namely –

(i) audited financial statements and record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later

(ii) a report of the valuation of the assets of the company, if any prepared by a registered valuer.

Special resolution after declaration - Within four weeks of a declaration, there shall be—

(i) **a special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily** and appointing an insolvency professional to act as the liquidator; or

(ii) **a resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration,** if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator:

Approval of creditors if company owes debt - If the company owes any debt to any person, creditors representing two-thirds in value of the debt of the company shall approve the resolution passed within seven days of such resolution [*proviso* to section 59(3)].

Notification to Registrar of company and the Board: The Company shall notify the Registrar of Companies and the Board about the resolution to liquidate the company within seven days of such resolution or the subsequent approval by the creditors, as the case may be.

Commencement of liquidation proceeding: The voluntary liquidation proceedings in respect of a company shall be deemed to have commenced from the date of passing of the resolution by members, subject to approval of creditors.

Application of provisions of this Code: The provisions of sections 35 to 53 of Chapter III and Chapter VII shall apply to voluntary liquidation proceedings for corporate persons with such modifications as may be necessary.

Application to adjudicating authority on complete wound up of the corporate person: Where the affairs of the corporate person have been completely wound up, and its assets completely liquidated, the liquidator shall make an application to the Adjudicating Authority for the dissolution of such corporate person.

Passing of an order of dissolution: The Adjudicating Authority shall on an application filed by the liquidator, pass an order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly. [Section 59(9)]

Forward of copy of order: A copy of an order shall within fourteen days from the date of such order, be forwarded to the authority (RoC) with which the corporate person is registered.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. RAB Bank Limited, a banking company, has defaulted in the payment of dues to their catering contractor. Can the contractor, as an operational creditor initiate insolvency process against the bank-

   (a) Yes, operational creditors are entitled

   (b) No, financial service providers are excluded

   (c) Yes, banking companies are covered under this code

   (d) No, catering is an excluded service under the Code

2. The time line of 180 days for the Corporate Insolvency Resolution process commences from the

   (a) Date of Debt

   (b) Date of preferring the application

   (c) Date of admission of application by NCLT

   (d) 90 days after the debt is due

3. Ruby Ltd. filed an application to the NCLT stating that corporate insolvency resolution process against him, cannot be completed within the 90 days under the fast track insolvency resolution process. Considering application and on being satisfied, NCLT ordered to extend the period of such process by 30 days. Later, again Ruby Ltd. initiated an application for further extension of time period of insolvency process by 15 days. Decide in the given situation, whether NCLT, can extend timelines by further 15 days.

   (a) Yes, because extension of duration in toto, is not exceeding 45 days.

   (b) Yes , depends of the facts , if it is justified , NCLT may extend the timelines.

   (c) No, extension of the fast track insolvency resolution process shall not granted more than once.

   (d) (a) & (b)

4. Whether an operational creditor can assign or legally transfer any operational debt to a financial creditor:

   (a) Yes. However, the transferee shall be considered as an operational creditor to such extent of transfer.

   (b) Yes but the transferee shall be considered as a financial creditor in relation to such transfer.

(c) No. An operational creditor cannot assign or legally transfer any operational debt to a financial creditor.

(d) No. An operational creditor can assign or legally transfer an operational debt only to an operational creditor.

5. ---------- shall be responsible for carrying out the entire Corporate Insolvency resolution process and managing the operations of the corporate debtor during the process.

(a) Committee of creditors

(b) Adjudicating Authority

(c) Insolvency professionals

(d) Resolution Professional

6. ABC and Co, the tax consultants of X Limited for which an interim resolution professional – Mr. A, has been appointed under the Corporate Insolvency resolution process has refused to furnish information to Mr. A on the grounds of client confidentiality. Are they right?

(a) Yes, they are right

(b) No, the Code provides powers to the IRP to access all information from various parties

(c) Partly right, they can do so only after consent of the directors

(d) Mr. A is not right in even asking for this information

7. Mr. Satya, file a petition for default of non –payment of the debt against Mr. X. The amount in default claimed by petitioner was ₹ 30 lakh. Mr. X (Respondent) pleaded before the adjudicating authority that the amount of claim was not belonging to the applicant. Mr. Satya, asserted that he himself with his son owns ₹ 26 Lakh to the respondent. Though nowhere in the petition he admitted that he himself with his Son owns ₹ 26 Lakh to the respondent. Considering the above facts in the light of the Insolvency and Bankruptcy Code, state the action to be taken by the Adjudicating Authority-

(a) NCLT will admit the application of Mr. Satya, as he jointly with his son owned the debt to the Mr. X, so he is a valid petitioner.

(b) NCLT will admit the application filed by Mr. Satya on behalf of his son.

(c) NCLT will reject the application considering that no default has occurred against Mr. Satya, and his stand as a financial creditor is not proved in the petition.

(d) NCLT will dismiss the application on the ground of non-clarity as to existence of dispute.

8. Person who has provided goods or services and the payment for same is due from the corporate debtor, is a:

(a) Financial Creditor

(b) Operational creditor

(c) Corporate applicant

(d) Both (a) & (b)

DESCRIPTIVE QUESTIONS

Question 1

When will the provisions of insolvency and liquidation of corporate persons be applicable on a corporate person?

Question 2

What is the Insolvency Resolution Process for financial creditors?

Question 3

What is the Insolvency Resolution Process for operational creditors?

Question 4

What are the eligibility criteria for appointment of an Insolvency Professional as a Resolution Professional for a corporate insolvency resolution process?

Question 5

What is the procedure of Insolvency Resolution Process for a Corporate Applicant?

Question 6

Is there any time limit for completion of the Insolvency Resolution Process?

Question 7

What is the effect of order of moratorium?

Question 8

What is a Resolution plan?

Question 9

When can a corporate person initiate voluntary liquidation process?

Question 10

Mr. Ram, an operational creditor filed an application for corporate insolvency resolution process. He does not proposed for appointment of an interim resolution professional in the application. State the provisions given by the Code in the given situation. State the term of such appointed IRP.

ANSWER/SUGGESTED

Answer to MCQs

1. **(b)** **Hint:** [No, financial service providers are excluded as per the explanation to section 1 of the I&B Code, 2016

2. **(c)** **Hint :** Refer Section 5(14) & 5(12) of the Code.

3. **(c)** **Hint:** As per section 56 of the I&B Code, 2016, the extension of the fast track corporate insolvency resolution process under this section shall not be granted more than once.

4. **(a)** **Hint:** Refer Section 21(5) of the Insolvency and Bankruptcy Code.

5. **(d)** **Hint:** As per section 23 of the IBC.

6. **(b)** **Hint:** No, because as Per Section 17 of the I&B Code, the officers and managers of the corporate debtor shall report to the interim resolution professional and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional.

7. **(c)** **Hint:** Refer section 7(5) of the IBC.

8. **(b)** **Hint:** As per the IBC, an Operational Creditor means a person to whom an Operational debt is owed. Operational creditor refers to anyone who has provided goods or services and the payment for same is due from the corporate debtor.

Answer to Descriptive Questions

1. The provisions relating to the insolvency and liquidation of corporate debtors shall be applicable only when the amount of the default is one lakh rupees or more. However, the Central Government may, by notification, specify the minimum amount of default of higher value which shall not be more than one crore rupees.

2. A financial creditor either itself or along with other financial creditors may lodge an application before the Adjudicating Authority (National Company Law Tribunal) for initiating corporate insolvency resolution process against a corporate debtor who commits a default in payment of its dues.

   The financial creditor shall along with the application give evidence in support of the default committed by the corporate debtor. He shall also give the name of the interim resolution professional.

Where the Adjudicating Authority is satisfied that a default has occurred and the application by the financial creditor is complete and there is no disciplinary proceedings pending against the proposed resolution professional, it may admit such application made by the financial creditor. Otherwise, the application may be rejected. However, the applicant may rectify the defect within seven days of receipt of notice of rejection from the Adjudicating Authority.

3. On the occurrence of default, an operational creditor shall first send a demand notice and a copy of invoice to the corporate debtor.

The corporate debtor shall within a period of ten days of receipt of demand notice notify the operational creditor about the existence of a dispute, if there is any and record of pendency of any suit or arbitration proceedings. He shall also provide the details of repayment of unpaid operational debt in case the debt has or is being paid.

After the expiry of ten days, if the operational creditor does not receive his payment or the confirmation of a dispute that existed even before the demand notice was sent, he may file an application before the Adjudicating Authority for initiating a corporate insolvency resolution process.

The Adjudicating Authority shall within fourteen days of receipt of the application, admit or reject the application. However, before rejecting the application, an opportunity shall be given to the applicant to rectify the defect within seven days of receipt of rejection.

4. As per Regulation 3 of Insolvency and Bankruptcy (Insolvency Resolution) Regulation, 2016, an insolvency professional shall be eligible for appointment as a resolution professional for a corporate insolvency resolution process if he and all partners and directors of the insolvency professional entity of which he is partner or director are independent of the corporate debtor i.e.,

- He is eligible to be appointed as an independent director on the board of the corporate debtor u/s 149 of the Companies Act, 2013, where the corporate debtor is a company.
- He is not a related party of the corporate debtor.
- He is not an employee or proprietor or a partner of a firm of auditors or company secretaries in practice or cost auditors of the corporate debtor in the last three financial years.
- He is not an employee or proprietor or a partner of a legal or consulting firm that has or had any transaction with the corporate debtor amounting to five per cent or more of the gross turnover of such firm in the last three financial years.

5. Where a corporate debtor has committed a default, a corporate applicant thereof may file an application for initiating corporate insolvency resolution process with the Adjudicating Authority.

The corporate applicant shall furnish the information relating to books of account and other documents and a resolution professional shall be appointed as interim resolution professional.

The Adjudicating Authority may either accept or reject the application within fourteen days of receipt of application. However, applicant should be allowed to rectify the defect within seven days of receipt of notice of such rejection.

6. Section 12 of the Code states that any Insolvency Resolution Process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate the process.

However, the National Company Law Tribunal (NCLT) may on an application made by the resolution professional, under a resolution passed by the Committee of Creditors, by a vote of 75% of voting shares, after consideration provide one extension which shall not extend more than 90 days.

7. Moratorium has been explained in Section 14 of the Code, during the moratorium period the following acts shall be prohibited:

(a) The institution of suits or continuation of any pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;

(b) Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

(c) Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFAESI Act, 2002

(d) The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

8. A resolution plan is a proposal agreed to by the Debtors and Creditors of an entity in a collective mechanism to propose a time bound solution to resolve the situation of insolvency.

As per Section 30, the Insolvency Resolution Professional (IRP) within the prescribed time i.e. 180 days or in case of extension 270 days, where Fast Track Resolution within 90 days or in case of extension 135 days, is required to submit the Resolution Plan to Adjudicating Authority (NCLT) prepared by the Resolution applicant on the basis of information memorandum.

The Resolution Plan should provide for:

(i) payment of insolvency resolution costs;

(ii) repayment of the debts to operational creditors;

(iii) management of affairs of the Company after approval of the resolution plan;

(iv) implementation and supervision of the resolution plan;

(v) does not contravene provisions of the law for the time being in force; and

(vi) conforms to such other requirement as may be specified by the Board.

9. Section 59 of the Code empowers a corporate person intending to liquidate itself voluntarily if it has not committed any default to initiate voluntary liquidation proceedings under the provisions of this Code.

Any corporate person registered as a company shall meet the following conditions to initiate a voluntary liquidation process:-

(a) A declaration from majority of the directors of the company verified by an affidavit stating

i. That they have made a full inquiry into the affairs of the company and have formed an opinion that either the company has no debts or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and

ii. That the company is not being liquidated to defraud any person.

(b) The declaration shall be accompanied with the following documents, namely:

i. Audited financial statements and a record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later;

ii. A report of the valuation of the assets of the company, if any, prepared by a registered valuer.

(c) After making the declaration the corporate debtor shall within four weeks -

i. Pass a special resolution at a general meeting stating that the company should be liquidated voluntarily and insolvency professional to act as the liquidator may be appointed.

ii. Pass a resolution at a general meeting stating that the company be liquidated voluntarily as a result of expiry of the period of its duration (fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, if any) and appointing an insolvency professional to act as the liquidator.

10. **Appointment of IRP:** As per Section16 of the Code where the application for corporate insolvency resolution process is made by an operational creditor and no proposal for an interim resolution professional is made in the said application. The Adjudicating Authority

shall make a reference to the Board for the recommendation of an insolvency professional who may act as an interim resolution professional.

The Board shall recommend the name of an insolvency professional to the Adjudicating Authority against whom no disciplinary proceedings are pending, within ten days of the receipt of a reference from the Adjudicating Authority.

Period of appointment of IRP: The term of the interim resolution professional shall continue from his appointment till the date of appointment of the resolution professional by CoC in first meeting of CoC under section 22 of the Insolvency & Bankruptcy Code, 2016.